EC-817-W

THE FARM'S LEGACY

A GUIDEBOOK FOR INTRA-FAMILY SUCCESSION

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The Succession Planning Team

EC-817-W

THE FARM'S LEGACY:

A GUIDEBOOK FOR INTRA-FAMILY SUCCESSION

The Purdue Succession Planning Team, comprised of Extension Educators and Specialists, was formed in 2011 to address the needs of families planning the continuation of farm businesses. The Purdue Succession Planning Team is committed to cultivating strong farm families through the succession planning process by providing educational opportunities and current resources.

This guidebook is a culmination of years of firsthand knowledge and expertise with farm families and the intricate inter-workings of the succession planning process. Within this guidebook, you will find articles and exercises to guide you and your family farm through the succession process.

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The Succession Planning Team

GUIDEBOOK EDITORS

Renee Wiatt
Shelly Surber
Saad Mukhtar
Pat Maier
Alison Grant
Edeoba Edobor

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ANALYZING INDIANA: TAKING STEPS TOWARDS SUCCESSION

Renee Wiatt | Department of Agricultural Economics | Purdue University
Edeoba Edobor | Department of Agricultural Economics | Purdue University
Alison Grant | Department of Agricultural Economics | Purdue University

A farm business is not just a business, it is an intersection of the family and the business. According to the USDA, 98% of farms are family businesses (2019). In the majority of farm businesses, the owners have reported the desire to pass the business to the next generation. An inter-generational farm succession survey conducted at Purdue found 56% of owners intend to sell or give the business to family while 14% of owners intended to sell the business to someone outside of the operation (Marshall et al., 2012). The remaining owners intend to liquidate the assets or did not know their intentions for the operation. In order to pass on a legacy to the next generation, the incumbent owners will have to continue the farm profitably enough to last until the next generation. Additionally, there is a need to keep the family cohesive and functioning into the future. We present some facts on farm succession in Indiana, derived from the family business succession survey (Marshall et al., 2012).

Roughly 80% of farm owners value the preservation and protection of assets (such as land and buildings) for the benefit of future generations. Even with the majority of farm businesses desiring the transfer of their business to a chosen successor, only 32.65% of farms have identified a designated successor. This is concerning considering the fact that successor identification is the primary step in the succession process. According to Goeller (2011), when successors are not identified, there is a great chance that the family will either rent or sell the business after the owner has passed. The non-identification of a successor, therefore, hinders the succession process and has a greater potential to remove farms from generational family operation.

Thirty-five percent of farms stated that they are prepared for management succession if it were to happen today. The conditions that may warrant immediate succession are usually unpredictable, for example, with a sudden demise or impairment of the owner. It is therefore important that the business is ready for immediate succession at any given point in time. Preparing for immediate succession will require the identification of a successor and the training of this successor(s) through delegation of responsibility. It will also require regular discussion of the estate plan as well as the different business aspects with relevant professionals (e.g. financial experts, accountants and lawyers). Only half of farms indicated that the senior generation actively engaged in discussing possible transfer plan alternatives with heirs or successors. Discussions including all generations of the farm are crucial to the longevity of farm businesses.

Moreover, thirty-seven percent of Indiana farms did not have enough capital or money to implement a business transfer. Capital is a very important part of the succession plan. The succession planning process usually requires a considerable capital outlay (Edobor et al., 2021). Furthermore, generational transfer means that enough capital must have been acquired by each succeeding generation (Mishra et al., 2010). Almost 80% of those surveyed stated that the preservation and protection of assets with sentimental value (such as land or buildings), so that these assets will benefit future generations, is one of their objectives.

At the core of succession is communication. Of course, other components are critical to succession as well. This guidebook covers the topics of: 1) Setting Goals for the Business, 2) Communication, 3) Financial Feasibility, 4) Protecting the Business & Mitigating Risk, 5) Management Transfer, and 6) Estate Planning & Ownership (Asset) Transfer. Our workbook Is meant to educate, as well as spark conversations that may otherwise be difficult to start. This workbook assembles a number of publications along with worksheets that will help you and your family take steps toward succession.

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CHAPTER 1

SETTING GOALS FOR THE BUSINESS

Goals and objectives provide the farm a target at which to aim. That aim can be related to farm size, profitability, the succession process, communication, risk, and more. Furthermore, the process of setting goals provides the opportunity to have some meaningful conversations that can spark growth and insight into the operation. In Chapter 1, goals and objectives will be explored and you will have the opportunity to write some of your own goals.

Renee Wiatt
Department of Agricultural Economics
Purdue University

Shelly Surber
Department of Agricultural Economics
Purdue University

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Defining Your Business Through Goals and Objectives

Maria I. Marshall
Department of Agricultural Economics
Purdue University

Starting a successful new business requires a lot of thought and time before even a cent is spent. Many people worry about whether they have a market for their product or service, but do not put a lot of thought into how this new business will fit with their current lifestyle or with the goals they have for their future.

This publication helps you determine how a new venture will fit with your personal and business goals, using the example of a new bakery start-up to illustrate the concepts discussed. The objective is to merge the new business with your personal life in a way that makes you happy and your business profitable.

Why Are Goals Important?

Just as your final destination is important to your journey, your goals are important to your business. They define your destination and shape what your business will become. They also help you determine a timeline for the things you need to do.

Begin by determining the reason(s) you want to start a business. Do you want to make a lot of money? Do you want to be your own boss? Do you simply want to provide a job for yourself and your family? Some potential reasons for starting a business are because you want to:

- Have more control over your life and career
- Increase your income
- Make a difference and contribute to society
- Reach your full potential by doing something you enjoy
- Use your available resources (labor, land, finances more efficiently

- Diversify your assets.

Think about your life as a business owner and manager, taking into account all aspects of your life. What benefits will you derive from the business? What are the impacts to your lifestyle? In other words, how will starting and managing a business affect your career and personal life? How do you measure success? Your reasons for starting a business will help guide your plan for starting and growing your business.

The reasons people start a business fall within four general business goals: service, social, profit, or growth. Service, profit, and growth goals are interrelated because most small businesses must provide quality service if they want to make a profit and grow. Many businesses have started from a social agenda, such as providing products that do not harm the environment, and have still been able to achieve the profit goal.

You must also think about how big you want the business to become. This is important because one of the reasons businesses fail is uncontrolled growth. Consider whether you want the business to remain small or grow enough to challenge a larger competitor. Is your goal to receive a profit commensurate with your effort and investment, or is it to receive as much profit as possible?

Setting Goals & Objectives

While goals can be broad or general in nature, objectives should be clear and concise. Goals do not have to be specific enough for you to act on, but should give you a future target or list of things you want to work on. Objectives, however, need to be **SMART**—**S**pecific, **M**easurable, **A**ction-oriented, **R**ealistic, and **T**imely. **Specific** objectives should be as detailed as possible. In order for the objectives to be **Measurable,** you should state them in terms of dollars or quantities. Objectives are clear targets of performance you can use to evaluate the operation.

Action-Oriented objectives state which actions need to be taken and who will take them. Objectives should be **Realistic** but challenging, with set deadlines in order to be **Timely**.

Write down a series of personal and business goals and objectives for next year. Next, write down goals and objectives for the next 3 to 5 years. Although goals are dreams with deadlines, make sure that your objectives are SMART.

Example - The Bakery

Isabel loves to bake and occasionally even gets paid for it. Several of her friends and neighbors routinely ask her to bake her famous cakes for special events, so Isabel is thinking about starting a bakery. She is very busy with her job in the family's orchard and her children's activities, and she knows that if she starts a bakery she might not get to some of her children's activities or be as active in the family business. However, she feels that owning her own business while doing something she really loves will not only fulfill her dreams but also provide her family with some extra needed income.

Action Plans

Once you have identified your objectives, the next step is to break each objective down into action plans, or all the steps necessary to achieve that objective. Think of action plans as small, manageable projects. Make sure the action plans are small enough that they can be accomplished in a few days or a week at most. Work on the most timely goals and objectives first, breaking them down into monthly action plans. Breaking down each objective into action plans will help you

Example - The Bakery's Goals & Objectives

Isabel's goal is to start a bakery specializing in special event cakes within the next 6 to 12 months. Isabel's first objective is to write a business plan within the next 3 months. Isabel's second objective is to contact an attorney, realtor, and her banker for technical assistance as she starts her business in the next 6 to 12 months. Her third objective is to have $10,000 in sales in her first year of business.

Example - The Bakery Action Plans

Isabel has decided to break down her first objective, the business plan, into manageable action plans. Some of her action plans for the first month are:

1. Assess her strengths and weaknesses.
2. Write a vision and mission statement.
3. Identify potential customer attributes.
4. Identify the target market.
5. Determine market potential.
6. Identify and assess bakeries in the area.
7. Research the industry.

make the daunting task of starting a new business manageable and less stressful.

Final Comment

Starting a business takes thought and planning. Understanding the reasons you want to start a business and setting personal and business goals are essential to your success. Breaking this process down into three steps will make it less daunting and more manageable.

In step one, you should set broad goals to be accomplished. For example, wanting to start a business and get a 10% return on your investment might be your goal. In step two, you should break up your goals into objects that are SMART—specific, measurable, action-oriented, realistic, and timely. In step three, you should further break down your objectives into action plans—smaller, more manageable projects. This process will not only help you decide where you are going and how you are going to get there, but also provide a map for your journey.

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How to Use Goals to Achieve Business Success

Christy Lusk & Maria Marshall

Department of Agricultural Economics

Purdue University

Most of us set goals and objectives everyday, perhaps without even knowing it. When you wake up in the morning, you might find yourself mentally creating your to-do list, in essence creating goals and objectives for that day. Many people find it helpful to create a to-do list on paper and check off items as they accomplish them. While you can use the principles of writing goals and objectives in any area of life, they prove particularly useful for complicated matters such as starting a business.

Why Are Goals Important?

Many have likened goals to a road map—they help identify where you are going and how you will get there. Others have described them as the rudder of a boat, which keeps you on course toward your destination. Goals are of critical importance for entrepreneurs because of the potential impact a new business has on personal resources like time and money. Without goals, these scarce resources can dwindle away before you even realize it.

In this frantic world of information overload, it's not surprising that a key reason for failing to reach goals is because they were not written down. There are four primary benefits to capturing goals on paper. First, goals become more concrete. This process forces you to not only identify the desired outcome but the steps, also known as objectives, necessary to achieve that goal. Second, documentation helps you to prioritize goals and objectives according to duration and importance. Third, this process enables you to track progress towards goals, allowing you to recognize when you are in danger of not meeting a goal. Fourth, documenting all goals and objectives can make the process of starting a business much less intimidating and overwhelming.

How to Write Goals, Objectives, and Tasks

If a goal is the desired outcome, then objectives can be thought of as the tasks critical to the success of that overriding goal. In other words, you will not achieve a goal if you do not meet the underlying objectives of that goal. For this reason, it is important to create objectives that are concise and allow you to determine whether or not you have met them.

You can find more information about writing SMART objectives in *EC-727, Defining Your Business through Goals and Objectives*. Example 1 illustrates the concept of how one might specify goals and objectives for a new bakery business started by a woman named Isabel.

Without the objectives that outline the critical steps to starting this new bakery business, the process of achieving the overall goal would be quite vague. The same could be said for the objectives if more detail were not provided. To turn objectives into actionable statements, you must identify tasks, and in so doing, you can identify all the steps necessary to accomplish a certain objective. Example 2 uses the new bakery business to illustrate this concept.

Example 1 - The Bakery: Goals and Objectives

Goal: Start a bakery specializing in special event cakes within the next 6 to 12 months.

- **Objective 1:** Write a business plan within the next three months.
- **Objective 2:** Contact an attorney, realtor, and banker for technical assistance as I start my business in the next 6 to 12 months.
- **Objective 3:** Generate $10,000 in sales in my first year of business.

Tracking Your Progress

One of the most difficult aspects of tracking goals and objectives is identifying the time required to accomplish each task, objective, and/or goal. The best way to do this is to consider the resources and time required to complete the task.

For example, is the task something that you can accomplish yourself, or will it take the involvement of an outside party? If you will handle the task, how many other constraints on your time exist that may influence your ability to complete the task on time? If the task will require the involvement of another, consider the actual time of the task as well any other potential hindrances. For example, getting a building permit signed may actually take only minutes, but paperwork processing time may translate into two weeks.

Regardless of how you will accomplish the task, make sure to realistically evaluate the time involved. Failure to do so will result in creating a timeline that is unrealistic, which will lead to missed deadlines and, ultimately, a sense of failure.

The process of identifying goals and objectives takes some time. All of that effort could be wasted if there were not a method in place to make sure tasks were completed. This has a domino effect, for if you do not complete tasks, then you cannot accomplish your objectives, which then means that you do not achieve your goals.

Example 2 - The Bakery: Action Plans

Objective 1: Write a business plan within the next three months.

- **Task 1:** Assess my strengths and weaknesses.
- **Task 2:** Write a vision and mission statement.
- **Task 3:** Identify potential customer attributes.
- **Task 4:** Identify the target market.
- **Task 5:** Determine market potential.
- **Task 6:** Identify and assess bakeries in the area.
- **Task 7:** Research the industry.

Fortunately, there are many methods and tools to help you do the job of tracking progress. These range from very simple methods such as using a calendar to much more complex options such as computer software

packages and interactive Web-based tools. Because it is possible to become so involved in doing the list that you lose sight of the reason for doing it, you should use the simplest method appropriate for the job. In this case, we will discuss using a simple calendar to track the progress of goals and objectives.

Example 3 again uses the new bakery business to illustrate the concept of how to use a calendar to track goals and objectives. This example tracks tasks and the overriding objective statement, but you can use this method to track objectives and goals as well.

Objective 1 for the new bakery business states that the business plan will be completed within three months. If it is assumed that today is January 1, 2020, it can be easily determined that this objective must be completed by March 31 to be accomplished on time. Using a calendar not only helps to set an actual due date, but it also helps to ensure that you do not overlook the deadline. By entering the date onto the calendar, you are able to visually see what needs to be accomplished on a specific date.

Example 3 - The Bakery: Goals and Objectives

Objective 1: Write a business plan within the next three months

Today's Date: January 1, 2020

Objective 1 Due Date: January 1 + 3 months = March 31

Calendar Entry: March 31, 2020 = Deadline for writing business plan

You should repeat this process of determining deadlines for each task that supports the overall objective. Again using the bakery example, if March 31 is the deadline for completing Objective 1, then all supporting tasks must also be completed by this date. Because we have identified the logical sequence of events when ordering tasks, we can use Task 1 to begin calculating all task deadlines. Adding together the estimated number of hours/days to complete the task beginning with the start date will result in a deadline for each task. Example 4 illustrates how to perform these calculations.

Task 1. Assess My Strengths and Weaknesses

Estimated Time	Start Date	End Date
4 Hours	January 3 + 4 Hours	= January 3

Task 2. Write a Vision and Mission Statement

Estimated Time	Start Date	End Date
10 Days	January 4 + 10 Days	= January 13

Task 3. Identify Potential Customer Attributes

Estimated Time	Start Date	End Date
6 Hours	January 17 + 6 Hours	= January 17

Task 4. Identify the Target Market

Estimated Time	Start Date	End Date
2 Days	January 18 + 2 Days	= January 19

Task 5. Determine Market Potential

Estimated Time	Start Date	End Date
1 Month	January 24 + 1 Month	= February 21

Task 6. Identify and Assess Bakeries in the Area

Estimated Time	Start Date	End Date
24 Days	March 1 + 24 Days	= March 24

Task 7. Research the Industry

Estimated Time	Start Date	End Date
24 Days	March 1 + 24 Days	= March 24

It should be noted that three assumptions were made to make this illustration as simple as possible. The first is that each task will be accomplished by the business owner. If this were not the case, other factors such as time constraints for others involved would have to be considered.

The second assumption is that tasks are completed in sequential order. However, some tasks may be accomplished concurrently. For example, instead of identifying and assessing bakeries in the area (Task 6) before researching the industry (Task 7), Isabel could have chosen to work longer hours so that she could accomplish both tasks during the same time period.

The third assumption is that the timeline would involve the entire calendar month. This arrangement could be altered to exclude weekends if Isabel could accomplish the same amount of work in less time.

After determining the deadline for each task, the next step is to go to the calendar and write down each task deadline. Example 5 provides the calendar entry for Task 1.

Example 5 - The Bakery: Tracking Task Deadlines

Task 1: Assess my strengths and weaknesses

Today's Date: January 1, 2020

Task 1 Due Date: January 3 + 4 hours = January 3

Calendar Entry: January 3, 2020 = Deadline for assessing strengths and weaknesses

The process of tracking goals, objectives, and tasks isn't really hard. The most challenging part is the discipline required to establish a system and follow it. The time and effort spent setting up this system is well worth it if the result is met deadlines and accomplished goals. If some tracking mechanism were not in place, it would be very difficult to complete tasks, which would lead to unmet objectives, which translates into missed goals.

Furthermore, the tracking process helps to identify when a goal, objective, and/or task is in jeopardy of not being met. If the ultimate goal is starting a new business, this could have serious consequenses such as lost time and money.

Missed Deadlines

There will be situations where the unforeseeable happens. This could be anything from a personal event, such as an illness, that causes an unexpected delay, to something that may be out of your control, such as an unanticipated office closing. Because these circumstances can occur even in the most carefully devised plans, it is important to recognize the potential for these types of events.

There are other times when the unmet deadline is your responsibility. If this is the case, there are a few questions you should consider. Was the reason for the unmet deadline an unrealistic timeframe? Were the resources underestimated? What can be done differently to develop better estimates?

Neither case negates the importance of putting together a realistic timeline for accomplishing goals, objectives, and tasks. Rather, it means that there should be a method in place to handle these situations if and when they do take place. Regardless of the cause for the delay, you will need to determine how many days this will cost and adjust deadlines accordingly. If you have built some lag time into the tracking system, this may help alleviate some of the problem caused by the unexpected.

In Example 4, all seven tasks are scheduled for completion by March 24, although the deadline for Objective 1 (to write the business plan) is not until March 31. This week between deadlines not only allows for time to assemble all the materials and write the business plan, but also allows flexibility if an unexpected delay should occur.

However, you should use the practice of padding, or overestimating, deadlines with caution. While incorporating some time to account for contingencies may increase your ability to meet scheduled deadlines, the reverse can also be true. That is, overestimating timeframes can lead to due dates that have no real meaning—and that's as bad as creating no plan at all.

Final Comment

Specifying and accomplishing goals and objectives are critical to the success of a business because they help identify the road map of how to proceed. Without this road map, you could get lost along the way.

There are several benefits to documenting goals on paper. They become more concrete, they can be prioritized and tracked for progress, and they become much less daunting when you break them down into more manageable pieces. The tracking aspect is extremely important, because this will allow you to determine if and when a goal, objective, or task will be met—or perhaps more important, unmet. When you do not make a deadline, you must make adjustments to ensure that the project gets back on schedule, so that future deadlines are not also jeopardized.

Using goals and objectives is not difficult. However, creating them does take time and requires thought. Sometimes the most challenging part is putting something down on paper. However, the benefits far outweigh the costs, and when used correctly, the process can greatly enhance your chances at achieving your goals.

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Involving the Family in Goal Setting & Decision Making

Aadron Rausch
Department of 4-H Youth
Purdue University

For more and more farm families, the traditional command-and-control management style is being replaced by a collaborative and participatory management style that includes everyone involved in the business of the family farm. This is essential for effective goal setting and decision making.

Participatory farm-family management involves everyone in defining goals and objectives that can foster participation in and commitment to the family farm. For the manager of the family farm, the participatory management style requires skills in negotiation and relationship management.

A critical part of relationship management is a basic understanding of individual expectations. Ideally, goals and decisions meet the expectations and needs of all family members, but this is not always the case. However, involving family members in the decision making process fosters participation and goal achievement.

Consider a situation where a commitment of resources, be it in time, energy, skills, or finances, is made by the primary manager of the family farm, but family members have not had a voice in the decision making process. If all family members are not willing to devote the resources needed, reaching the desired goal can be difficult or even impossible. The time expended in goal setting and making decisions then feels like time wasted. This is frustrating for all involved.

Involving family members in family-farm decisions gives each a voice and allows for the opportunity to work through, clarify, and resolve issues in ways that can best meet everyone's expectations and the needs of all. So, you may be saying, "this sounds pretty good, but how do I get started?"

Step 1: Identify the Issue

Before any issue can be addressed, the family must reach a consensus about what the issue is and how it relates to individual expectations and family values.

- Does everyone see the problem the same way?
- Do all family members understand the issue?
- Have family members shared their opinions and expectations?
- In which areas are there agreements/ disagreements?
- What family values are most important to the situation?

Step 2: Generate Alternative Strategies

The process of generating alternative strategies involves listing all possibilities and includes seeking additional guidance when necessary.

- Has everyone had a chance to generate strategies for addressing the issue?
- What resources, expertise, and guidance are available for exploring additional options?
- What benefits and consequences are associated with each option? In other words, has the family evaluated the cost and benefit of each strategy?

Step 3: Choose the "Best" Strategy

Choosing the best strategy is easy when all family members agree, but what if they don't? Remember, the best strategy is an alternative that offers the most benefits at the least cost for each family member.

- Can family members reach a consensus on one course of action knowing that there are other possible alternatives?
- If agreement is not possible now, have family members determined a future time for reaching a consensus?
- What additional resources or guidance can be sought to help family members make a decision?
- Can all family members agree to try one strategy for a limited time, and can they be open and flexible to alternative strategies?
- Are all family members willing to accept responsibility for the decision?
- Once reaching a decision, how do family members feel about the process and the decision that has been reached?

Step 4: Develop an Action Plan

Once they have made a decision, even if only a temporary one, family members must develop an action plan and ways to evaluate its effectiveness.

- What does the family ultimately want to achieve?
- What activities must the family carry out to achieve the final goal?
- Who will be responsible for carrying out the plan, and what are their specific responsibilities?
- Are there other decisions that the family needs to make as a result of the selected strategy?
- When will the family evaluate the plan's effectiveness? (In other words, when do family members check to see how they're doing?)

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Identifying Farm Business Goals and Succession Planning Goals

Chapter 1

Craig Dobbins, Angela Gloy, & Renee Wiatt

Department of Agricultural Economics

Purdue University

Before jumping into the finer legal and/or technical points of a transfer plan, take time to clearly discuss, define and refine your farm business' mission and vision statements. In addition, be specific as to what you see as the short-term and long-term goals of the business. These production characteristics are important, but there are several other, less noticed and less talked about business management functions that farm managers of the future must perform in order to achieve success. Furthermore, they must perform these functions well. In addition to being good production or plant managers, future farm managers must be skilled general managers.

On the next page, take some time to write the following for your business: vision statement, mission statement, short-term goals, and long-term goals. Notes for each are below.

- Vision: A vision is a mental picture of a preferred future state, a description of what the farm would be like some years from now. The vision is where you want your farm to go.
- Mission: Stemming from the vision, the mission guides how the farm will achieve its vision.
- Short-Term Goals: Be sure to set a timeline for short-term goals. Specify how, how much, and when. For example, "To increase the total acres of crops produced by 100 acres/year for 5 years".
- Long-Term Goals: Long-term goals should drive you towards your vision. An example could be: "To increase the use of options as part of the marketing program" or "To increase the amount of time that is available to provide leadership to a community organization".

Vision:

Mission:

Short-Term Goals:

-
-
-

Long-Term Goals:

-
-
-

Succession Planning Goals

With our farm, we would like to accomplish the following:

-
-
-

Our greatest concerns regarding a farm succession plan include:

-
-
-

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The Succession Planning Team

Inventorying Your Succession Planning Team

Chapter 1

Angela Gloy & Renee Wiatt

Department of Agricultural Economics

Purdue University

There are a number of people involved in your business that can have an impact on your succession plan. On the following page, you will find a table where you can document contact information for members of your succession team.

Inventory of Your Succession Team

	Name	Address	Email	Phone
Business Owner or Family Member				
Business Owner or Family Member				
Business Owner or Family Member				
Business Owner or Family Member				
Business Owner or Family Member				
Business Owner or Family Member				
Business Owner or Family Member				
Business Owner or Family Member				
Business Owner or Family Member				
Attorney				
Accountant				
Insurance Agent				
Lender 1				
Lender 2				
Neutral 3rd Party Facilitator				
Financial Planner				

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Preliminary Succession Planning Timeline

Chapter 1

Angela Gloy & Renee Wiatt

Department of Agricultural Economics

Purdue University

There are a number of checkpoints and tasks along the road as your business heads towards a succession process. On the next page, you will find a table that highlights some of the major milestones that you can start to map out in your process. For each major task, you will see a target completion date, the estimated amount of time that it will take to accomplish this task (this can range from a couple of months to a few years), whether or not that task is completed, people responsible for the completion of that task, and who will lead that particular charge.

Preliminary Timeline for Your Succession Process

Task	Target Completion Date	Time It Will Take To Complete	Task Completed (Yes/No)	People Responsible	Who Will Lead?
Identify estate and transfer planning goals					
Meet with family members to discuss identified goals					
Establish your estate plan: ▪ Collate necessary documents/ paperwork ▪ Determine titled property dispersion goals ▪ Determine non-titled property dispersion goals ▪ Schedule meetings with advisory team members ▪ Finalize estate plan with attorney ▪ Follow-up meeting with family to share estate plan					
Establish the 6 parts of a succession plan: ▪ Assess farm financial health/ transfer feasibility ▪ Develop estate plan ▪ Establish business entity agreement ▪ Establish buy-sell agreement ▪ Establish operating agreement ▪ Establish sales/lease contracts					

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Retirement Planning

Chapter 1

Amanda Dickson

International Programs in Agriculture

Purdue University

In recent years, an increasing number of farm and ranch businesses have been pursuing an objective of continuation of the farm or ranch beyond the lifespan of the founders. A succession plan provides helpful guidance as individuals move into and out of the farm or ranch business with their own life cycles. One component of a succession plan is retirement planning. Retirement planning for farm families should be done as early as possible and revisited early to make sure that they are on track.

Retirement planning for farm families is complicated. Their income is often tied to their land and other assets and many times, farm families do not have any outside pensions or health insurance. Once the family decides to stop farming, their income stops as well. Farming is an integral part of their life to the point where the distinction between work and life are indistinguishable. Because of the demands of farming, many times farm families fail to develop hobbies or other interests outside of the farm business. Once the farming is done, it becomes difficult for them to retire successfully.

Many farmers make the same mistakes when planning for their retirement. The first is not taking into consideration how long they will need income in retirement. Right now, a 65 year old male/female is expected to live for 20 more years. Making sure you plan for 20 years of income is crucial. Often times, farmers have a hard time envisioning retirement so they postpone it and wait too long to make succession planning decisions. The second mistake is banking on unsure things. The market is ever changing, and we can not count on the sale of a house or business to fund our retirements. Inheritances can vaporize and investments can shrink. Another common mistake is underestimating retirement living expenses. Many times expenses balloon in retirement, especially during illness or extended stays in skilled nursing facilities.

These four considerations are the primary elements that need to be contemplated in having sufficient funds for retirement. Early retirement requires greater financial assets to finance your living expenses for those extra years. Inflation is often discounted by many people, but it is real and retirement plans need to factor inflation. The main goal when considering inflation is to safeguard against spending assets down too quickly and running out of money prior to death. Depending upon your retirement age, withdrawal rates need to be conservative so you do not allow your cash and/or investments to dwindle at a value that will not support your living expenses. Since we do not know the future, it is wise to be conservative in your spending and not use up capital for living expenses any sooner than necessary.

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CHAPTER 2
COMMUNICATION

Effective communication is key for managing family operations efficiently. It allows businesses to build a strong team that will not only withstand the great task of developing a succession plan, but also the everyday tasks that the business faces. Outside of working with your team, communication skills are also important when working with agribusiness professionals. This chapter introduces you to communication skills you can use within your family operation to enhance your ability to negotiate, discuss, and make decisions that will impact the overall efficiency of your family operation. In essence, communication is the backbone of a family operation. It impacts not only the dynamic of your team, but also the profitability of the operation.

Jenna Nees
Purdue Extension, Putnam County
Purdue University

Articles

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Maria Marshall

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Planning Meeting Recommendations

Chapter 2

Angela Gloy

Department of Agricultural Economics

Purdue University

Below, you will find six recommendations that can lead to more productive and harmonious meetings:

1. Develop an agenda for each meeting and share it with meeting participants either in advance or at the start of each meeting. Allow participants to add to the agenda.

2. Ensure that everyone's opinion is heard. If someone has not contributed to a particular discussion topic, ask them for their feedback.

3. Include spouses of farm business owners in business meetings.

4. Develop a strategy for managing dissention. Recognize different viewpoints and work to find win-win solutions.

5. Have one person at each meeting take notes highlighting key discussion points, concerns, ideas.

6. Set a date and assign agenda responsibilities for the next succession planning meeting at the close of each meeting.

Farm businesses are often a complicated mix of family and business. Before each meeting, it can be helpful for each member of the farm to write down concerns that they may have.

Existing Farm Business Concerns:

Existing Familial and/or Communication Concerns:

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Communication in the Family

Aadron Rausch

Department of 4-H Youth

Purdue University

Communication, although essential, is not always easy. Individual differences in personality, communication styles and skills, and expectations all play a part in how well your family communicates. Sometimes you'll find it is best to let issues rest before trying to communicate. Other times, however, issues can't be allowed to rest, because lack of communication can interfere with daily living. After all, every family is a team, and this is particularly true of families with family farms. They must communicate effectively in order to manage their farms effectively.

Just as you, the manager of your family farm, must communicate and negotiate with employees, suppliers, processors/merchandisers, lenders, landlords, and providers of money or land in any given day, you must communicate with those family members directly or indirectly affected by farm-family issues and decisions. And it's equally important that they communicate with you. Successful families operate systematically, as do successful farms.

Each family member plays different roles in the family and in the management of the family farm. Each of these roles carries with it different responsibilities and expectations. But sometimes one person sees his or her roles and responsibilities in one way, while others see them very differently. Different perceptions and expectations can lead to a great deal of confusion and frustration.

Communication allows for discussion and clarification of roles, responsibilities, and expectations that can lead to more effective, collaborative, and supportive relationships within the family. And, when the farm family is functioning effectively, the family-farm business functions more effectively.

Effective Communication

So, what is effective communication? The best way to answer that question is to break the concept down. Effective communication involves interpersonal skills, rapport with others, and active listening.

Interpersonal Skills: Interpersonal skills enable us to interact with others. Effective interpersonal communication involves putting people at ease, respecting others' opinions and capabilities, and encouraging the sharing of feelings and perceptions.

Rapport: To develop rapport with others is to develop a connection, a relationship, or an understanding with them. To do this, you should signal that you are open to the thoughts and opinions of others. You should express an interest in what others have to say in a friendly and open manner.

Active Listening: Active listening encourages others to continue interacting. As an active listener, you can demonstrate your interest in what is being said using both verbal and nonverbal communication techniques.

Rephrasing: Rephrasing what you have heard is an effective technique. For example, a family member says, "It bothers me when you commit me to do something before asking if I am available." You can reply, "I understand what you are saying; it upsets you when I commit your time without checking with you first." Thus, you make sure you have clearly understood what you have heard, and you validate the speaker and his or her message.

Tone of Voice: Your tone of voice can determine the effect of your message. For example, if you try to communicate your anger or unhappiness, but do so in a light and jovial manner, your listener may miss your point. Your tone of voice should match the message you're trying to convey. Varying the pitch to demonstrate excitement or disappointment can help your listener to hear the intent of the message.

Nonverbal Cues: Just as what you say and how you say it are important to effective communication, nonverbal cues can also add to or detract from your message. For example, leaning toward the speaker, nodding, and smiling all convey interest in and understanding of what is being said. In contrast, looking away, shuffling your feet, looking at a watch or clock, or turning away when someone is speaking can be perceived as lack of interest in or uneasiness with the person or message.

Beyond Effective Communication

At times, even effective communication fails to achieve a desirable outcome. In those cases, outside help, guidance, or support can be helpful. You may seek support through your church, a community agency, or close friend. However, factors such as individual personality, upbringing, and culture can influence how comfortable families feel sharing private concerns with others. For families conditioned to believe that personal problems should remain private, seeking outside help may seem virtually impossible.

Sometimes, it can help to think about reaching out as strength. Consider how you would feel if someone reached out to you in need. Reaching out to others can be a real comfort and help when times are tough.

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ag.purdue.edu/agecon
ID-240

Balancing Work & Family

Aadron Rausch
4-H Youth,
Purdue Extension

Owning and managing a family business such as a family farm offers unique benefits and challenges to the family members involved. On the up side, the family farm offers family members the opportunity to cooperate, set goals, develop strategic plans, and make decisions that generate profits to support economic success and financial independence. The challenge, however, is to create and sustain appropriate boundaries between the family and the farm business. One way to meet this challenge is to pay as much attention to family relationships as you do to the management of your farm business.

Family-relationship management is entirely different from farm-business management. Maintaining family relationships entails attention to personal relationship, parenting, cooperation, and love and respect among family members. You are probably thinking, "easier said than done."

Strategies for Maintaining Balance Between Work & Family

Managing boundaries between the farm business and the family is challenging. For example, managers of farm businesses need to decide how to distribute income between the farm and family expenses, and how to balance work and family time. Intensity of feelings, confusion between family roles and management roles, and personal temperament and communication style influence how the family and farm business function. Conscious and deliberate goal setting and planning can help family members anticipate possible challenges and create effective strategies for addressing issues related to farm-business and family-relationship management.

1. Explore Family Feelings

Identify feelings and issues that get in the way of sound business practices. Families that talk about feelings and concerns before they become problems can develop effective coping

strategies that provide the most benefit for the family and the farm business.

2. Develop Guidelines & Agreements

Anticipate possible problems, and establish guidelines and agreements that provide effective solutions but still allow enough flexibility to address the unique nature of particular issues.

3. Recognize the Family's Role in the Business

Establish agreements about family members' roles in the family and in the farm business. The role of the family is to promote and support the growth, development, and welfare of family members. The role of the family in promoting and supporting the farm business is dependent upon the individual family member's role in the family business. For example, one person may provide support through balancing farm finances, while another family member may assist during periods of high production.

4. Assessing Your Success

Effective farm-business and family management involves identifying, managing, and resolving problems. Effective managers identify problems, generate and evaluate possible solutions, work towards agreement, put a plan into action, and reevaluate the effectiveness of the solution. Flexibility is critical!

Use the assessment below to help you and your family assess how you are doing at balancing work and family on your farm. Answer each question honestly and analyze your results to see how your family and business can improve its balance.

Assessment: Balance of Work and Family

How well are you balancing work and family issues?	Yes	No	Not Sure
I recognize family issues and feelings that get in the way of sound business practices.			
We usually talk about family-business issues before they become a crisis.			
Our family has developed agreements or guidelines for dealing with business and family issues.			
The members of our family have identified their family and business roles.			
We have a set time each day, week, or month when we get together as a family to discuss feelings and concerns related to the family business.			
Our family is good at identifying issues or concerns related to the family business.			
We usually talk about our issues and concerns, and the family generates possible ideas for handling them effectively.			
Each person in our family has the opportunity to express his or her feelings or concerns.			
When our family is faced with a tough decision, we can usually agree on an action plan.			
The members of our family are usually willing to try different strategies if one strategy is not working.			

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A research, outreach, and teaching program for family business stakeholders.

PURDUE INSTITUTE FOR FAMILY BUSINESS (PIFB)

The FB-BRAG: A Functioning Assessment for Family Businesses

Renee Wiatt
Family Business
Management Specialist

Maria I. Marshall
Professor
Department of
Agricultural Economics

Purdue University

Our aim was to create an assessment, drawn up specifically for family businesses, that is not cumbersome or time-consuming and can be easily compared across members of the family and the business. Understanding family business functioning from the multiple viewpoints of family and business stakeholders can help enhance communication. The FB-BRAG (family business balance, resolve, adaptability, and growth) is an easy-to-understand tool for family businesses and family business practitioners alike – and the results are simple to calculate and interpret.

Introduction

In a family business, the family and the business are constantly competing for limited amounts of time, attention, and resources. The FB-BRAG allows users to measure family business functioning from a variety of viewpoints, in a way that holistically incorporates family and business functionality into one assessment. The four questions included in the assessment are modeled after Smilkstein's (1978) family APGAR and work APGAR assessments. **APGAR** assessments measure adaptability, partnership, growth, affection, and resolve (Smilkstein, 1978), while the **FB-BRAG** measures family business balance, resolve, adaptability, and growth.

Validating the Scale

The FB-BRAG was validated and results were compared using two sets of family business data: The Family Business Succession Survey (FBSS) (712 responses, Marshall et al., 2012), and the National Family Business Survey (NFBS) (759 responses, NE-167R). Only questions one through three were considered in the NFBS; the "family balance" question (question 4) was added via the FBSS. By comparing the datasets, we can see that both have a very low reporting rate of "dysfunctional" (1% for the FBSS and 3%

Table 1. Distribution of FB-BRAG scores

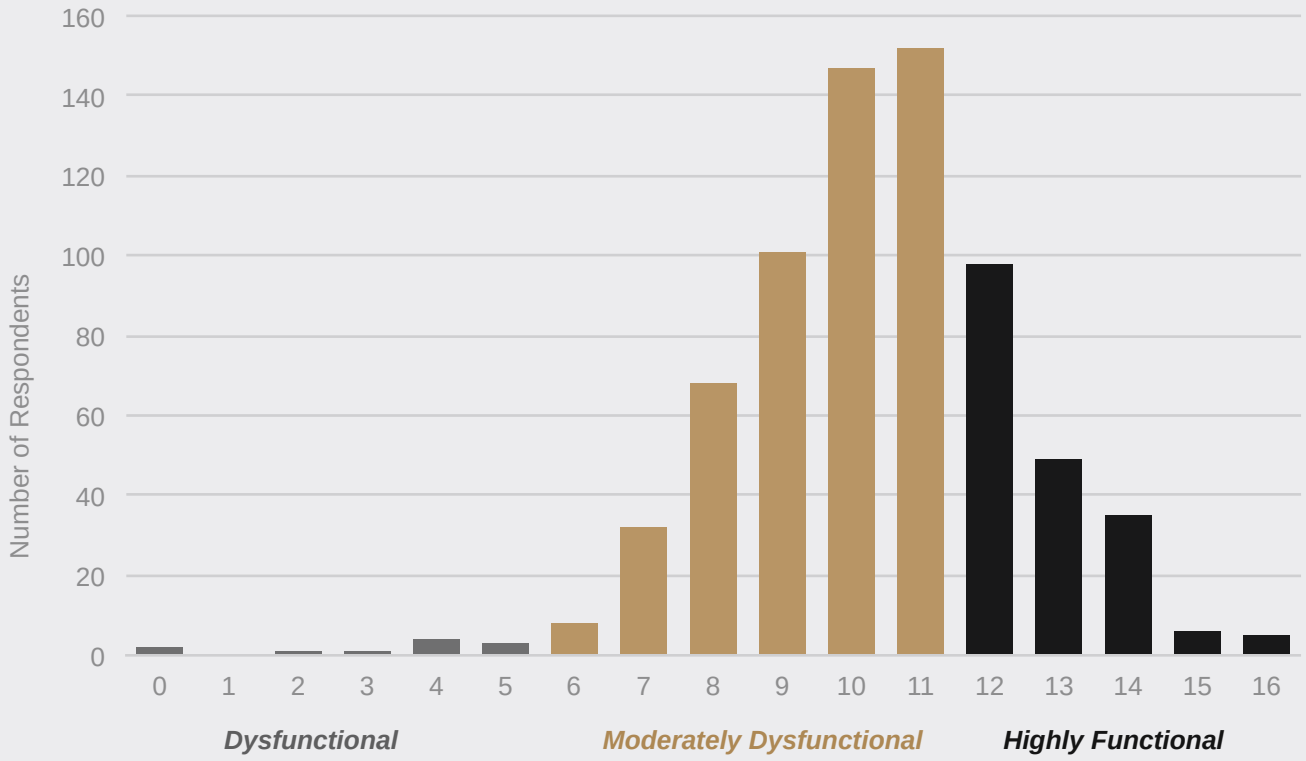
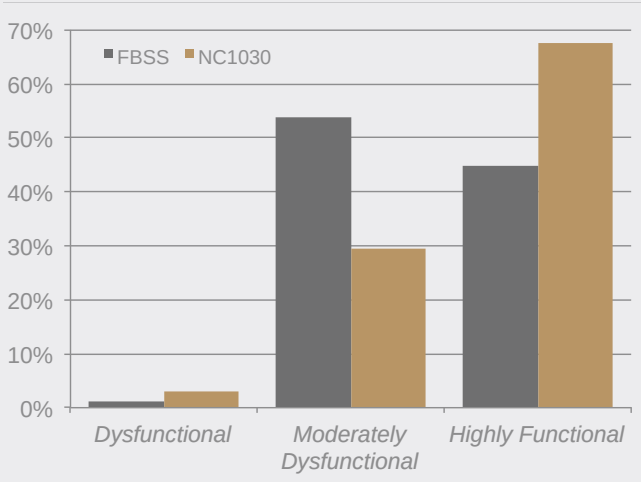


Table 2. FB-BRAG validation using FBSS and NC1030 data



for the NFBS). The two surveys differ in the "moderately dysfunctional" and "highly functional" categories. The FBSS reports 54% of surveyed businesses in the "moderately dysfunctional" category and 45% of businesses in the "highly functional" category. The NFBS reports 30% of businesses in the "moderately dysfunctional" category and 68% of businesses in the "highly functional" category. The NFBS slightly differs in results and shows an upward bias in responses (see Tables 1 and 2).

Administering the FB-BRAG

Administering the FB-BRAG takes very little time and effort. Table 1 shows the four questions in the assessment. Participants use Handout 1 (page 5) to record their responses to the four questions. Time expected to complete should not exceed five minutes. After completing the assessment, a score guide (Handout 2, page 6) allows individuals to score their own assessment on their family business' functionality. The four questions focus on functionality and satisfaction that people gain from the intersection of the family and the business. For each "never" response, zero points are given; "hardly ever" receives one point, "some of the time" receives two points, "most of the time" receives three points, and "all of the time" receives four

Table 1.

FB-BRAG: A Functioning Assessment for Family Businesses, Scoring Guide

Place a check mark in the box that corresponds to the answer of each question.

	Never	Hardly ever	Some of the time	Most of the time	All of the time
1. How often are you satisfied that you can turn to people at home and work for help when something is troubling you?					
2. How often are you satisfied that others in your family and business accept and support your ideas or thoughts?					
3. How often are you satisfied with the way others in your family and business share time together?					
4. How often are you satisfied with the outcome when a decision has to be made in favor of what is best for the family versus the family business?					
Rating scale: Never = 0 pts; Hardly ever = 1 pt; Some of the time = 2 pts.; Most of the time = 3 pts; All of the time = 4 pts.					
Scoring: 0-5 pts. = Dysfunctional ; 6-11 pts. = Moderately dysfunctional; 12-16 pts. = Highly functional					

Example: Total score = 8 pts. Moderately dysfunctional

points. Totaling the responses provides an overall score that is measured this way: "highly functional" (12-16 points), "moderately dysfunctional" (6-11 points), or "dysfunctional" (0-5 points).

How the FB-BRAG Can Analyze Family Business Health

Danes and Stafford (2011) found that from 1997 to 2007, according to National Family Business Survey data, family APGAR scores of family businesses increased. We can interpret this as businesses that are assumedly successful — by surviving from 1997 to 2007 — have improved family functioning over time. The questions included in the FB-BRAG directly analyze three of the five properties of a traditional APGAR (adaptability, growth, and resolve; Smilkstein, 1978). Question 1 measures adaptability, question 2 measures growth, and question 3 measures resolve of a family business. We added question 4 to analyze family business balance; conflict can arise where resources and time intersect, but the conflict can sometimes be healthy.

Kaplan et al. (2009) found that many farm families relied heavily on passive communication, which can easily be misconstrued and misunderstood. The FB-BRAG helps to discourage passive communication by giving family businesses a set of talking points. By comparing results of the FB-BRAG from different viewpoints, members of a family business are able to see what they are lacking, where they are succeeding, and, most importantly, issues where opinions differ. Family businesses can celebrate successes while also exploring areas that need improvement. By exploring the differences in responses and having a number to refer to, family business members may be more comfortable expressing why they scored something as they did, versus merely bringing up an issue without having a prompt.

Next Step: Comparing FB-BRAG Results

Family business members who take the FB-BRAG assessment should compare results and discuss differences and similarities. Just knowing scores among family business members can prove helpful. The FB-BRAG scores on their own can give some insight into the functioning of a family business, but improvement in functionality can come from open discussions on differences and similarities in scores among members of the family business.

What to do if results among members of the family business are:

- All **highly functional**: Members of the family business should continue to communicate effectively and re-evaluate functionality as new members enter the family business.

- All **moderately dysfunctional**: Many family businesses fall into this category. A moderate amount of conflict in a family business can be healthy. However, try to address the categories in which members may not feel satisfied. For example, if many members of the family business report that they are not satisfied in the way that the family and business share time together, make sure that there are distinct times for the family and distinct times for the business. For instance, do not have a family business meeting during Thanksgiving at the dinner table.
- All **dysfunctional**: Members of this family business need to enhance communication and schedule meetings on a regular basis to discuss family business issues. The business should work toward more open communication that allows people to openly discuss their ideas and thoughts. There needs to be separate work time and family time; the goal of this business should be to strive for more positive family time and more positive business time.
- Mix of two or more of the following - **dysfunctional, moderately dysfunctional,** and **highly functional:** Members of the family business need to investigate why some members are satisfied and others are not satisfied with how the family and business interact. If some members are not satisfied with the family business and others are, then the root cause of that disparity needs to be examined. Set aside time to openly discuss these differences and listen to why some people do not agree on the family business' functionality. Also, check to see if there are trends in scores. For example, if the younger generation is scoring the family business as *moderately dysfunctional* and the senior generation is scoring the business as *highly functional*, then there are more than likely some underlying issues. The younger generation may value time at home, or they may require later start times due to family commitments (e.g., young children). Traditional norms that were once accepted as business practices may need to be adjusted to better appeal to both generations.

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FB-BRAG: A Functioning Assessment for Family Businesses, Scoring Guide

Place a check mark in the box that corresponds to the answer of each question.

	Never	Hardly ever	Some of the time	Most of the time	All of the time
1. How often are you satisfied that you can turn to people at home and work for help when something is troubling you?					
2. How often are you satisfied that others in your family and business accept and support your ideas or thoughts?					
3. How often are you satisfied with the way others in your family and business share time together?					
4. How often are you satisfied with the outcome when a decision has to be made in favor of what is best for the family versus the family business?					

FB-BRAG: A Functioning Assessment for Family Businesses

To calculate a score for your FB-BRAG Family Business Functioning assessment:

1. Total the number of each never, hardly ever, some of the time, most of the time, and all of the time responses that were checked. Record that number in the Number of responses row in the grid below.
2. Multiply each column's Number of responses with each column's Multiplication factor and record the result in the Multiplication total row.
3. Add all Multiplication total results together to get the FB-BRAG Score.
4. See scoring grid below to see which category your assessment places your family business' functioning.

   Example: FB-BRAG Score of 8 points translates to Moderately Dysfunctional.

	Never	Hardly ever	Some of the time	Most of the time	All of the time
Number of responses					
Multiplication factor	0	1	2	3	4
Multiplication total					
FB-BRAG Score (add all multiplication totals):					

Rating Scale	
Never	0 pts.
Hardly ever	1 pt.
Some of the time	2 pts.
Most of the time	3 pts.
All of the time	4 pts.

Scoring Guide	
Highly functional	12-16 pts.
Moderately dysfunctional	6-11 pts.
Dysfunctional	0-5 pts.

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CHAPTER 3
FINANCIAL FEASIBILITY

Regardless of the desire to bring in the next generation to the family farm, the financials need to accommodate the transfer. Chapter 3 explores financial analysis, which includes taking an inventory of assets and liabilities, estimating living expenses, valuing the current business, and sorting out sweat equity and salaries. Conducting a thorough financial analysis of the farm business prior to a transfer will help both generations. The incumbent generation exits the business and eases into a comfortable retirement while the successor generation enters into a successful and sound farm business.

Renee Wiatt
Department of Agricultural Economics
Purdue University

Articles

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Michael Langemeier

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Valuation of Agricultural Land for Business Transfer Decisions
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Current Market Valuation of Property
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How Should Business Income Be Divided?
Michael Langemeier

Putting a Value on Sweat Equity in Your Farm Business
Michael Langemeier
Denise Schroeder

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Financial Preparedness Strategies for Succession Planning

Chapter 3

Michael Langemeier

Department of Agricultural Economics

Purdue University

Transferring the farm from one generation to the next should involve an assessment of skills, weaknesses and resources in the farm operation. A financial review is an important part of this assessment. With year-end market value balance sheets, a historical cash flow statement, and tax returns, a farm can compute accrual net farm income. A market value balance sheet shows changes in inventories of crops, market livestock, seed, fertilizer, and other supplies. Additionally, a market value balance sheet records changes in land values from year to year.

The following three key financial questions must be addressed:

1. Does my farm have sufficient liquidity to repay current debt obligations and bring another family member into the business?
2. Does my current solvency position (measured using the debt to asset ratio) allow me to expand?
3. Is my farm profitable enough to compensate family members, replace machinery and buildings in a timely fashion, and expand?

The first question involves liquidity, which is the ability of a business to meet its cash flow obligations as they come due. The current ratio is a liquidity measure computed by dividing current assets by current liabilities. If a farm has a current ratio of 2.0, the farm has twice as many current assets as current liabilities, providing a cushion or safety net to mitigate low net returns.

Many lenders are focused on current ratios because they want to be sure debt payments can be made on a timely basis for the coming year. The University of Minnesota Farm Database (FINBIN) recently

reported an average current ratio of 1.40. For many farms, liquidity has been affected by low net returns or profitability since 2013. There may be options to improve liquidity including refinancing current debt into longer term debt, slowing expansion, or liquidating assets.

The second question addresses solvency, which is examining the relationship between the assets owned and business debt. A farm with a debt to asset ratio of 0.25 owes money on one-fourth of all of its assets. In other words, the farm owns three-fourths of its assets. A benchmark debt to asset ratio is below 0.40. FINBIN reported for 2018 that 63% had a debt to asset ratio above 0.40 and 22% had a debt to asset ratio above 0.70.

For the final question, profitability measures the extent to which a business generates a profit from the use of land, labor, management, and capital. Net farm income is an absolute measure of profitability. For comparisons made between farms, it is common to calculate return on assets (net income divided by total assets). For greater accuracy, it is suggested to make accrual adjustments to account for the balance sheet changes (i.e. Inventories and accounts payable) that took place during the accounting period even though no cash exchanged hands.

Summary

In summary, if the average net farm income over the last 5 to 10 years has not been sufficient to compensate family members, repay debt, and replace machinery and buildings in a timely manner, then bringing another family member into the business may not be prudent. Farms may see an opportunity to expand by adding more land to increase revenue. A good rule of thumb is that it takes approximately $500,000 of gross revenue per employee (family member or hired employee) for a farm business to be sustainable. Using average profitability over time, each $500,000 in gross revenue will generate $100,000 in net farm income. A farm cannot make intelligent changes to the operation without first measuring financial position and performance. In other words, you cannot control what you do not measure!

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The Succession Planning Team

Feasibility Test of Adding Another Family Member

Chapter 3

Angela Gloy & Renee Wiatt

Department of Agricultural Economics

Purdue University

On the following 2 pages, you will find an inventory of proficiencies needed in a farm or family business in the areas of: management, policies, critical agreements reviewed, and farm financials. This test is designed to highlight the key proficiencies considered essential to successfully adding another family member feasibly. Farmers, advisers, spouses and new family members can use this to assess strengths and weaknesses to implement management changes and address proficiencies needed. For each topic/proficiency, you can indicate "In Place Now", "Working on It", "Need It", and "Don't Need It".

Key Proficiency Areas (Place 'X' in Column That Applies)	In Place Now	Working On It	Need It	Don't Need It
Management				
1. Farm history is documented				
2. Financing trends documented				
3. Core values and vision are in writing				
4. Strategic plan				
5. Update strategic and action plans for achieving goals with change of adding another family member				
6. Cash flow projection addressing production, capital purchases, sales changes, storage, cost of compensation program				
7. Repetitive or routine tasks (and/or job descriptions) are documented for new member as well as standard operating procedures for how members of the business interact				
Policies				
1. Written understanding of housing provisions				
2. Meals provided, utilization of premises, vehicle usage, fuel, insurance on vehicles and premises				
3. Vacation and sick leave use and allocation				
4. Retirement, health insurance, tax withholding, etc.				
5. Compensation for level of management proficiencies				
6. Different pay based on tenure				
7. Classification: Owner, manager, and employee member				
8. Defined who has access to management and financial information				

Key Proficiency Areas: (Place 'X' in Column That Applies)	In Place Now	Working On It	Need It	Don't Need It
Critical Agreements Reviewed				
1. Partnership agreements				
2. Buy-sell agreement				
3. Wills				
4. Estate plans				
5. Lease/rental arrangements				
6. Liability insurance				
7. Health and disability				
8. Revenue sharing arrangements are defined and understood				
Farm Financials				
1. Cash flow projection/impact for adding a family member				
2. Balance sheets and income statements for measure of true profitability				
3. Depreciation schedules				
4. Cost center tracking enterprise profitability				
5. Production records complete and accessible with historical trends				
6. Partial budgets for evaluating enterprise shifts				
7. Key performance measure and ratios				
8. Trend lines for all critical production				
9. Audit systems and reconcile to inventories				
10. Team meetings with banker, lawyer, accountant, estate planner, key production management				
11. Identify proficiency issues and have professional development training plan to address				

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Estimating Living Expenses and Income Needs

Chapter 3

Nicole Widmar, Angela Gloy, & Renee Wiatt

Department of Agricultural Economics

Purdue University

Before adding an individual (and his or her family) to a farm or family business, estimating income needs is a crucial step to take. By having an estimation of income needs, it is possible to evaluate the impact of adding someone to the operation. The key to this exercise is being realistic. On the following page, you will find a table of family living expenses to consider, giving you a chance to map out the expenses of your family. Table 2 shows an example of how to calculate income needs. Table 3 gives you the opportunity to calculate income needs for YOUR family.

This section is designed to help you get started in evaluating the financial feasibility of bringing in new owners to your business. Below are a few points to keep in mind:

- Financial transparency is essential. Debts and liabilities will always surface during a review of one's finances and it's best to be honest from the beginning.
- Discuss how and at what levels new owners will be compensated. Expectations may differ so it's best to discuss this early.

Remember, this is intended only to help you establish a reasonable reference point for further financial evaluation. The equation below is your starting point for evaluating your financial feasibility:

(Estimated Annual Income) - (Sum of Fixed Expenses) + (Sum of Variable Expenses)

Table 1. Family Living Expenses to Consider

Income Streams	Annual Fixed Expenses		Variable Annual Expenses	
Spouse 1:	Housing		January	_____
	Rent/Mortgage	_____		
_____	HELOC*	_____	February	_____
	Property Taxes	_____		
	Home Owners' Insurance	_____	March	_____
	Gas and Electric	_____		
Spouse 2:	Phone	_____	April	_____
	Water	_____		
_____	Garbage	_____	May	_____
	Cable/Internet	_____		
	Association Dues	_____	June	_____
	Other	_____		
Other Income:	Other	_____	July	_____
	Other	_____		
_____		_____	August	_____
	Insurance Premiums		September	_____
	Term Life Insurance	_____		
Sum of Income:	Whole Life Insurance	_____	October	_____
	Medical/Dental	_____		
_____	Disability	_____	November	_____
	Umbrella Policy	_____		
	Auto	_____	December	_____
	Other	_____		
Less Estimated Taxes:	Other	_____		
			Sum	_____
_____	Other Expenses			
	Credit Card Payment	_____		
	Car Payment	_____		
	Car Payment	_____		
	Cell Phone	_____		
	Child Care/Alimony	_____		
	Other:	_____		
	Other:	_____		
	Other:	_____		
Estimated Annual Income:				
	Sum	_____		
_____				

***Note:** HELOC stands for Home Equity Line of Credit

Table 2. Example of Income Needs

Family Living Expense	$20,000
Debt Service	$2,500
Income & Self-Employment Taxes	$5,000
New Investment in Business	$10,000
Savings for Child's Education	
Retirement	$2,000
Family Living in Capital Expenses	
Other	$1,000
Total Need for Income	**$40,500**
Expected Net Non-Farm Income	$0
Desired Spendable Income	**$40,500**

Note: Family living expenses can include items such as mortgage/rent, insurance for dwelling and cars, property taxes, health insurance, medical costs, utilities (phone bill, internet, gas, electric, cable, etc.), groceries, and clothing.

Table 3. Fillable Income Needs

Family Living Expense	$
Debt Service	$
Income and Self-Employment Taxes	$
New Investment in Business	$
Savings for Child's Education	$
Retirement	$
Family Living in Capital Expenses	$
Other:	$
Other:	$
Other:	$
Other:	$
Other:	$
Total Need for Income	$
Expected Net Non-Farm Income	$
Desired Spendable Income	$

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Asset and Liability Inventory

Chapter 3

Angela Gloy & Renee Wiatt

Department of Agricultural Economics

Purdue University

Why Should You Inventory Your Assets and Liabilities?

Part of assessing the financial position of your business includes inventorying your assets and liabilities. If you have a current balance sheet (within the past year), then that is a great place to start. If you are thinking of adding a member to your farm or family business, you may want to perform separate inventory analyses of your business assets and liabilities as well as your personal assets and liabilities.

Assets are property, cash, equipment, and other articles that can provide benefits in the future. For example, assets can include:

- Cash
- Marketable securities
- Accounts receivable
- Fertilizer/supplies
- Breeding livestock
- Machinery and equipment
- Buildings
- Investments in cooperatives
- Land
- Other investments

Liabilities are articles that are owed to an outside entity. For example, liabilities can include:

- Accounts payable
- Taxes payable
- Accrued expenses
- Deferred taxes (current and noncurrent portions)
- Notes due within one year
- Current portion of term debt
- Notes payable (noncurrent portion)
- Real estate debt (noncurrent portion)

In the following tables, you can take inventory of both your business and personal assets and liabilities.

Reference:
Langemeier, M. (2020). Computation of deferred tax liabilities. Retrieved at: https://ag.purdue.edu/commercialag/home/sub-articles/2020/09/computation-of-deferred-tax-liabilities/

Table 1. Business Asset Inventory

Business Asset	How is the property held? *(Refer to title, deed, ownership structure that owns asset)*	Estimated Value of Asset	Other Relevant Information

Table 2. Business Liability Inventory

Business Liability	How is the property held? *(Refer to title, deed, ownership structure that owns asset)*	Estimated Value of Liability	Other Relevant Information

Table 3. Personal Asset Inventory

Personal Asset	How is the property held? *(Refer to title, deed, ownership structure that owns asset)*	Estimated Value of Asset	Other Relevant Information

Table 4. Personal Liability Inventory

Personal Liability	How is the property held? *(Refer to title, deed, ownership structure that owns asset)*	Estimated Value of Liability	Other Relevant Information

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Valuation of Agricultural Land for Business Transfer Decisions

Chapter 3

Michael Langemeier

Department of Agricultural Economics

Purdue University

When transferring assets from one generation to the next, it is imperative that the farm values the assets that are going to be transferred. This is particularly important when developing a buy-sell agreement and when examining the financial feasibility of transferring assets to the younger generation. This article will focus on the valuation of agricultural land.

There are three approaches that appraisers use to value agricultural land.

1. The first approach is referred to as the market or sales approach. The market or sales approach uses comparable sales to value agricultural land. This approach recognizes the fact that a buyer was willing to pay a certain amount for a farm and that a seller was willing to accept the buyer's offer. In other words, this approach recognizes that supply equals demand. One of the problems with this approach is that there are often special circumstances involving the sale of a specific parcel. For example, the buyer may have land adjacent to the parcel that sold and thus bid accordingly. These special circumstances need to be taken into account when using the market or sales approach.
2. The second approach is referred to as the income approach. The income approach uses the net return to land and the capitalization rate to value agricultural land. The net return to land can be computed using long-run prices, yields, and costs, or market-based cash rent. The capitalization rate varies over time, and depends on interest rates, the rate of growth of net return to land, and the relative

riskiness of farmland compared to a portfolio consisting of stocks and bonds. Currently, the capitalization rate is approximately 3 percent.

3. The third approach is referred to as the cost approach. The cost approach uses a cost-based balance sheet to value assets such as agricultural land. An obvious problem with this approach is that land that was purchased many years ago was purchased at a price well below its current value. In this instance, the cost approach would arrive at a value well below the values obtained with the market or income approaches.

A buy-sell agreement is a legally binding agreement between co-owners of the business that governs how assets are dispersed if one or more of the co-owners leave the business. Buy-sell agreements can be very useful to the younger generation because with these agreements they are often given the opportunity to purchase land or other assets when the older generation wants to sell or dies. A buy-sell agreement should include a mechanism for how agricultural land or other assets will be valued.

An installment contract is a type of contract in which the payments are made in a series of installments rather than as lump sum. Installment contracts are often used to transfer agricultural land between generations or between farm and non-farm siblings. Again, a mechanism for how agricultural land or other assets will be valued is an important component to these contracts. It is also important to establish the terms of the installment contract pertaining to the number of years in which the installments will be made and the interest rate.

When developing a buy-sell agreement or when examining the financial feasibility of transferring land across generations, it is important to value farm assets. This article briefly discussed the market, income, and cost approaches to valuing agricultural land. Also, the article briefly discussed buy-sell agreements and installment contracts.

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Current Market Valuation of Property

Determining the current market valuation of property can be important for both families and businesses. Whether you are recording the value of personal titled property such as real estate or a home, or business titled property such as real estate, buildings, animals, machinery, etc., you can keep track of the appraiser's name, contact information, and the value and date at which the property was appraised on the following page.

Chapter 3

Angela Gloy

Department of Agricultural Economics

Purdue University

Market Valuation Form

☐ Inventory of titled property (personal) including real estate/home

☐ Inventory of titled property (business) including real estate/buildings, machinery, animals, etc.

Appraiser Name _____

Contact Information _____

_____

Farm Appraisal Value $ _____

Date of Appraisal _____

_____

Appraiser Name _____

Contact Information _____

_____

Farm Appraised Value $ _____

_____

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How Should Business Income Be Divided?

Chapter 3

Michael Langemeier

Department of Agricultural Economics

Purdue University

If everyone in the farm business owned a similar amount of business assets, worked the same number of hours, and provided management expertise, the answer to the question in the title would be very straightforward. In this unlikely scenario, business income could be split equally. Unfortunately, asset ownership, hours worked, and management responsibilities vary across managers, operators, and owners of the business. This increases the importance of coming up with a conceptual framework to divide farm business income. This article describes a model that can be used to divide farm business income, and provides an illustration of how this model can be used in practice.

Contributions Model

Hofstrand (2016) describes two methods that can be used to divide business income between parties in the business in an equitable manner. These two methods are the contributions model and the 50/50 model. With the contributions model, which is the focus of this article, an annual contribution is computed and allocated to each party before splitting net income. Annual contributions are computed using the relative value of each party's contribution of resources to the farm business. The discussion below will focus on farm resources that need to be included in the contributions model and possible ways to value these resources.

Resources that need to be included in the contributions model include land, buildings, machinery and equipment, breeding livestock, working capital, and labor and management.

Here, we are focusing on resources that are owned by each party. Owned resources are typically valued at their opportunity cost. For example, if we have two generations, and the older generation owns 500 acres and the

younger generation does not own any acres, the older generation should receive compensation for their owned acres. The easiest way to compensate the older generation for the owned acres would be to use a current rental rate for the area. The annual value of buildings, and machinery and equipment can be estimated using a rental rate or the cost of ownership.

The opportunity cost approach is often used to compute the cost of ownership. This approach typically uses economic depreciation (estimated useful life and straight-line depreciation are often used as proxies) and an opportunity interest charge, which is computed regardless of whether there are debt obligations pertaining to specific assets. Buildings include machine sheds, general storage buildings, office space, and grain storage. Assuming that the owner of the buildings covers insurance and repairs, economic depreciation and the opportunity interest charge could be used to value the annual contributions for the buildings.

For example, if the buildings have a 20-year useful life, the total annual value of the buildings owned by each party could be multiplied by 10% (5% for economic depreciation and 5% for the opportunity interest charge). A similar approach could be used for machinery and equipment. If the owner of the machinery and equipment pays for insurance and repairs, the value of the machinery and equipment could be multiplied by 15%. This assumes an average machine life of 10 years, use of straight-line economic depreciation, and a 5% opportunity charge for interest.

Breeding livestock could be valued at its current sale value. Working capital; which includes cash, accounts receivable, purchased inputs, grain inventories, and market livestock inventories; contributed by each party to cover the cash flow needs of the business can be valued using the rate of return that would have been received from alternative investments.

Investing in production agriculture is certainly not risk-free so I recommend using an opportunity charge for working capital of at least 5%. Note that annual contributions for buildings, machinery and equipment, and working capital can be computed using balance sheet values for these items at the beginning of the year, the end of the year, or the average of the beginning and end of year values. Labor and management can be valued using typical wages for performing comparable work or the opportunity cost associated with other employment opportunities. For example, if one of the parties could work for a local agribusiness for a salary with benefits of $50,000, this figure could be used to estimate their labor and management contribution. The annual value of the contributions for each party are computed by adding up their opportunity costs for land, buildings, machinery and equipment, breeding livestock, working capital, and labor and management. The annual value of each party's contribution is paid before net income is split between the parties. Net income can be split using a corporate, a partnership, or some other type of agreement.

The above conceptual framework works well when there is sufficient income to pay all of the resources. U.S. net farm income is expected to be relatively low again in 2017. How should income be divided in years when income is very low? This is not an easy question to answer, which means that it is important to plan for this event. In years with low income, it would make sense to have a hierarchy with regard to which resources are going to be covered first, second, third, etc. This hierarchy would likely vary among farms. However, it would make sense for labor and management to be the first resource covered. Any resources that are not fully compensated could receive extra compensation in later years. This is similar to how sweat equity is often treated (see Langemeier, 2017).

Case Farm Illustration

Table 1 (at the end of this publication) contains an illustration of how the contributions model can be used to divide business income. Periodically, net farm income is relatively low. In this illustration, the older generation owns the vast majority of the land, buildings, machinery and equipment, and working capital. The farm operates 2000 acres, of which 500 acres are owned by the older generation. The annual contribution for land is computed using current cash rent values, the annual building contribution is computed by

multiplying building investment by 10%, the annual machinery and equipment contribution is computed by multiplying machinery and equipment investment by 15%, and the annual working capital contribution is computed by multiplying working capital investment by 5%. The investments in buildings, machinery and equipment, and working capital were obtained by averaging the beginning and end of the year balance sheet values. In this example, the owner of each asset is covering insurance and repairs on the portion of the buildings, and machinery and equipment they own.

If this is not the case, the percentages used for buildings, and machinery and equipment above may need to be modified. The opportunity cost associated with labor and management is assumed the same for both parties. The lower contribution for the older generation reflects the fact that this individual is working a fraction of the year. It is important to note that the annual contributions reported in table 1 are distributed before net income is split between the parties.

The annual value of the contributions will need to be updated every year to account for changes in owned acres, building values, machinery and equipment values, and working capital. When dealing with a younger generation and an older generation, what typically happens is the annual contribution of the younger generation increases over time while the annual contribution of the older generation decreases over time. If assets were purchased together, the ownership shares would need to be divided accordingly. It is also important to note that if assets are disposed of the sales amount needs to be divided using the ownership percentages.

Concluding Comments

This article described a model that can be used to divide farm business income and provided an illustration of how this model could be used in practice. The illustration involved only two parties. However, the conceptual framework presented could be used with three or more parties.

References

Hofstrand, Don. "Dividing Business Income." *Ag Decision Maker*, C4-16, Iowa State University, December 2016.

Langemeier, M. "Should Sweat Equity be Used to Compensate a Returning Family Member?" *farmdoc daily* (7):6, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, January 13, 2017.

USDA-ERS. "Highlights from the February 2017 Farm Income Forecast." https://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/highlights-from-the-farmincome-forecast/.

Table 1. Annual Value of Contributions for Case Farm, Year 1

Item	Younger Generation	Older Generation
Land	$0	$125,000
Buildings	$0	$50,000
Machinery and Equipment	$15,000	$135,000
Breeding Livestock	$0	$0
Working Capital	$5,000	$25,000
Labor and Management	$60,000	$45,000
SUB TOTAL	**$80,000**	**$380,000**

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Putting a Value on Sweat Equity in Your Farm Business

Chapter 3

Michael Langemeier

Department of Agricultural Economics

Purdue University

&

Denise Schroeder

Purdue Extension, White County

Maintaining family ownership of the farm land is not the same as maintaining the family farm. The former is an investment in an illiquid, long-term, appreciable fixed asset and the latter is a business. If inheriting farm land makes you a farmer, then inheriting economic books makes you an economist. Many times, as a family business or farm, we fail to separate the two.

With that thought in mind, let us look at the differences between a family and a business. In general, a successful family is loving, loyal, affectionate, supportive, empathetic, understanding, enduring and communicative. These attributes help people get along with others and build lasting relationships. On the other hand, a successful business is efficient, profitable, goal-directed, effective, aggressive, innovative, proficient and evaluative. Thus, the traits of a successful business are often perceived as the direct opposite of a successful family or personal relationships.

No two persons are alike, even though people in families may have similar values and character traits. Your children and heirs may not be the same persons, and may therefore have different needs or desires. So, how do you determine what is fair, equal, or both (if possible) when you are looking at developing an estate plan for your business, and a succession plan for your family?

Resources for a farm could include:

- Land
- Buildings
- Machinery
- Equipment
- Livestock
- Working Capital
- Labor
- Management

When we think about evaluating what is fair and equal, there are two common income sharing models to consider:

1. Contributions Model - Compute the annual value of each party's contribution of resources to the venture. Next, the net income (or loss) is shared in proportion to the individual party's respective contribution to the resources.
2. 50/50 Model - Each resource (including an individual) is paid a return similar to a rental payment or wage and then the remaining return (or loss) is shared equally among the parties and may include; but are not necessarily limited to; insurance, housing, and vehicle use. In this instance, sweat equity can be computed by examining the difference between the agribusiness and farm opportunities.

Many times, there is one or more family members who have stayed on or returned to the farm to help maintain the business. Let us look at a family situation (below) to illustrate a few key points.

Mom and Dad want to keep the "farm in the family". One of their three children, Michael, is involved in the running of the farm. Unfortunately, if the farm business were divided into three equal parts, it would not be of adequate size to create a viable enterprise for any of their heirs.

When Michael came back to the family farm in 1990, the fair market value of the business was $420,000. At that time, mom and dad agreed that the contribution of each child up to 1990 was equal. Dividing the $420,000 by three results in a contribution of each child of $140,000.

Today's fair market value of the business is $1,680,000. If we divide the value by three, $560,000 would be left to each child. However, the contributions of the three children have not been equal since 1990. In addition to working on the farm, decisions were made because Michael came back to the farm – land and equipment were purchased, the operation expanded, etc. Even though few promises were made to Michael when he returned, he helped with the expansion of the farm.

Mom, Dad, and Michael know that his contribution to the family farm has resulted in Michael putting a sizable investment of 'sweat equity' into the farm business. In this example, there are two dilemmas: 1. Treating each child fairly; and 2. Farm assets have increased dramatically since Michael's return to the farm.

Thus, the question remains: how do we put a value on 'sweat equity'? When we look at these two dilemmas, there are many things to think about. We do not want the non-farm kids to feel that they have been mistreated or slighted, but if Mom and Dad were to divide the farm business into equal pieces, would each piece be large enough to create a viable business? What about the contribution of the farming child to the growth or success of the business? What has the involved child given up or done without by being involved in the business? Could Michael have made more money if he would have had an off-farm job or career?

The second dilemma remains: can Michael earn adequate income to pay for the increased value of the assets? For example, if he buys out each sibling, it would cost more than $1 million. Many times, this can be difficult (if not impossible) for a successor to accomplish. For Michael to be successful, both the income the business generates and market value of the farm assets have to be considered.

If we put a value on sweat equity and account for the fact that the business looks different today because Michael came back to the farm, then we need to acknowledge that there should be some compensation differences between him and his siblings. It is often difficult to determine how much 'sweat equity' contributed to the increase in value of the business. We also need to consider the level of Michael's annual compensation (market value compensation) when we put a value on the sweat equity.

To keep our example relatively simple, we will use the value of the business in 1990 and the current value to create an example of how to distribute the estate to each of the three heirs. We potentially can divide the estate in the following way:

Michael receives $980,000:	Non-farm siblings receive $350,000 each:
$140,000 (1/3 of the 1990 value)	$140,000 (1/3 of the 1990 value)
$630,000 (50% of growth)	$210,000 (1/3 of parent's contribution to growth)
$210,000 (1/3 of parent's contribution to growth)	

This is a simple example for accounting for sweat equity, but it is a prime example of how fair does not translate to equal. Hopefully you will consider the contributions of the on-farm heir as you develop your estate plan for your family business.

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Langemeier, M. "Should Sweat Equity be Used to Compensate a Returning Family Member?" farmdoc daily (7):6, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, January 13, 2017. Retrieved at: https://farmdocdaily.illinois.edu/2017/01/should-sweat-equity-be-used-compensate-family.html.

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CHAPTER 4

PROTECTING THE BUSINESS & MITIGATING RISK

The succession process is a perfect example of the human resource risk inherent in most family businesses. It's important that business owners give some thought to how they will protect their business from illness, death and divorce, but also from incompetence and poor communication and management practices. This chapter will provide guidance on how to ensure that your business not only gets passed on to the next generations, but thrives during the succession process.

Maria Marshall
Department of Agricultural Economics
Purdue University

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Planning for the Unexpected: Human Resource Risk and Contingency Planning

Maria Marshall & Corinne Alexander

Department of Agricultural Economics

Purdue University

Small businesses are confronted by many different types of risk: production, marketing, financial, legal, and human. Managers generally spend most of their time dealing with production, marketing, financial, and legal risks and give little consideration to human resource risk and how the absence of key personnel can affect their business. This is a serious oversight because people are the key component in many risk management strategies.

Human resource risks are events that prevent employees from fulfilling their responsibilities and thus keep the business from operating at full efficiency. Human resource risks include but are not limited to:

- Death
- Disability (Temporary or Permanent)
- Divorce
- Management Error/ Incompetence
- Unexpected Temporary Leave
- Employee Turnover

One way that you can combat human resource risk is by writing a contingency plan. A contingency plan is a structured way of deciding what to do if key operations are disrupted or key personnel are not available. It can help you identify and prevent or modify the impact of unacceptable risks. It helps you recognize the best possible options and ensures that your risk management dollars are spent wisely.

Writing a Contingency Plan

A contingency plan is a set of procedures that defines how a business will continue or recover its critical functions in the event of an unplanned disruption to normal activities. It allows you to assess your business operations and processes to determine how well the business

can function when key resources, such as critical personnel, are not available.

When writing your contingency plan you should use the knowledge and input of your business's key employees and outside stakeholders, such as your banker, accountant, insurance agent, and lawyer. You may also want to include family members who are not currently involved in the business but may have a future interest. You should establish a planning team in order to share the responsibility among key personnel. This is important because key employees and other team members will be a critical part of any recovery strategy that you put together. An added advantage of including employees in your planning team is to reassure employees that their jobs are secure even as you are preparing and implementing the plan.

A contingency plan consists of six main sections:

- Executive Summary
- Risk Management Goals
- Risk Assessment
- Business Impact Analysis
- Risk Management Strategies
- Plan Maintenance

Writing a contingency plan is a continuous process. Once you decide which risk management strategies make sense for your business, you may need to re-assess the risks in your original plan. You should not be discouraged if this causes you to rewrite several sections. This often leads to an even better understanding of your business and how everyone in it fits together. The executive summary is the first section of your contingency plan. However, it is the last section you should write and so is discussed at the end of this publication.

Risk Management Goals

In this section, you should identify your risk management goals. The purpose of risk management goals is to reduce uncertainty. For example, you may want to reduce employee absence or accidents, which reduces uncertainty about labor availability. Risk management goals can also be about managing business opportunities. For example, you may want the business or farm to stay within the family, which reduces uncertainty about the continuation of the business. Risk management goals help you decide which opportunities and risk management strategies to pursue.

Risk Assessment

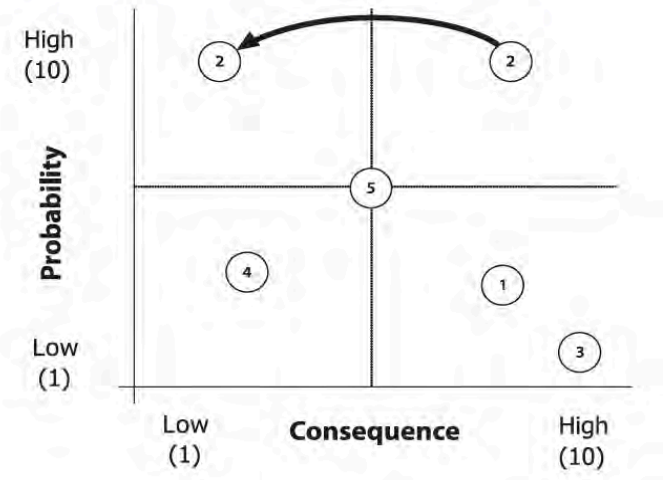
This section of the contingency plan is about identifying and assessing the risks to the business. You should pinpoint the events that could cause financial or operational harm to the business.

Rate the probability and consequence (severity, cost) of each event on a 1-10 scale (1=Low, 10=High).

Event	Probability	Consequence
Owner Accident, Out 6 Weeks	2-3	8
Owner, 80, Passes Away	8	8
Owner, 35, Passes Away	1	10
New Employee Quits	3	3
Employee Injured	5	5

For each event, evaluate both the probability of occurrence and the consequence or impact of occurrence on a scale of 1 to 10, where 1 is low and 10 is high. You can think of the consequence of the event both in terms of severity and cost to the business. The first event in Table 1 is an owner of a business identifying as a possible risk a car accident that prevents her from fulfilling her normal duties for six weeks. The owner rates the probability of a car accident at between 2 and 3. She rates the consequence of being unable to fulfill her duties for six weeks at 8. Use Worksheet 1 to list the events that pose a threat to your business.

Figure 1. The Risk Matrix



Once you have rated the probability and consequences of each event, you can place them all on the risk matrix as shown in Figure 1. In event 2, the owner passes away; he is 80 years old and did not write a succession plan. The owner rates the probability very high at 8 and the consequence also very high at 8. Event 2 demonstrates the importance of succession planning. If the 80-year-old business owner had a succession plan, the consequences to the business would be reduced to around 2. Introducing a succession plan moves the location of event 2 on the risk matrix from high consequence to low consequence, as shown by the arrow. Part of successful contingency planning is to identify areas in which risk management, such as succession planning, is needed.

In event 3, a young owner (35 years old) passes away. The owner rates the probability very low at 1, but believes the consequences for the business will be devastating at 10. Event 4 identifies the probability of a new employee quitting at 3 and consequences also low at 3. In event 5, an employee is injured on farm equipment, which is a common occurrence, and the consequences vary greatly, so the owner rates both the probability and consequences at 5.

You should answer two main questions in this section of the contingency plan:

1. What are the events that could harm my business or reduce my ability to accomplish my risk management goals?
2. On a scale of 1 to 10, how likely is it that the event will occur?

Business Impact Analysis

You can assess the impact of an event on a business in three ways: operating impact, financial impact, and legal impact. Operating impact is loss of operating efficiency, such as decrease of sales or production volume due to the absence of key employees. It can be as simple as not having someone to answer the phone. Loss of customers, increased costs, and cash flow problems are examples of financial impact. Legal impact involves the inability to fulfill business contracts with suppliers, customers, or vendors. In many ways, these impacts are interrelated. For example, hiring inexperienced temporary personnel to cover the day-to-day duties of an injured business owner might lead to decreased operating efficiency and cash flow problems, which might mean the business cannot pay its vendors, thereby causing a decrease in the business's credit rating and a lawsuit. This section also includes identifying critical functions within the business and how the loss of key personnel will affect those functions. You should ask yourself the following questions:

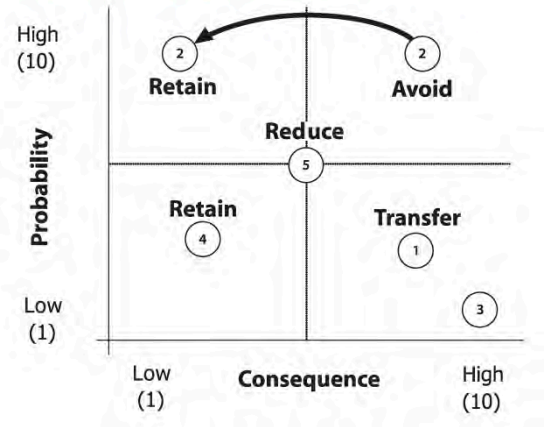
- What are the critical functions performed by each individual?
- How will the event (loss of key personnel) affect that function?
- What are the consequences or impacts on the business (operating, financial, and legal) if that function is not completed?
- How long can that function remain deficient?

When you think about the recovery timeframe, you should try to determine whether that particular function has to be covered immediately in order to keep the business going or if it can be part of a long-term recovery strategy.

Risk Management Strategies

Now that you have identified the risks to the business, their probability, and their consequences, you should prioritize and begin to establish management strategies for those risks. As a small business owner, you can decide to retain, reduce, avoid, or transfer the risks you detailed in the risk assessment section. The risk matrix can then guide your choice of risk management strategy. Depending on where the event lies on the risk matrix in Figure 2, there are four corresponding risk management strategies depicted. Use Worksheet 2 to locate the events you identified in Worksheet 1 on the risk matrix. This will help you choose your risk management strategy.

Figure 2. The Risk Matrix Guides the Choice of Risk Management Strategy



With a risk avoidance strategy, the business takes action to avoid the risk. Typically, this means the business chooses not to undertake an activity. For example, a farmer may decide not to grow strawberries because she does not have enough reliable labor to pick the strawberries. Event 2 falls into the avoid category; the business owner could avoid the severe negative consequences to the business with a succession plan.

A risk reduction strategy requires you to take action to reduce either the probability or consequence of the risk or both. Typical examples include worker safety training and safety equipment, both of which are appropriate measures to address event 5. In the case of event 2, the business owner can invest the time and money to develop a succession plan or will.

Unanticipated events will inevitably occur, and, when you choose to retain those risks that are of low consequence to the business, you are choosing a risk retention strategy. Businesses face many small risks, such as a new employee quitting or a customer's bounced check, and these events are seen as the cost of doing business. You can invest time or money to protect the business when these events occur. A rainy day fund is a common risk retention strategy, saving money when the business is doing well to be able to minimize the impact of customer's bounced checks and the like.

A risk transfer strategy requires that you transfer the risk to a third party, such as an insurance company. The insurance company will pay an indemnity when the event occurs. Typical insurance options for farmers include crop insurance or revenue insurance. Liability insurance, disability insurance, key personnel insurance, and life insurance are types of insurance that small businesses should investigate. In event 1, the business will be better off if the owner has car insurance and disability insurance. In event 3, the business may survive if the owner's life insurance provides sufficient cash to allow the spouse or partners to learn how to fulfill the owner's duties.

Each strategy should include the roles and responsibilities of everyone involved in the recovery stages of an event. It should also include the procedures to be followed if that event should occur. The main questions to be answered in this section are:

- What are the resources required to continue to perform critical functions?
- How can the business decrease the likelihood of an event occurring?
- How can the business lessen the impact of an event?

Executive Summary

The executive summary in its basic form should tell the reader who is involved in the plan and what events are considered. It should also summarize the risk management strategies used in the plan. The executive summary is the last thing you write but the first section of the contingency plan.

Plan Maintenance

It is important that you keep the contingency plan up to date and revise it at least once a year. The plan should reflect any changes in the business. You should identify ways to keep the plan fresh and relevant.

Next Steps

Use Worksheets 1 and 2 to list your human resource risks and identify your risk management strategies. Then write your contingency plan. Besides human resource risk, you can use a contingency plan to identify risk management strategies associated with production, marketing, financial, and legal risks.

Remember that writing a contingency plan is a continuous and evolving process. It can be time consuming but it is the best process to assess the efficiency of your business operations and how well your business can recover from serious disruptions.

Acknowledgements: We would like to thank the North Central Risk Management Education Center for their support.

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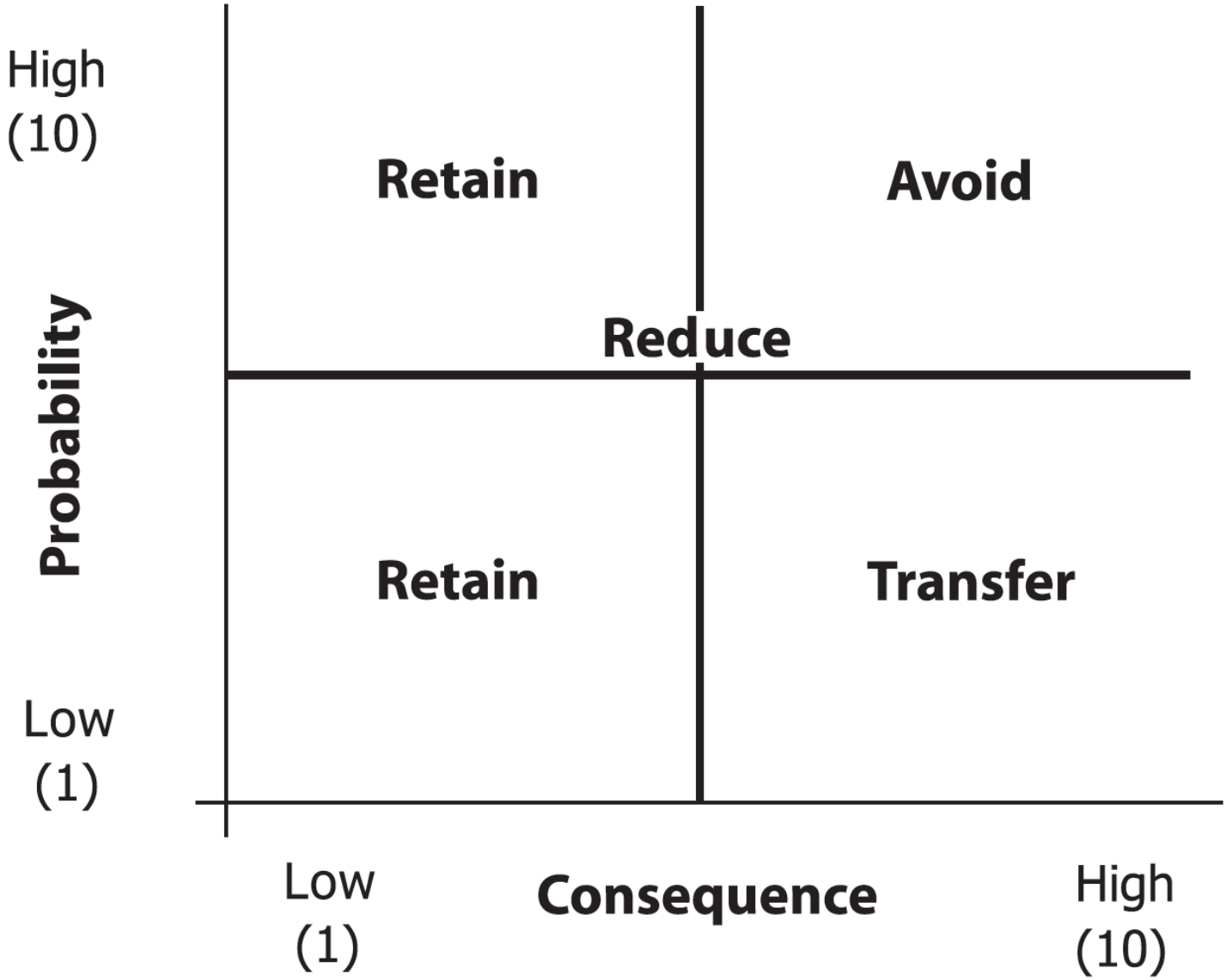
Worksheet 1. What Human Resource Risks Does Your Enterprise Face?

Rate the probability and consequence (severity, cost) of each event on a 1-10 scale (1=Low, 10=High).

Event	Probability	Consequence
1.		
2.		
3.		
4.		
5.		
6.		
7.		
8.		
9.		
10.		
11.		
12.		

Worksheet 2. Risk Assessment Matrix

Locate the events you identified in Worksheet 1 on the risk matrix. This will help you choose your risk management strategy.



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Risk Management Assessment

This worksheet is intended to help you address on-farm risks as part of your transfer planning process. You are asked to assess your farm's risk exposure to the listed items. The following categories of risk are addressed in this publication: financial, production, marketing/price, human resource, and legal. Ideally, as part of the transfer process, you incorporate additional risk management strategies to enhance farm viability. For each item listed, indicate whether it causes an issue in your operation (yes, somewhat, or no). If you responded 'somewhat' or 'yes', write down how your farm can address that issue.

Note: This assessment is drawn from a 2004 USDA-RME financial risk management project conducted at Cornell University

Chapter 4

Angela Gloy & Renee Wiatt

Department of Agricultural Economics

Purdue University

Table 1. Financial, Production, and Marketing/Price Risk Assessment

Financial	Is this an issue in your operation?	How can you address this?
Record keeping: Do you have a set of well-maintained financial records?	Yes Somewhat No	
Financial analysis: What kinds of trends is your business experiencing? Are these trends due to internal management or external forces?	Yes Somewhat No	
Cost of debt capital: What is my current cost of capital? How can I reduce borrowing costs?	Yes Somewhat No	
Meeting cash flow requirements: Do you have enough cash to keep accounts current?	Yes Somewhat No	
Investment risk: Where are you investing the profits from the farm business? Are you keeping up with inflation? Are you planning for your eventual retirement?	Yes Somewhat No	
Family well-being: Will your family be able to cover living expenses now and in the future?	Yes Somewhat No	
Production	**Is this an issue in your operation?**	**How can you address this?**
Crop yield losses: How much of a crop loss can your farm sustain and still meet cash commitments?	Yes Somewhat No	
Crop income losses: What factors affect the quality and in turn price you receive for your farm product? How do you plan for risks?	Yes Somewhat No	
Marketing/Price	**Is this an issue in your operation?**	**How can you address this?**
Price risk: Risk that the price for your product or prices you pay for products will rise/fall to a point of jeopardizing cash flow commitments.	Yes Somewhat No	
Not planning for market forces: Do you have a marketing plan? What tools are you using to better help market your product?	Yes Somewhat No	

Table 2. Human Resource and Legal Risk Assessment

Human Resource	Is this an issue in your operation?	How can you address this?
Losing key employees: Risk that a key employee quits, becomes disabled, or dies without provisions to hire someone of equal skill.	Yes Somewhat No	
Losing key business partners: Risk that a business partner leaves voluntarily (i.e. disagreement) or involuntarily (i.e. death, divorce) and business is subjected to disruption (e.g. having to buy out exiting partner's share). Is there a plan for business continuity with respect to exiting partner's responsibilities?	Yes Somewhat No	
Disability risks to one's self and family: The risk that you or someone in your family becomes disabled.	Yes Somewhat No	
Health care risks: Risk of prolonged health care needs by business owners and/or their families. How will the business accommodate health care expenses?	Yes Somewhat No	
Business continuity: Failure to identify a next generation manager and/or owner. What happens to the farm business in the absence of a farm succession plan?	Yes Somewhat No	
Family relationships: Risk that personal family relationships are compromised for the sake of the farm business.	Yes Somewhat No	
Legal	**Is this an issue in your operation?**	**How can you address this?**
Personal liability: Are personal assets protected from business liability risk?	Yes Somewhat No	
Contractual risk: Risk of business agreements being broken by yourself or business partners.	Yes Somewhat No	
Legal obligations: Risk that management is operating outside legal regulations; laws change periodically.	Yes Somewhat No	
Personal/property damage liability: Liability resulting from negligent or intentional damage to property or persons.	Yes Somewhat No	
Environmental liability: Liabilities arising from failure to comply with environmental regulations. General liability insurance does not cover criminal proceedings.	Yes Somewhat No	

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Business Entity Structures

Chapter 4

Kyle Weaver

Switzerland County, Purdue Extension

&

Renee Wiatt & Angela Gloy

Department of Agricultural Economics, Purdue University

Consideration of a farm business structure is crucial to your farming operation. Producers should review their operational goals as they look towards choosing a business structure. A farm business structure can affect daily farming operations, decision making, tax liability, and flexibility for ownership. Farming operators should develop a team of professionals to review the legal, financial, and tax implications of the business structure for their operation. Below, we explore some advantages and disadvantages of sole proprietorships, partnerships, corporations, and LLC's.

Developing the right business structure for your farming operation is vital to your success. Special care should be taken to analyze the advantages and disadvantages of each business structure as it relates to your operation. The information provided below is general in nature and producers should form a team of professionals to assist them in making the right decision for their operation.

Take some time exploring the pros and cons of each business entity structure. Also take some time to analyze your farm's current structure and pros/cons, as well as pros/cons of an alternate structure for your business. By taking time to be thorough with your business structure analysis, you can make an informed and beneficial decision for your farm business.

Table 1. Comparing Business Entity Structures

Business Entity Structure	Advantages (Pros)	Disadvantages (Cons)
Sole Proprietorships: A single producer that may or may not have hired help.	1. No double taxation. 2. Simple and inexpensive to create and use. 3. Owner has a great deal of control over the business.	1. Producer is solely, personally liable for all risk and debt in the operation 2. Business typically dies with the owner.
Partnership: Two or more producers can form a partnership. It is recommended that a written partnership agreement be developed to establish detailed instructions on topics that may include partner contributions, profit and loss shares, management decisions, and property ownership.	1. Partnership agreements are very detailed and have very defined roles for each partner. 2. Ease of setting up partnership agreements. 3. Income is taxed the same as a sole proprietor.	1. Partners are responsible for debts and liabilities for all partners. 2. Partners can conduct business in the partnership name thus binding all partners to contracts and financial obligations.
Corporation: Corporations are a separate business that is owned by it's shareholders. Corporations are titled as S or C. Tax liability defines the difference between the two. In corporations the stockholders elect a board of directors. The board of directors hires the management of the operation. Small farming operations often see family members serve in multiple roles.	1. Corporations can continue to operate indefinitely if corporation requirements are maintained. 2. Corporations can be a great tool to utilize to transfer ownership to the next generation. 3. Opportunity for outside investment and growth. 4. A corporation is taxed as a separate entity.	1. Corporations can be complex and expensive to form. 2. Minority stakeholders may have little decision making in the operation of the corporation. 3. Corporations must maintain and update their articles of incorporation and other vital records.
Limited Liability Company (LLC): One or more producers can form an LLC. An LLC is very similar to a corporation. However, its ownership is defined as units and their directors are called managers.	1. Management of the LLC can be flexible. 2. An LLC may provide protection of personal assets. 3. An LLC is taxed as a separate entity.	1. An LLC must be dissolved when a person leaves the operation. 2. A member's personal assets are not protected in the case of wrongful action.

Table 2. Comparing Your Current Business Structure with Alternate Structure(s)

Your Current Business Structure:	Advantages:	Disadvantages:

Alternate Structure #1:	Advantages:	Disadvantages:

Alternate Structure #2:	Advantages:	Disadvantages:

Reference: Liebold, K. 2019. Evaluating your estate plan: Business entities. Iowa State University Ag Decision Maker, File C4-52

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Operating Agreements and Buy-Sell Agreements: *Defining the Rules for Operating Your Business and Transferring Business Assets*

Chapter 4

Craig Dobbins &
Renee Wiatt

Department of
Agricultural Economics

Purdue University

Introduction

Business-owning families devote substantial amounts of time, ingenuity, creativity, and money to the creation and growth of their business. If the business is successful, it is likely that one or more of the children will develop an interest in joining the business with the intention of continuing that business. While each family business manager thinks that the management problems they face are unique, the reality is that there are more similarities across small businesses than there are differences. In addition, small business research has found a set of common and predictable family business issues that managers of these businesses will face. A few of these issues include:

- Communication is critical. Business families with a long history of success are families that work very hard at communication. It is important to put in place practices that promote ongoing sharing of information, ideas, opinions, and feelings.
- Succession. There are struggles with choosing a successor, teaching the next generation about the business, financing the transition of the business, and letting go of the business.
- Financing business growth and family liquidity. Here is a built-in conflict for the family business: both entities have a need for liquidity. This leads to a continual pull between the family and the business for resources and assets.
- Attracting, retaining, motivating, and rewarding the non-family employees needed to complete the staff of

managers and workers.

- The overall issue of compensation. This is an issue for both family and non-family members.
- Employment of family members. Who can join the business and under what conditions?
- Other issues. Who should be owners? How are in-laws handled? How is the next generation of owners educated?

Some of these issues arise early in the life of the business. Others will be later in the business' evolution, but all successful family businesses will face these issues. In every case, it is desirable to have a policy in place for handling the issue before it is needed. This publication addresses two issues that family businesses need to address during succession. The first is the development of an operating agreement for guiding multi-manager decision making. The second is the development of a buy-sell agreement that ensures the family retains control of the business' assets.

The process of succession is a period in which knowledge about the business along with its assets are transferred from the incumbent generation to the next generation. During this period, the two generations should work closely together making decisions. Will the business have an operating plan to guide the newly formed multi-manager business operation or will it just be made up as it goes? Of course, there should be an operating agreement. "Making it up as you go" contributes to only about two out of five family businesses enduring into the second generation of business owners.

At the time of forming the operating agreement, the plan for how to divide assets and ownership when a partner leaves is often overlooked. The idea of one of the partners leaving the agreement is often delegated to the "category of things that will not happen" and thus does not need to be considered. However, the reality is a partner always leaves, whether voluntarily or non-voluntarily, and sometimes unexpectedly. And if it happens without being planned for, it is a major disruptor that will likely threaten the continuation of the business. The plan for guiding decisions when a partner leaves is referred to as a buy-sell agreement.

Sound management principles requiring business partners to set up an operating agreement also require the establishment of a buy-sell agreement. Ideally, both documents are developed before the business begins operation. Operating agreements and buy-sell agreements are the focus of this publication.

Operating Agreements

An operating agreement is an agreement that identifies the parties that will be participating in the business, the contributions and responsibilities of each party, and how decisions will be made within the business. With an operating agreement, a business can form policies related to the operation of the business. If you are planning to use a partnership or an LLC as part of your succession plan, it is important to have an operating agreement (even though an operating agreement is not necessarily required). Even if you decide to operate two separate businesses that work jointly in some areas, a written agreement will be helpful as time progresses and memories of the initial agreement become unclear.

What is often included in an operating agreement? A list of common items is provided below. This list is not intended to be exhaustive, but it provides a starting point.

- **Parties involved:** Names and addresses of the parties that will participate in the agreement.
- **Purpose of the agreement:** Why is this agreement being created? If this agreement is being used with a new partnership or limited liability company (LLC) business entity, state the purpose of the partnership or LLC. If the operating agreement is used for a business entity that has already been created, also provide the name and address of the business and the name and address of the initial registered agent.
- **Not a partnership:** If you are concerned this agreement might be viewed as a partnership, making you personally liable for acts of the business, the agreement needs to include a statement that nothing about the agreement is meant to suggest a formal partnership is being formed.
- **Duration of the agreement:** How long do you want this agreement to last? It is possible to establish a specific date. If you desire, the agreement can continue until it is terminated. If you choose to use this indefinite approach, then you must define the process that allows the agreement to be terminated.

- **Initial contributions to operating agreement:** What amount of cash or capital assets are contributed by each of the initial members to the agreement? Will these members receive any compensation for this contribution? Typically, there is no compensation for initial contributions. However, if members of the agreement want to provide a return on capital contributions, the terms of compensation need to be specified.

  After all initial capital contributions are accounted for, each member to the agreement will have an individual capital account. Based on these numbers, the percentage ownership associated with each member needs to be specified and documented. Will members be allowed to withdraw funds from their capital account? The answer is typically no. But again, it is up to the members. There may be exceptional cases in which members want to allow for capital withdrawal. Again, these cases need to be specified and documented.

- **Membership voting:** If decisions are made by voting, how will each member's vote be counted? It is typical to give each member voting power in the same proportion as their ownership interest; however, this is not required. Each member could be given an equal vote even if ownership is not equal. It would also be possible to assign a certain number of votes to each member. For example, Member A could have 2 votes, Member B could have 1 vote, and Member C could have 1.5 votes. Consider: will a majority vote be enough to decide an issue? While this is a commonly accepted standard, there may be some decisions such as admitting new members to the agreement or the dissolution of the agreement where a higher standard is needed. For these two examples, it is common to require all members to agree (i.e. a unanimous vote).

- **New members:** Can new members join the agreement? If so, what is the procedure for them joining? Can new members substitute for old members? Are new members required to make capital contributions? How will the admission of new members change the percentage ownership of current members?

- **Management decision making:** Will there be an individual or a group of individuals specified as managers in the agreement or will the management decisions be made by all members of the agreement? Must members in the management team be associated with the agreement or can people that are not associated with the agreement hold a management role? If management decisions are made by specified managers, how are they selected? How long can a person serve as a manager? What is the procedure for removing a manager from their management position?

- **Meetings:** Are parties to the agreement required to hold formal meetings? If so, who can call a meeting and what kind of notification must be given? Is oral notification enough or must there be written notification? Who can request a formal meeting? What kind of meeting records will be kept?

- **Financial records:** Under the agreement, what financial records need to be kept? Who is responsible for the record keeping? Will there be any audits of these records? If so, how will it be conducted? What business records and reports will be provided to non-management members? Will a cash or accrual record keeping system be used? Under the cash method, the business deducts expenses when paid and reports income when received. Under the accrual method, the business deducts expenses when it becomes legally obligated to pay them and reports income when the business is legally entitled to receive the income. There are often tax advantages to using a cash system.

  What fiscal year will be used? Income tax regulations require the specification of a tax year. An accounting period of January 1 to December 31, a calendar year, is commonly used because it typically matches the tax year of the individuals. However, if there are justified reasons for some other period, it may be possible to use an alternative tax year.

  What type of income tax information must be provided to the individual members of the agreement? In many cases, the profits or losses incurred by the agreement will be treated as pass-through income. This means any income taxes will be paid by the members to the agreement. However, there will be forms that must be filed with the Internal Revenue Service (IRS). In some cases, you may be required to identify someone to serve as a "tax matters partner" for the IRS.

- **Establishing accounts with banks and other institutions:** Receipts and expenses from the business activity should not be co-mingled

with other funds. As a result, all the members of the agreement must decide who will have the authority to deposit into and withdraw funds from these accounts. This could be one or more members associated with the agreement.

- **Division of profits & losses:** If the joint operation results in a profit or loss, how will they be shared? Will sharing profits and losses be done in the same way? Sharing profits and losses in the same way may be common, but it is not required. Sharing profits and losses differently may be advantageous if the objective of the agreement is to help a younger member gain control of the business assets over time.

  Will payouts be required or will profits and losses be used to adjust the capital accounts associated with the agreement? If there are profits associated with a pass-through business venture, income taxes will need to be paid by the individual parties. It is common to disperse at least enough cash for the individuals to pay these added taxes.

- **Membership withdrawals and transfers:** There are a host of reasons a withdrawal or transfer might occur – member death, member disability, member disagreement, member dismissal, member divorce, and member bankruptcy. Under what conditions can a member retract from the agreement? Do the remaining members need to approve the withdrawal? What kind of notice must be given and how far in advance of withdrawal must notice be given? Can a member transfer their membership to a new person? Do the non-transferring members need to approve the transfer and the admission of the transferee to membership?

  In addition to these considerations, there are a host of issues associated with determining the fair market value of the withdrawing member's share and to whom these assets can be sold or transferred. How will the value of the member's business assets be determined? Who will be allowed to buy these business assets? If the business set up by the agreement must purchase the assets, where will the cash be found? It is common to have a separate buy-sell agreement that guides decisions in this situation, but these guidelines can also be included in the operating agreement.

- **Agreement dissolution:** What is the process for ending the agreement? Will you specify a fixed date of termination? Will the agreement terminate if one of the members dies unexpectedly or becomes disabled? Will the agreement terminate if one of the members wishes to leave voluntarily? When the agreement is terminated, how will liabilities of the business be paid, and how will any remaining assets be distributed? The policy used in this situation may be similar to those used when a single member wishes to leave, but in this case, there is no concern about the continuation of the agreement. Are there restrictions on who can purchase assets in this situation?

Operating Agreement Summary

An operating agreement is a contract establishing the rules that guides how a business venture will be managed both financially and operationally. The operating agreement is an internal document. This means that you do not need to submit it to any governmental agency. In the formation of a partnership or an LLC, Indiana and many other states do not require an operating agreement. You simply keep a copy with your other business papers. However, you may find you will need to share the operating agreement with other businesses such as lenders.

One of the benefits of an operating agreement is flexibility. It is meant to allow changes as the business grows. For simple changes, like a change in address for a member of the agreement or changing the registered office/registered agent, you will just need to revise the original agreement. After all the changes have been made, all the members need to sign the revised agreement. For complex changes, such as one member purchasing another member's interest or how assets contributed to the agreement are dispersed, it is best to seek professional advice from a lawyer and/or a certified personal accountant (CPA). Changes like these can have unexpected negative legal and tax consequences if done incorrectly. Keep a copy of each new agreement as well as the original and any updated agreement for a history of changes made.

Appendix A (found at the end of this publication) contains an example operating agreement that is meant to provide guidance in the operation of an LLC. The purpose of this example is to illustrate the language and clauses used in developing an operating agreement (Mancuso, 2015).

Buy-Sell Agreements

A buy-sell agreement is a binding contract between business co-owners controlling when an owner can sell their interest, who can buy the selling owner's interest, when the company or co-owners must buy another owner's interest, and how the sale price of the business interest will be determined.

Losing a person that is a joint owner of a business means losing a member of the leadership team, but it could also mean new (and possibly unwanted) owners of the business. It could also result in the loss of a significant amount of the business's property, damaging the viability of the business. Such events are what buy-sell agreements are designed to prevent. A buy-sell agreement creates a set of rules for the transfer of business assets in specified situations. By developing a buy-sell agreement, preferably at the time the business is created, rules are agreed to well in advance of needing them.

The occurrence of a triggering event initiates the execution of the provisions of the buy-sell agreement. The thought behind these agreements is a business has a better chance of surviving the triggering event with pre-planned rules of operation. Using a buy-sell agreement requires planning by the business leaders.

Any defined triggering event can be used to initiate the execution of the buy-sell agreement. A common triggering event is the loss of a business partner due to an unexpected death or disability. In this situation, the deceased partner's heirs may wish to sell rather than retain the partner's share of the business. In this situation, there is likely to be a need for a large amount of cash quickly. In another case, a partner may choose to sell their share of the business and leave to pursue other interests. In either situation, having an agreed to plan in the form of a buy-sell agreement can make the transition much easier than trying to establish rules as the change is being made. Remember, try to put policies in place before problems arise.

What Can the Buy-Sell Agreements Do?

A buy-sell agreement can serve copious important functions. The overall purpose of the agreement is to preserve the close ownership of the business and/or the business property by restricting how ownership interests are transferred. These agreements may be used to provide any or all of the following:

- **A market for the ownership interests in a closely held business.** If a partner dies or is disabled, are the remaining partners or the business required to buy the departing partner's property? An event such as a death or disability often requires significant cash immediately. Without prior planning, it may not be possible to generate the needed cash in the time allowed. Prior planning will allow the business to continue uninterrupted rather than needing to address the crisis of retaining ownership of the business.
- **Agreements can provide the process for valuing ownership interests.** Reaching agreement about how the process of determining the business value is often easier when partners are not also facing time pressure for establishing these procedures. Set a schedule and procedure for valuing the business (every 3-5 years or as expansion/a large investment is made should be sufficient for most businesses).
- **Financing the transfer of property is also commonly addressed in buy-sell agreements.** In the case where a partner dies unexpectedly, life insurance is often a part of the financing plan. Life insurance is designed to create large amounts of cash upon the death of a partner. Funds from life insurance could be used by the beneficiary of the policy (remaining partners or the business) to purchase the deceased partner's business share. A different financing plan will be needed if the partner becomes disabled or wishes to leave the business.
- **Agreements can be used to specify who will have the opportunity to buy business assets and the procedure for how the transaction will be conducted.**

Buy-sell agreements are legally binding contracts restricting who the owner of the property may sell to. A partial interest in a business is often difficult to sell on the open market because such a purchase comes with limited managerial control. The purchase of part of a business or specific business assets of a closely held business comes with partners. These partners often hold a majority interest in the business. Because of the limited management authority, most buyers will be unwilling to pay the current market value. To achieve the sale of a minority business interest, a discounted sale price is typically necessary. With the proper provisions, the buy-sell agreement creates an immediate market for an owner's minority interest at a price closer to the current market value.

Arranging the sale of a business partner's assets

allows the assurance that the business will remain in the hands of the remaining owners. Funding of a buy-sell agreement is an important aspect of this planning. Funding the agreement might be done using current cash flow, loans, life insurance proceeds, cash reserves, or an installment sale.

General Design of Asset Transfer Agreements

Regardless of the purpose of the asset transfer agreement, there will be several common provisions:

- **Parties involved:** all the participating parties and their addresses should be clearly defined.
- **Purpose:** A statement indicating why the agreement was developed is crucial. This serves to document the intent of the agreement, reducing the likelihood of a future dispute.
- **Commitments:** The agreement needs to specify the obligations of each party.
- **Business interest description:** This provision supplies a description of the business interests subject to the agreement.
- **Transfer restrictions:** This section prevents the people involved in the agreement from transferring their business interest to outsiders. This can be accomplished by including a right-of-first-refusal, a provision that allows the company or individuals involved in the company the opportunity to purchase the business interest of current owners before it can be offered to outsiders. The agreement could also specify the remaining owners, or the business must buy the assets of departing members.

  But at what price? The agreement can specify a fixed purchase price or a process by which a purchase price will be determined. While a fixed valuation sounds like a simple, straightforward way of establishing a business value. At the time of a triggering event, failure to keep the value up-to-date might require the person selling to do so at a very low price. If the specified sale price is not routinely updated, this value may have lost its appropriateness and a negotiator may need to be hired to determine a more equitable price. An alternative to the fixed price is a process for price determination. This approach often involves the hiring of one or more professional appraisers to provide an objective estimate of the business' value.
- **Funding:** This provision provides guidelines for funding the purchase. When a partner's business interest is for sale, this typically triggers a need for a larger amount of cash. If the reason for the sale is the death of a partner, life insurance can supply cash to purchase the partners' interest from their estate. However, other events can lead to the desire of a person to sell their business interest where life insurance would not be helpful. What financing alternatives are available to the remaining members of the agreement for financing the buy-sell agreement?

  An installment sale will allow the partner selling assets to finance the sale and be paid over time. In this situation, the agreement could specify the interest rate and the payment schedule. Funding could also be provided by borrowing the needed funds from a third-party lender. Allowing funding flexibility is important in the buy-sell agreement. Improper financing terms can be a big mistake. A mandatory purchase at the time of a triggering event or a first-right-of-refusal on behalf of the survivors can affect business marketability and continuity if profits are lacking.

  Business managers need to make sure the business and the business partners will be able to meet the specified commitments. A commitment to fairness in all events or possible circumstances under the buy-sell agreement is important to the success of the agreement.
- **Buy-Sell agreement modification:** Over time, the business changes. The business may become larger and more complex. It may be necessary to change some of the initial provisions of the buy-sell agreement. This section specifies the process for making changes. Regular review and discussion of your buy-sell agreement as life events change is necessary.

Types of Asset Transfer Agreements Used in Closely Held Business Entities

Cross Purchase Agreement: This creates a market for business property when one or more business owners wish to sell their share of the business. The remaining members of the business may have an obligation to purchase the business interest offered for sale. Each party agrees to purchase a share of any other persons share and binds the seller to sell their business interest to the other parties to the agreement.

When protecting against the death of a member to the agreement, a life insurance policy on the lives of all owners is required in a cross-purchase agreement. At the time of death, these funds are bound to the purchase of the deceased's business interests. Each party to the agreement owns a life insurance policy on all other owners. If there are several owners there will be many policies associated with a cross purchase agreement. The number of needed life insurance policies is n*(n-1), where "n" is the total number of owners. If there are only two partners, only two life insurance policies are required, 2*(2-1). If there are four partners, there will need to be a total of 12, 4*(4-1), life insurance policies. While life insurance may work well in the case of a partner's death, what approach will be used to finance a cross purchase agreement of a partner that wishes to sell and pursue other interests?

Entity Purchase Agreement is when the business entity (partnership, corporation, limited liability company, etc.) buys the business interest. In this case, the owners of the business and the business entity are involved in the contract agreement. Now if life insurance policies provide the source of financing, the business entity holds a life insurance policy on each owner and is obligated to buy the interests of the deceased with the proceeds. This requires the company to own a life insurance policy on each owner. As the number of owners increases, the number of life insurance policies increases by one for each new member. This type of agreement has a smaller number of insurance policies, but the size of the policy will be larger compared to the cross-purchase agreement. If the reason a partner leaves is other than death, an alternative way of financing the agreement is necessary.

Wait and See Agreement allows owners to postpone the choice between an entity purchase agreement and a cross-purchase agreement until the occurrence of a triggering event (e.g., death, retirement or disability). This agreement requires both the business and the shareholders to agree to purchase the stock of a departing shareholder.

To illustrate the operation of the agreement, assume there are three owners, A, B, and C, each with a one-third share of a corporate business. In the typical Wait-and-See Buy-Sell Agreement, at A's death the corporation has the first option to buy A's stock from his estate. If the corporation fails to exercise this option, or exercise it only with respect to a portion of A's stock, then B & C have the second option to buy A's stock (or the remainder of it). If B & C leave any of A's stock unpurchased, then the corporation must purchase any remaining shares.

Buy-Sell Agreements Summary

The buy-sell agreement is an agreement among the owners of a business and the business that stipulates a framework for the purchase and sale of business interests when a triggering event occurs. The triggering event could be the death of a partner, the disability of a partner, a partner leaving the business, a divorce of a partner and their spouse, or a host of other events that could disrupt business operations. When a triggering event occurs, the agreement specifies who is eligible to purchase the business interests of the departing partner (will it be the company or the other partners or both?), the funding of the purchase, and how the value of the business interest will be determined. A carefully designed buy-sell agreement periodically reviewed and updated should achieve its goal of supplying a successful pre-arranged process for working though the transfer of business assets when the trigger event occurs.

Appendix B provides an example of a buy-sell agreement associated with an Illinois farmland trust. This example was taken from, Harrison, Gerald A., "Family Business Transfer: Importance of Buy-Sell Agreements with an Example and Attached Explanation," Purdue Extension. This example was selected for two reasons. First, trusts are a common estate planning tool. Second, in farm businesses, farmland is commonly the most valuable estate asset, controlling farmland is important to the continuation of the business, and farmland is frequently divided between family members regardless of their interest in continuing an operating business. Without the current generation supplying a set of rules to aid the family members owning the operating business retain control of farmland, this ownership group is likely to face an increasing struggle to retain control of the existing farmland as time passes.

Appendix A.

Example Operating Agreement for a Limited Liability Company (LLC)

Operating Agreement for Member-Managed Limited Liability Company

I. Preliminary Provisions

(1) Effective Date: This operating agreement of _____, effective _____, is adopted by the members whose signatures appear at the end of this agreement.

(2) Formation: This limited liability company (LLC) was formed by filing articles of organization, a certificate of formation, or a similar organizational document with the LLC filing office of the state of _____ on _____. A copy of this organizational document has been placed in the LLC's records book.

(3) Name: The formal name of this LLC is as stated above. However, this LLC may do business under a different name by complying with the state's fictitious or assumed business name statutes and procedures.

(4) Registered Office and Agent: The registered office of this LLC and the registered agent at this address are as follows: _____. The registered office and agent may be changed from time to time as the members may see fit, by filing a change of registered agent or office form with the state LLC filing office. It will not be necessary to amend this provision of the operating agreement if and when such a change is made.

(5) Business Purposes: The specific business purposes and activities contemplated by the founders of this LLC at the time of initial signing of this agreement consist of the following: _____ _____ .

It is understood that the foregoing statement of purposes shall not serve as a limitation on the powers or abilities of this LLC, which shall be permitted to engage in any and all lawful business activities. If this LLC intends to engage in business activities outside the state of its formation that require the qualification of the LLC in other states, it shall obtain such qualification before engaging in such out-of-state activities.

(6) Duration of LLC: The duration of this LLC shall be _____. Further, this LLC shall terminate when a proposal to dissolve the LLC is adopted by the membership of this LLC or when this LLC is otherwise terminated in accordance with law.

II. Membership Provisions

(1) Nonliability of Members: No member of this LLC shall be personally liable for the expenses, debts, obligations, or liabilities of the LLC, or for claims made against it.

(2) Reimbursement for Organizational Costs: Members shall be reimbursed by the LLC for organizational expenses paid by the members. The LLC shall be authorized to elect to deduct and amortize organizational expenses and start-up expenditures as permitted by the Internal Revenue Code and as may be advised by the LLC's tax adviser.

(3) Management: This LLC shall be managed exclusively by all of its members.

(4) Members' Percentage Interests: A member's percentage interest in this LLC shall be computed as a fraction, the numerator of which is the total of a member's capital account and the denominator of which is the total of all capital accounts of all members. This fraction shall be expressed in this agreement as a percentage, which shall be called each member's "percentage interest" in this LLC.

(5) Membership Voting: Except as otherwise may be required by the articles of organization, certificate of formation, or a similar organizational document, by other provisions of this operating agreement, or under the laws of this state, each member shall vote on any matter submitted to the membership for approval in proportion to the member's percentage interest in this LLC. Further, unless defined otherwise for a particular provision of this operating agreement, the phrase "majority of members" means the vote

of members whose combined votes equal more than 50% of the votes of all members in this LLC, and a majority of members, so defined, may approve any item of business brought before the membership for a vote unless a different vote is required under this operating agreement or state law.

(6) Compensation: Members shall not be paid as members of the LLC for performing any duties associated with such membership, including management of the LLC. Members may be paid, however, for any services rendered in any other capacity for the LLC, whether as officers, employees, independent contractors, or otherwise.

(7) Members' Meetings: The LLC shall not provide for regular members' meetings. However, any member may call a meeting by communicating his or her wish to schedule a meeting to all other members. Such notification may be in person or in writing, or by telephone, facsimile machine, or other form of electronic communication reasonably expected to be received by a member, and the other members shall then agree, either personally, in writing, or by telephone, facsimile machine, or other form of electronic communication to the member calling the meeting, to meet at a mutually acceptable time and place. Notice of the business to be transacted at the meeting need not be given to members by the member calling the meeting, and any business may be discussed and conducted at the meeting.

If all members cannot attend a meeting, it shall be postponed to a date and time when all members can attend, unless all members who do not attend have agreed in writing to the holding of the meeting without them. If a meeting is postponed, and the postponed meeting cannot be held either because all members do not attend the postponed meeting or the nonattending members have not signed a written consent to allow the postponed meeting to be held without them, a second postponed meeting may be held at a date and time announced at the first postponed meeting. The date and time of the second postponed meeting shall also be communicated to any members not attending the first postponed meeting. The second postponed meeting may be held without the attendance of all members as long as a majority of the percentage interests of the membership of this LLC is in attendance at the second postponed meeting. Written notice of the decisions or approvals made at this second postponed meeting shall be mailed or delivered to each nonattending member promptly after the holding of the second postponed meeting.

Written minutes of the discussions and proposals presented at a members' meeting, and the votes taken and matters approved at such meeting, shall be taken by one of the members or a person designated at the meeting. A copy of the minutes of the meeting shall be placed in the LLC's records book after the meeting.

(8) Membership Certificates: This LLC shall be authorized to obtain and issue certificates representing or certifying membership interests in this LLC. Each certificate shall show the name of the LLC and the name of the member, and state that the person named is a member of the LLC and is entitled to all the rights granted members of the LLC under the articles of organization, certificate of formation, or a similar organizational document; this operating agreement; and provisions of law. Each membership certificate shall be consecutively numbered and signed by one or more officers of this LLC. The certificates shall include any additional information considered appropriate for inclusion by the members on membership certificates.

In addition to the above information, all membership certificates shall bear a prominent legend on their face or reverse side stating, summarizing, or referring to any transfer restrictions that apply to memberships in this LLC under the articles of organization, certificate of formation, or a similar organizational document, and/or this operating agreement, as well as the address where a member may obtain a copy of these restrictions upon request from this LLC.

The records book of this LLC shall contain a list of the names and addresses of all persons to whom certificates have been issued, show the date of issuance of each certificate, and record the date of all cancellations or transfers of membership certificates.

(9) Other Business by Members: Each member shall agree not to own an interest in, manage, or work for another business, enterprise, or endeavor, if such ownership or activities would compete with this LLC's business goals, mission, profitability, or productivity, or would diminish or impair the member's ability to provide maximum effort and performance in managing the business of this LLC.

III. Tax and Financial Provisions

(1) Tax Classification of LLC: The members of this LLC intend that this LLC be initially classified as a _____ for federal and, if applicable, state income tax purposes. It is understood that, subject to federal and state law requirements, all members may agree to change the tax treatment of this LLC by signing, or authorizing the signature of, IRS Form 8832, Entity Classification Election, and filing it with the IRS and, if applicable, the state tax department within the prescribed time limits.

(2) Tax Year and Accounting Method: The tax year of this LLC shall be _____. The LLC shall use the _____ method of accounting. Both the tax year and the accounting period of the LLC may be changed with the consent of all members if the LLC qualifies for such change, and may be effected by the filing of appropriate forms with the IRS and state tax authorities.

(3) Tax Matters Representative: If this LLC is required under Internal Revenue Code provisions or regulations, it shall designate a "tax matters representative," who will fulfill this role by being the representative of the LLC in dealings with the IRS, who will report to the members on the progress and outcome of these dealings, and who will make any required elections on income tax forms in consultation with the LLC's tax adviser.

(4) Annual Income Tax Returns and Reports: Within 60 days after the end of each tax year of the LLC, a copy of the LLC's state and federal income tax returns for the preceding tax year shall be mailed or otherwise provided to each member of the LLC, together with any additional information and forms necessary for each member to complete his or her individual state and federal income tax returns. If this LLC is classified as a partnership for income tax purposes, this additional information shall include a federal (and, if applicable, state) Schedule K-1 (Form 1065, Partner's Share of Income, Deductions, Credits, etc.) or equivalent income tax reporting form. This additional information shall also include a financial report, which shall include a balance sheet and profit and loss statement for the prior tax year of the LLC.

(5) Bank Accounts: The LLC shall designate one or more banks or other institutions for the deposit of the funds of the LLC, and shall establish savings, checking, investment, and other such accounts as are reasonable and necessary for its business and investments. One or more members of the LLC shall be designated with the consent of all members to deposit and withdraw funds of the LLC, and to direct the investment of funds from, into, and among such accounts. The funds of the LLC, however and wherever deposited or invested, shall not be commingled with the personal funds of any members of the LLC.

(6) Title to Assets: All personal and real property of this LLC shall be held in the name of the LLC, not in the names of individual members.

IV. Capital Provisions

(1) Capital Contributions by Members: Members shall make the following contributions of cash, property, or services as shown next to each member's name below. Unless otherwise noted, cash and property described below shall be paid or delivered to the LLC on or by _____. The fair market values of items of property or services as agreed between the LLC and the contributing member are also shown below. The percentage interest in the LLC that each member shall receive in return for his or her capital contribution is also indicated for each member.

Name	Contribution	Fair Market Value	Percentage Interest in LLC
		$	
		$	
		$	
		$	
		$	
		$	

(2) Additional Contributions by Members: The members may agree, from time to time by unanimous vote, to require the payment of additional capital contributions by the members, on or by a mutually agreeable date.

(3) Failure to Make Contributions: If a member fails to make a required capital contribution within the time agreed for a member's contribution, the remaining members may, by unanimous vote, agree to reschedule the time for payment of the capital contribution by the late-paying member, setting any additional repayment terms, such as a late payment penalty, rate of interest to be applied to the unpaid balance, or other monetary amount to be paid by the delinquent member, as the remaining members decide. Alternatively, the remaining members may, by unanimous vote, agree to cancel the membership of the delinquent member, provided any prior partial payments of capital made by the delinquent member are refunded by the LLC to the member promptly after the decision is made to terminate the membership of the delinquent member.

(4) No Interest on Capital Contributions: No interest shall be paid on funds or property contributed as capital to this LLC, or on funds reflected in the capital accounts of the members.

(5) Capital Account Bookkeeping: A capital account shall be set up and maintained on the books of the LLC for each member. It shall reflect each member's capital contribution to the LLC, increased by each member's share of profits in the LLC, decreased by each member's share of losses and expenses of the LLC, and adjusted as required in accordance with applicable provisions of the Internal Revenue Code and corresponding income tax regulations.

(6) Consent to Capital Contribution Withdrawals and Distributions: Members shall not be allowed to withdraw any part of their capital contributions or to receive distributions, whether in property or cash, except as otherwise allowed by this agreement and, in any case, only if such withdrawal is made with the written consent of all members.

(7) Allocations of Profits and Losses: No member shall be given priority or preference with respect to other members in obtaining a return of capital contributions, distributions, or allocations of the income, gains, losses, deductions, credits, or other items of the LLC. The profits and losses of the LLC, and all items of its income, gain, loss, deduction, and credit shall be allocated to members according to each member's percentage interest in this LLC.

(8) Allocation and Distribution of Cash to Members: Cash from LLC business operations, as well as cash from a sale or other disposition of LLC capital assets, may be distributed from time to time to members in accordance with each member's percentage interest in the LLC, as may be decided by _____ of the members.

(9) Allocation of Noncash Distributions: If proceeds consist of property other than cash, the members shall decide the value of the property and allocate such value among the members in accordance with each member's percentage interest in the LLC. If such noncash proceeds are later reduced to cash, such cash may be distributed among the members as otherwise provided in this agreement.

(10) Allocation and Distribution of Liquidation Proceeds: Regardless of any other provision in this agreement, if there is a distribution in liquidation of this LLC, or when any member's interest is liquidated, all items of income and loss shall be allocated to the members' capital accounts, and all appropriate credits and deductions shall then be made to these capital accounts before any final distribution is made. A final distribution shall be made to members only to the extent of, and in proportion to, any positive balance in each member's capital account.

V. Membership Withdrawal and Transfer Provisions

(1) Withdrawal of Members: A member may withdraw from this LLC by giving written notice to all other members at least _____ days before the date the withdrawal is to be effective.

(2) Restrictions on the Transfer of Membership: A member shall not transfer his or her membership in the LLC unless all nontransferring members in the LLC first agree to approve the admission of the transferee into this LLC. Further, no member may encumber a part or all of his or her membership in the LLC by

mortgage, pledge, granting of a security interest, lien, or otherwise, unless the encumbrance has first been approved in writing by all other members of the LLC.

Notwithstanding the above provision, any member shall be allowed to assign an economic interest in his or her membership to another person without the approval of the other members. Such an assignment shall not include a transfer of the member's voting or management rights in this LLC, and the assignee shall not become a member of the LLC.

VI. Dissolution Provisions

(1) Events that Trigger Dissolution of the LLC: The following events shall trigger a dissolution of the LLC, except as provided:

(a) the death, incapacity, bankruptcy, retirement, resignation, or expulsion of a member, except that within _____ of the happening of any of these events, all remaining members of the LLC may vote to continue the legal existence of the LLC, in which case the LLC shall not dissolve

(b) the expiration of the term of existence of the LLC if such term is specified in the articles of organization, certificate of formation, or a similar organizational document, or this operating agreement

(c) the written agreement of all members to dissolve the LLC, or

(d) entry of a decree of dissolution of the LLC under state law.

VII. General Provisions

(1) Officers: The LLC may designate one or more officers, such as a president, vice president, secretary, and treasurer. Persons who fill these positions need not be members of the LLC. Such positions may be compensated or non-compensated according to the nature and extent of the services rendered for the LLC as a part of the duties of each office. Ministerial services only as a part of any officer position will normally not be compensated, such as the performance of officer duties specified in this agreement, but any officer may be reimbursed by the LLC for out-of-pocket expenses paid by the officer in carrying out the duties of his or her office.

(2) Records: The LLC shall keep at its principal business address a copy of all proceedings of membership meetings, as well as books of account of the LLC's financial transactions. A list of the names and addresses of the current membership of the LLC also shall be maintained at this address, with notations on any transfers of members' interests to nonmembers or persons being admitted into membership in the LLC.

Copies of the LLC's articles of organization, certificate of formation, or a similar organizational document; a signed copy of this operating agreement; and the LLC's tax returns for the preceding three tax years shall be kept at the principal business address of the LLC. A statement also shall be kept at this address containing any of the following information that is applicable to this LLC:

- the amount of cash or a description and value of property contributed or agreed to be contributed as capital to the LLC by each member
- a schedule showing when any additional capital contributions are to be made by members to this LLC
- a statement or schedule, if appropriate, showing the rights of members to receive distributions representing a return of part or all of members' capital contributions, and
- a description of, or date when, the legal existence of the LLC will terminate under provisions in the LLC's articles of organization, certificate of formation, or a similar organizational document, or this operating agreement.

If one or more of the above items is included or listed in this operating agreement, it will be sufficient to keep a copy of this agreement at the principal business address of the LLC without having to prepare and keep a separate record of such item or items at this address.

Any member may inspect any and all records maintained by the LLC upon reasonable notice to the LLC.

Copying of the LLC's records by members is allowed, but copying costs shall be paid for by the requesting member.

(3) All Necessary Acts: The members and officers of this LLC are authorized to perform all acts necessary to perfect the organization of this LLC and to carry out its business operations expeditiously and efficiently. The secretary of the LLC, or other officers, or all members of the LLC, may certify to other businesses, financial institutions, and individuals as to the authority of one or more members or officers of this LLC to transact specific items of business on behalf of the LLC.

(4) Mediation and Arbitration of Disputes Among Members: In any dispute over the provisions of this operating agreement and in other disputes among the members, if the members cannot resolve the dispute to their mutual satisfaction, the matter shall be submitted to mediation. The terms and procedure for mediation shall be arranged by the parties to the dispute.

If good-faith mediation of a dispute proves impossible or if an agreed-upon mediation outcome cannot be obtained by the members who are parties to the dispute, the dispute may be submitted to arbitration in accordance with the rules of the American Arbitration Association. Any party may commence arbitration of the dispute by sending a written request for arbitration to all other parties to the dispute. The request shall state the nature of the dispute to be resolved by arbitration, and, if all parties to the dispute agree to arbitration, arbitration shall be commenced as soon as practical after such parties receive a copy of the written request.

All parties shall initially share the cost of arbitration, but the prevailing party or parties may be awarded attorneys' fees, costs, and other expenses of arbitration. All arbitration decisions shall be final, binding, and conclusive on all the parties to arbitration, and legal judgment may be entered based upon such decision in accordance with applicable law in any court having jurisdiction to do so.

(5) Entire Agreement: This operating agreement represents the entire agreement among the members of this LLC, and it shall not be amended, modified, or replaced except by a written instrument executed by all the parties to this agreement who are current members of this LLC as well as any and all additional parties who became members of this LLC after the adoption of this agreement. This agreement replaces and supersedes all prior written and oral agreements among any and all members of this LLC.

(6) Severability: If any provision of this agreement is determined by a court or arbitrator to be invalid, unenforceable, or otherwise ineffective, that provision shall be severed from the rest of this agreement, and the remaining provisions shall remain in effect and enforceable.

VIII. Signatures of Members and Spouses

(1) Execution of Agreement: In witness whereof, the members of this LLC sign and adopt this agreement as the operating agreement of this LLC.

Date: _____

Signature: _____

Printed Name: _____, Member

Date: _____

Signature: _____

Printed Name: _____, Member

(continued on the next page)

Date: _____

Signature: _____

Printed Name: _____, Member

Date: _____

Signature: _____

Printed Name: _____, Member

(2) Consent of Spouses: The undersigned are spouses of the members of this LLC who have signed this operating agreement in the preceding provision. These spouses have read this agreement and agree to be bound by its terms in any matter in which they have a financial interest, including restrictions on the transfer of memberships and the terms under which memberships in this LLC may be sold or otherwise transferred.

Date: _____

Signature: _____

Printed Name: _____

Spouse of: _____

Date: _____

Signature: _____

Printed Name: _____

Spouse of: _____

Date: _____

Signature: _____

Printed Name: _____

Spouse of: _____

Date: _____

Signature: _____

Printed Name: _____

Spouse of: _____

Appendix B.

Example Buy-Sell Agreement

Note: the "Articles" shown that make-up a specific "buy-sell agreement" are taken from a "family trust agreement." The beneficial owners took their interests in an "Illinois Land Trust" subject to this agreement.

In other business arrangements, or in a will, the terminology would differ, but the purpose and effect may be similar. In a corporation, we would refer to "stock" rather than "beneficial interest" in a trust. The actual agreement including the "buy-sell articles" was drafted by an attorney, practicing in Illinois. The italics in the Articles below is the exact language in the agreement. Comments about the articles and other items are in gold.

ARTICLE III. RIGHTS TO TRANSFER BENEFICIAL INTEREST TO LINEAR RELATIONS.

1. A current interest holder in this entity shall have the right to sell, give or bequeath all of any part of his or her interest to his or her spouse, lineal descendants or parents, or to trust for their benefit.

A trust or custodianship is generally required if the transfer is to a minor or disabled person. Interests transfer subject to rules governing the business entity.

ARTICLE IV. TRANSFER OF BENEFICIAL INTEREST TO A PERSON OTHER THAN LINEAL RELATION.

1. In the event any party or parties desire to sell, give, or otherwise transfer all or any part of his or her interest to a person or entity not described in Article III above, or in the event of the bankruptcy of any party, assignment for benefit of creditors by any party, or any levy, garnishment or other court enforcement of collection of debt against a beneficial interest, then the other parties who are current owners shall have the first right to purchase an interest, on the following terms and conditions.

(a) Each party shall have the right to purchase in the same proportion as his or her individual interest bears to the total interest of the other beneficial interest holders at that time, provided that if one or more of the beneficial interest holders shall elect not to purchase his or her proportion of the selling party's interest, the unexercised portion of the first right to purchase shall be pro-rated among those who exercised their right to purchase on the basis of their respective pro-rata interests.

This language is intended to prevent current owners from gaining or losing the proportion they have which in entities, such as corporations, may be critical to the control of the organization.

Thus, if 10% is for sale an owner of another 10% has a right to buy at least 10% of what is for sale. The 10% owner may have a right to the share in relation to the shares of the others who are interested in buying what is for sale-if three 10% owners respond to the offer then each would be allowed to buy one-third of the 10%. And it is possible that if all other owners pass on buying-up a share for sale, one individual may buy the entire share and thereby increase his or her relative proportion. In selected situations one or a few individuals may have the financial strength to be able to buy what is for sale.

(b) If the selling party or parties have received a bona fide offer from a third party or any person not specified in Article IV above, which he or they desire to accept, to purchase all or part of his or their interest, then the selling party or parties shall give notice to the other parties hereto of the terms and conditions of such offer, and the other parties hereto have the right, if they so elect, to purchase on the terms and conditions so offered. Such right shall be in accordance with the provisions and in the proportions stated in Article IV, paragraph I, sub-paragraph (a) above.

There is a series of notice times--first 35 days, then another 25 days for a second round of notices to announce the response to the first notice, for a total of 60 days. This rule is to allow the potential buyers time to consider the offer and time to obtain necessary financing. Should 120 days elapse in the process, the process must re-start. Note for lifetime transfers, there is no guarantee that potential buyers will have the necessary liquidity to buy what is for sale nor be willing to borrow to buy an

interest. One may wish to buy life insurance on interest owners in order to have cash to buy once they die—should their interest be for sale in their estate.

Of course, available funds or borrowing capacity of a current beneficial owner can be a limiting factor. However, requirements may be waived if the parties with rights are asked and elect to do so, thus in effect, shortening the time required between an offer and transfer of an interest.

Note, the buy-sell agreement itself, and other restrictions on the interests in an entity or upon a property holding can be discount factors in the fair market value of an interest. It may be that the seller refuses to recognize the reality of market place discounts in agreeing to an acceptable price for an interest.

(c) All offers to sell shall be made in writing and acceptance thereof shall be in writing. Any assignment or attempted assignment of beneficial interest, whether inter vivos, testamentary, by personal representative or by any means, to any party not defined in Article III above, shall be deemed an offer to sell pursuant to the terms of this Article of the agreement.

Note the transfers to lineal descendants or to parents may be done privately without any requirement for advance notice.

(d) If there is no bona fide offer of purchase, the sale price shall be a price equal to the value of the selling party's interest at its then value, as agreed to by all the beneficial interest holders, or as determined by the average of appraisals by two real estate appraisers who shall be approved by a majority in interest of the then beneficial interest holders, or their trustees or personal representatives. All parties hereto shall be given notice of the desire to sell, and shall be given notice of the appraisals obtained.

(e) Cost of appraisals shall be borne by the beneficial interest holder desiring to sell.

This stipulation about who must pay for appraisals could be a dampening factor toward individuals being willing to sell, especially when the interest is a small percent of the total holding or entity. In practice, this rule may simply force the interested parties to come up with an "acceptable" offer.

ARTICLE V. TRANSFER IN THE EVENT OF DEATH OR INCOMPETENCY.

1. In the event of the death or upon the appointment of a conservator for any beneficial interest holder, and upon the offer by such beneficial interest holder's personal representative to sell all or part of such beneficial interest holder's interest, the other beneficial interest holders shall have the first right to purchase such interest of the deceased or the incompetent in the manner described in Article IV, paragraph I (a) and (d)(1) above, all subject to the rights set out in Article III. Except that, for this purpose, the appraisal fee shall be paid by those participating in the purchase.

Provided, however, that in the event no beneficial interest holder elects to purchase, the personal representative shall be free to sell the interest at public sale without further compliance with Article IV. Any purchase at public sale shall be subject to the conditions and requirements of this agreement.

ARTICLE VI. LIENS IN THE EVENT OF TRANSFER.

1. In the event of any transfer of any interest, whether inter vivos, intestate or testamentary, there shall be a lien on such beneficial interest and any income attributable thereto for any outstanding indebtedness, taxes, assessments or other charges, whether or not yet due or payable, and any proceeds of sale or income shall first be applied to payment of the transferring beneficial interest holder's pro-rata portion of such debts, taxes, assessments, or other charge.

From Trust No. Harrison #76 Land Trust -Dec. 1976

Selected Parts of Restrictive Transfer Agreement

Restrictive transfer agreements (such as buy-sell agreements) can become complicated and there are many options of articles that can be included. Some examples and verbiage are further explained below.

ARTICLE III. RIGHTS TO TRANSFER BENEFICIAL INTEREST TO LINEAR RELATIONS.

Each beneficial interest holder shall have the right to sell, give or bequeath all of any part of his or her interest to his or her spouse, lineal descendants or parents, or to trust for their benefit, on any terms, subject however to Article VIII hereof. The right accorded each party under this paragraph may also be exercised by any executor, administrator, spouse or child who may have succeeded to his interest.

Rights of the owner of the beneficial interest in the trust to transfer interest to spouse, children and parents.

ARTICLE IV. TRANSFER OF BENEFICIAL INTEREST TO A PERSON OTHER THAN LINEAL RELATION.

(1) In the event any party or parties desire to sell, give, or otherwise transfer all or any part of his or her interest to a person or entity not described in Article Ill above, or in the event of the bankruptcy of any party, assignment for benefit of creditors by any party, or any levy, garnishment or other court enforcement of collection of debt against a beneficial interest, then the other parties hereto shall have the first right to purchase such beneficial interest, on the following terms and conditions.

If transfer is to a person not described in Article III or if the beneficial interest is used to secure legal judgements or involved in a bankruptcy, the other interest holders have the right to purchase the interest.

(1) (a) Each party shall have the right to purchase in the same proportion as his or her individual interest bears to the total interest of the other beneficial interest holders at that time, provided that if one or more of the beneficial interest holders shall elect not to purchase his or her proportion of the selling party's interest, the unexercised portion of the first right to purchase shall be pro-rated among those who exercised their right to purchase on the basis of their respective pro-rata interest.

Limits the amount that any one individual can purchase.

(1) (b) If the selling party or parties have received a bona fide offer from a third party or any person not specified in Article IV above, which he or they desire to accept, to purchase all or part of his or their interest, then the selling party or parties shall give notice to the other parties hereto of the terms and conditions of such offer, and the other parties hereto have the right, if they so elect, to purchase on the terms and conditions so offered. Such right shall be in accordance with provisions and in the proportions stated in Article IV, paragraph 1, sub-paragraph (a) above.

If someone receives an offer to purchase their beneficial interest from an outside party, they must notify all others owning a beneficial interest.

(2) More limited terms of the offer notwithstanding, the non-selling party or parties shall have thirty-five (35) days after notice is given to elect to purchase, and if some, but less than all non-selling beneficial interest holders shall initially elect to purchase on or before thirty-five (35) days from receiving notice, the electing party or parties shall have twenty-five (25) days after expiration of the original thirty-five (35) day period to make the final election to purchase his pro-rata share of any unexercised portion of the first right to purchase. All parties will give notice to all other parties of their intent to purchase or not to purchase.

Parties have 35 days to express an interest to buy (first right of refusal). If the entire interest is not sold under the fist right or refusal, there is a 25 day period for the those expressing a purchase interest to decide if they want to purchase the remaining unsold interest.

(3) All interest or part thereof offered for sale and not elected to be purchased by any of the other parties hereto, after the expiration of the sixty (60) day period for acceptance, may be sold to the original proposed purchaser.

If there is an unsold interest after the total of 60 days, the remaining interest can be purchased to the

outside party. (Someone outside the family owns a part of the Harrison Trust.)

(4) If a party has notified the others that he has a bona fide offer to purchase, and that he desires to sell all or part of his interest, and if the other beneficial interest holders do not exercise the right to purchase provided for herein, and if thereafter the party giving notice of offer to sell does not complete the sale of such interest within one hundred twenty (120) days from the date of his notice to the other beneficial interest holders, the right of that party to sell his interest pursuant to that notice shall terminate, and the reasons for notice and first right to purchase provided for in this section shall thereafter apply anew.

Person selling has another 60 days to complete the sale. If this is not accomplished, the offer is terminated and the process starts anew.

(4) (a) All offers to sell shall be made in writing and acceptance thereof shall be in writing. Any assignment or attempted assignment of beneficial interest, whether inter vivos, testamentary, by personal representative or by any means, to any party not defined in Article Ill above, shall be deemed an offer to sell pursuant to the terms of this Article of the agreement.

Just have all offers and responses in writing.

(4) (b) If there is no bona fide offer of purchase, the sale price shall be a price equal to the value of the selling party's interest at its then value, as agreed to by all the beneficial interest holders, or as determined by the average of appraisals by two real estate appraisers who shall be approved by a majority in interest of the then beneficial interest holders, or their trustees or personal representatives. All parties hereto shall be given notice of the desire to sell, and shall be given notice of the appraisals obtained.

This would be a case with the holder to the beneficial interest just decides to sell. Describes the process for determining the price of the beneficial.

(4) (c) If any of the other parties hereto agree to exercise the right to purchase after notice of the appraisals, notice shall be given to the selling party within thirty-five (35) days of such notice of appraisals. Unless the offer to sell otherwise provides, payment shall be made upon tender of proper instruments of transfer not later than sixty (60) days after the notice of acceptance is given.

After there is notification of the prices, people have 35 days to decide if they wish to buy.

(4) (d) In the event no party exercises the right to purchase after notice of the appraisals, the selling party or parties shall have no right to sell or otherwise dispose of their property except as provided for herein.

If no other family members want to buy the interest, those wishing to sell are just stuck with it.

(4) (e) Cost of appraisals shall be borne by the beneficial interest holder desiring to sell.

Person wanting to sell pays for the appraisal if an appraisal is done.

ARTICLE V. TRANSFER IN THE EVENT OF DEATH OR INCOMPETENCY.

In the event of the death or upon the appointment of a conservator for any beneficial interest holder, and upon the offer by such beneficial interest holder's personal representative to sell all or part of such beneficial interest holder's interest, the other beneficial interest holders shall have the first right to purchase such interest of the deceased or the incompetent in the manner described in Article IV, paragraph 1 (a) and (4) (b) above, all subject to the rights set out in Article III. Except that, for this purpose, the appraisal fee shall be paid by those participating in the purchase. Provided, however, that in the event no beneficial interest holder elects to purchase, the personal representative shall be free to sell the interest at public sale without further compliance with Article IV. Any purchase at public sale shall be subject to the conditions and requirements of this agreement.

If the owner of a beneficial interest dies or becomes incapacitated, they can sell their beneficial interest. This follows the same procedure, except for the who pays the cost of an appraisal.

ARTICLE VI. LIENS IN THE EVENT OF TRANSFER.

In the event of any transfer of any interest, whether inter vivos, intestate or testamentary, there shall be

a lien on such beneficial interest and any income attributable thereto for any outstanding indebtedness, taxes, assessments or other charges, whether or not yet due or payable, and any proceeds of sale or income shall first be applied to payment of the transferring beneficial interest holder's pro-rata portion of such debts, taxes, assessments, or other charges.

Insures loans where the beneficial interest is used as collateral are repaid, keeps income to pay income, capital gain, and property taxes associated with the beneficial interest, and miscellaneous judgments and expenses are paid.

ARTICLE VI. LIENS IN THE EVENT OF TRANSFER.

In the event of any transfer of any interest, whether inter vivos, intestate or testamentary, there shall be a lien on such beneficial interest and any income attributable thereto for any outstanding indebtedness, taxes, assessments or other charges, whether or not yet due or payable, and any proceeds of sale or income shall first be applied to payment of the transferring beneficial interest holder's pro-rata portion of such debts, taxes, assessments, or other charges.

Insures loans where the beneficial interest is used as collateral are repaid, keeps income to pay income, capital gain, and property taxes associated with the beneficial interest, and miscellaneous judgments and expenses are paid.

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Brainstorming Worksheet: Buy-Sell Agreement, Operating Agreement, and Sales/Lease Contracts

Chapter 4

Angela Gloy
&
Renee Wiatt

Department of Agricultural Economics

Purdue University

Before drawing up agreements and contracts for your farm business, there are a number of questions to ponder and discuss. By having a discussion over the topics before drawing up formal documents with a lawyer, you can not only save your farm time and money, but it can also help to improve transparency and reach consensus.

Table 1. Buy-Sell Agreement

Do you currently have a buy-sell agreement in effect? YES NO If yes, then fill out the current terms of your agreement below. If not, write down some of your desired terms.	
1. Participating Partners:	
2. Funding Agreements:	
3. Terms of Entry/Exit:	

Table 2. Operating Agreement

An operating agreement may or may not be required by law depending upon your chosen business structure. Typically, an operating agreement will address formal roles and titles of individuals in a company. Where there are multiple members, the benefits of specifying such issues as (1) how profits/losses are distributed, (2) management structure, (3) voting methods, (4) exit protocol, and (5) dissolution protocol are clear.	
What details would you like to see included in your operating agreement upon completion of a successful farm succession plan?	
For example, is there a particular role/title you feel more comfortable assuming in the beginning? Are there complimentary skills amongst owners that would enhance management performance?	
Other Considerations:	

Table 3. Sales/Lease Contracts

As a reminder, be sure to have the following in place for your farm and documented. Do you have the following documented? Indicate yes or no and include notes as needed.	
	Yes/No and Notes
Sales Contracts	
Purchase Options	
Lease Contracts	
Lease Purchase Contracts	
Other: Customized Contractual Agreements in Effect	
Other:	
Other:	
Other:	

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Exiting the Business

Chapter 4

Linda Curley

Purdue Extension,
Lake County

For many farmers, retiring can be a source of great apprehension as "the identity of a farmer is often closely tied to their occupation" (Eggers 2012). After years of planning, planting, harvesting, and caring for livestock, it's often hard to see oneself functioning outside of the farm environment. Retirement can certainly trigger a range of emotions. "Work structures us and gives us routine in our lives," says psychologist Louis Primavera, co-author of the book, The Retirement Maze: What You Should Know Before and After You Retire. Primavera states that the "fear of loss of identity is a major fear" (2012). While it may be a slow process, those considering exiting the business should work to identify non-work related activities of interest. This is also the time to strengthen relationships inside and outside the work environment. An exit from the business should be about simplifying life, taking on fewer obligations, doing things you've always wanted to do, and thinking about how you envision your future. Once this is accomplished, one can move forward with future planning.

When exiting the business, a team approach will certainly help make for a smooth transition. As you pull a team together, make sure that you are comfortable with the advisor(s) that you've chosen to assist with your exit strategy. Remember to involve all those that will be assuming responsibility throughout the entire process. Think carefully about needs and desires when exiting the business and be sure to share these thoughts with advisors and successors (Thomas, 2013). Often, identifying team members with business expertise outside the operation can provide valuable insight, as well. Understanding family business functioning from multiple viewpoints of family and business stakeholders can help enhance communication. (Marshall & Wiatt, 2017). Effective communication is key.

The clarification of roles, responsibilities and expectations for all involved is essential (Rausch, 2001).

Start planning early for your exit strategy. One of the first items to consider would be the cost of living needs for all those involved. Here are a few items to consider:

- Standard living costs
- Beneficiaries
- Providing for young children
- Transfer of property
- Estate taxes
- Planning for illness or incapacity

Thinking about the general operation of the business, work to enhance accountability by assigning formal roles, titles, and responsibilities to all parties involved. After all of this, focus on the transfer of management. Hopefully, a system of responsibility has been established. While the successor begins to take responsibility, work with the successor to "learn the ropes", understand processes and procedures, and learn all aspects of the work that needs to be done to successfully run the business. Make sure to involve successors in decision-making and management strategies while helping to build skills. Use the skills assessment tool (below) to identify strengths and weaknesses. This tool is a self-assessment that can be utilized by various members of the business and the family.

Table 1. Evaluation of Farm Management Strengths and Weaknesses

Place a checkmark under the number indicating your self-assessment of your skill level.

	Low			Medium				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. 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 Accept Risk										
15. Communication Skills										
16. Negotiation Skills										
17. Leadership Skills										

Use the checklist below as you implement your exit plan:

_____ Start early – give yourself enough time to develop and implement your plan.

_____ Establish a timeline. This includes setting realistic goals.

_____ Groom the next generation for success. Give control over various sectors of the business so the successor can master each one independently.

_____ Establish a management system and re-evaluate for optimal performance. Promote leadership skills through mentorship.

_____ Remember the equitable doesn't necessarily mean equal. Create a strategy that doesn't create hardship for a particular party.

_____ Know your retirement needs – mortgage, bills, car payment, insurance, travel, daily living.

_____ Be flexible when "life happens". Use family meetings to "check-in" so everyone is on the same page.

_____ Enjoy retirement – identify those things you've forgotten to make time for over the years.

Key Points and Conclusion Questions:

Have you thought about non-work related activities that interest you? Which of these interests might you pursue after exiting the business?

Are you taking time to strengthen relationships with those inside and outside of your work environment?

Have you considered all of your cost of living needs for retirement?

Have you developed a timeline from your exit plan?

What do you envision for your future?

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CHAPTER 5
MANAGEMENT TRANSFER

Transferring the farm from one generation to the next is usually a gradual process. When done correctly, it is like the smooth transferring of a baton between relay racers. In Chapter 5, you will learn how management transfer takes communication and understanding across all generations. If management transfer is not addressed early and if the process is not started, then the successor can build resentment. Management transfer includes educating and training the successor generation, handing over responsibilities, and instilling the legacy of the farm in the next generation.

Jenna Nees
Purdue Extension, Putnam County
Purdue University

Ed Farris
Purdue Extension, Huntington County
Purdue University

Renee Wiatt
Department of Agricultural Economics
Purdue University

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Transferring Business Management

Chapter 5

Michael Langemeier

Department of Agricultural Economics

Purdue University

Transferring business management between generations is one of the most critical steps in transitioning the business from an older generation to a younger generation. However, in numerous instances, this step is given little thought. Transitioning management cannot be done overnight, and often requires a trial and error approach before it can be determined how each generation fits into the business. This article briefly describes some of the key factors that need to be considered when transitioning business management from an older generation to a younger generation. The outline of this article roughly follows Hofstrand (2016c). However, this article elaborates on many of the points made by Hofstrand (2016c) and provides additional focus on getting the process started.

In the discussion below, I assume that the two parties can work together and that the business is large enough to support two generations. This means that the older generation is ready to bring in a new generation and begin turning over management, control, ownership, and income; and that the younger generation is committed.

Aligning Goals and Objectives

For a multiple generation business to be successful, the parties need to agree on the future direction of the business. In other words, the parties involved need to share a common vision of their future together in farming. One of the ways to come up with this common vision is to explore the goals and objectives of the relevant parties, which would include the older generation, the younger generation that is planning to return to the farm, and the off-farm heirs. Though often used interchangeably, those that help businesses with their transition plans typically have unique definitions for goals and objectives. Goals are broad and general statements of what an individual wants to achieve. In contrast,

objectives are precise and quantifiable measures of how you will achieve your goals. In addition to having an impact on management transfer, goals and objectives impact how business income should be divided between the parties and how property will be divided between the younger generations coming back to the farm and off-farm heirs.

Getting Started

Even before the younger generation returns to the farm, it is imperative that both the younger and the older generations think about what skills the younger generation is bringing to the operation. We often want to hire individuals that are like us. In a small business, hiring someone that is like you or bringing in a family member that has a similar skill set is problematic. For example, if both parties are not particularly fond of keeping and analyzing records and financial statements, this is a problem. In today's world, to be successful, someone in the business will need to be interested in these tasks. Other areas that are sometimes overlooked are procurement and marketing skills, and personnel management skills. The issue pertaining to the skill sets of the respective parties is important enough that many farms conduct a skill assessment of current and returning family member's skills, and use this information to choose areas where additional training and professional development are needed.

Management tasks cannot be transferred overnight. Typically, the younger generation is given some responsibility relatively soon after joining the operation. For example, they may be assigned responsibility for a small area or part of the decision-making process of an enterprise or function. I have found the following two related questions helpful when determining where to start the management transfer process: First, what specific areas is the new generation passionate about? Second, does this passion for specific areas correspond with areas in which they are skilled or have experience?

Let us give a few examples of how the generation could obtain some management responsibility. With a grain farm, it is relatively easy to have the younger generation rent a tract from the older generation or from one of the farm's landlords. In this instance, the younger generation typically makes the input decisions regarding the tract. With a livestock farm, the younger generation may be responsible for specific duties pertaining to one of the laying hen, turkey, or swine barns on the farm, or for a pen of cattle. Again, the younger generation would be responsible for making decisions regarding the specific duties identified. When assigning responsibility for a tract of land or specific duties to the younger generation, it is important to think about how mistakes are going to be handled. Everybody makes mistakes and thus should have the opportunity to make mistakes. The important thing is for individuals to learn from their mistakes. It is also important to celebrate successes, in addition to pointing out mistakes. Setting standards for success is important, and having high standards is not necessarily problematic. However, it is important to realize that individuals meet high standards in incremental steps. When we celebrate movements in the right direction, we affirm and validate the efforts of our coworkers. If providing feedback, positive and negative, is difficult for the older generation, which it often can be, just remember how important this feedback can be. Often times when a new family member or employee is added to the business, the current family members and employees find out how important it is to improve communication skills.

Decision-Making Authority

Individuals have different management styles because they have different personalities. As noted above, it is important to assess the skill set associated with each family member involved in the business. Similarly, it is imperative to assess each individual's management styles. For example, one family member may be more analytical and detailed oriented. Another family member may have better interpersonal skills and thus likes interacting with others. Assuming that the personalities of the family members do not clash, it is often beneficial for family members to have different management styles.

Once the younger generation has had a chance to manage part of the business, it is time to develop a general structure that can be used to make business decisions. Hofstrand (2016c) discusses two general structures: general manager and equal voice. With the general approach, one party has final authority. At least in the early stages of the new business arrangement between the two generations, this party is typically the

older generation. It is important to note that under this approach both parties have responsibilities for major operating decisions and are involved in major decisions. The final authority, however, rests with one party. This approach typically works well during the early stages of the new business arrangement while the younger generation is still garnering valuable management experience. The second approach is to give each party an equal voice in decision-making. This approach often works best during middle or later stages of the two-generation arrangement.

Division of Management Responsibility

In addition to adapting a method to make business decisions, it is important to think about how daily management responsibilities are divided between the two generations. Again, this occurs after the younger generation has been given a chance to manage part of the business. Dividing management responsibilities between parties often leads to more expedient and better decisions. Obviously, individual interests and skills should be considered when dividing responsibilities. There are two primary methods that can be used to divide responsibilities. The first method divides responsibilities by enterprise. The second method divides responsibilities by function (e.g., finance, marketing, personnel, or production). Under both of these methods, decisions that affect the entire business would need to be made by both parties using the general manager or equal voice approach. It is also common to make joint decisions regarding major asset purchases, regardless whether these assets pertain to just one enterprise or function.

The discussion above makes the management transfer process seem smooth with few hiccups. This is often not the case. Given that this is the case, it is often helpful to use a management transfer worksheet or checklist. Table 1 contains a checklist that can be used to keep track of the transfer of specific duties. This checklist was adapted from Baker (2006). The duties are separated by function. Both short-term and long-term management tasks are included in the table.

Withdrawing from Management

Every two-generation arrangement reaches the point where the older generation withdraws from active management of the business. This is often a difficult time for the older generation. To the extent that they are interested, keeping the older generation involved in the operation by helping during peak labor periods (e.g., planting or harvesting), and asking for their advice can ease their transition out of an active management role.

Conclusions

This article briefly described some of the key factors that need to be considered when transitioning business management from an older to a younger generation. After concluding that both generations are committed to adding someone to the operation and determining that there will be sufficient income for both parties; it is imperative to develop a transition plan involving management transfer. This plan needs to address goals and objectives of both parties, the initial management transfer steps, decision-making authority, and division of management responsibility.

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Table 1. Transfer of Management Checklist from Management

Notes: Select the degree to which you feel the following management responsibilities are being retained by the older generation or transferred to the successor. Select 1 if the decision is being made solely by the older generation. Select 5 if it is being made solely by the successor. If the responsibility is shared select 2, 3, or 4 appropriately.

Item	Retained to Transferred Spectrum				
Finance					
Decide and plan capital projects	1	2	3	4	5
Decide type and make of machinery and equipment	1	2	3	4	5
Decide when to pay bills	1	2	3	4	5
Identify sources and negotiate loans and financing	1	2	3	4	5
Keep farm records	1	2	3	4	5
Negotiate purchase of machinery and equipment	1	2	3	4	5
Marketing					
Decide when to sell crops/livestock	1	2	3	4	5
Negotiate sales of crops/livestock	1	2	3	4	5
Personnel					
Decide amount and quantity of work	1	2	3	4	5
Decide when to hire more help	1	2	3	4	5
Decide work method/way jobs are done	1	2	3	4	5
Plan day-to-day work	1	2	3	4	5
Recruit and select employees	1	2	3	4	5
Supervise employees	1	2	3	4	5
Production					
Decide level of input use	1	2	3	4	5
Decide timing of operations	1	2	3	4	5
Determine enterprise mix	1	2	3	4	5
Make annual crop/livestock plans	1	2	3	4	5

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What Makes a Good Partner in Business?

Chapter 5

Krista Pullen

Purdue Extension,
Cass County

Adding a partner to your business can open doors to many opportunities for you and the business. Often times, a business partner is added with the intention that they will become a successor in the future. The partner could be one of your children, a loyal employee, or a candidate from outside the business that has expressed interest. The earlier you begin the transition planning in the life of the business, the smoother the transition will be. It is important that the successor has time to learn the role of the leader and show that they are prepared to lead the business in order to gain credibility. This addition of a learning period can add a balance of responsibilities between the incumbent generation and the successor generation which can prove rewarding to both parties. It is important to weigh out all of the pros and cons of having a business partner and develop a clear set of visions and goals that are well communicated in order to form a successful partnership.

Identifying Successor Options

There are three options for transferring ownership/management of the business to the next successor: transition to a family member, transition to a loyal employee or selling the business to a candidate from outside the business. To best prepare a successor for transfer of management and/or ownership, it is helpful to initiate transition plans early. This allows for the successor to learn the role of a leader. The successor needs time to become a student of the business in order to learn about its value proposition, processes and people. In addition to learning about the mechanics of the business, it is just as important that he or she becomes a student of leadership, motivation, and management in business. Integrity and commitment are the most important traits of a leader. Nothing is valued higher than honesty, hard work and perseverance. These skills need to be well developed in the successor and demonstrated to

employees, customers and third-party vendors. The more time the successor has to develop and build these skills, the more credibility he or she will gain. This process allows for all parties to adapt to the transition and re-learn their place in the business.

Form a Development Plan

A development plan is an action plan that formalizes the training and development process between an owner and a successor. It puts in writing what a successor has been asked to do to prepare for a bigger role in the family operation. The plan is specific to your business; it is individualized for the successor according to his or her skills and knowledge. A variety of methods should be used for teaching and development of a new leader.

Among the methods to consider:

- Demand outside work experience
- Link to a mentor
- Allow for on-the-job experience
- Participate in training at local colleges or industry seminars/workshops
- Attend business planning and strategy sessions with accountants and bankers
- Attend commodity, co-op, association or grower meetings
- Attend personal or group meetings with advisers and experts on various subjects.

Leadership

Leadership matters immensely when talking about the development of the next generation. Family firms have different goals than publicly owned companies. Family operations are oriented to serve a broad set of objectives that serve familial demands and personal issues. Family operations have a greater potential for long-term conflict. People are emotional beings; it is the atmosphere of the family business that causes some to respond inappropriately to disagreement and conflict. Leadership succession is far more important for family firms than non-family firms due to the family aspect. Failure in a family firm can be devastating due to the personal nature of the endeavor and the breadth of family that may be actively involved. Most family operations would be willing to sacrifice an overwhelming majority of the family's net worth to keep the family unit intact.

Shared Responsibilities

A development plan should detail the management needs of the operation. It should also detail the steps necessary to ensure that management is properly trained and positioned to succeed. A responsibility section of a development plan forces the team to establish the status of the business. This section of a development plan gives confidence to team members, supports management/personnel decisions and details some of the critical responsibilities of the management team. All team members need education and development to grow in their positions within the business. Development programs should be tailored to serve individual needs of managers and the specific responsibilities of their role. A common partner conflict occurs when responsibilities and parameters are not set up from the beginning of the relationship. Often times, these conflicts can cause stress on the relationship and stunt farm growth and success. The senior generation must delegate responsibility and allow the successor to make decisions (and suffer potential ramifications of those decisions). Learning requires the consequence of real risk/reward trade-offs.

Mentorship

As a successor is preparing for a leadership position, they may benefit from a mentor, coach or adviser. Do not overlook the value of a good mentor. The opportunity to learn from the experience of another person is invaluable. In a business that includes a related successor and senior generation, the generational shadow cast by the senior generation may cause conflict. The controlling generation must become mentors to the next generation, allowing them to grow and succeed in a nurturing, non-judgmental environment.

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Is It Feasible for My Farm to Add an Operator or Hired Employee?

Chapter 5

Michael Langemeier

Department of Agricultural Economics

Purdue University

As a farm expands, it important to evaluate the feasibility of adding an operator and/or hired employees as well as the feasibility of purchasing or renting additional land, and machinery and equipment. The feasibility of augmenting labor on a farm depends to two critical factors: gross revenue and profitability.

Let's start by discussing gross revenue. Most accrual income statements include a line for gross revenue. To compute gross revenue we add crop and livestock sales to government payments, crop insurance indemnity payments, and miscellaneous income (e.g., patronage dividends; income from custom work) and subtract beginning crop and market livestock inventories from ending crop and market livestock inventories.

Profitability can be measured using the net farm income ratio, the operating profit ratio, return on assets, or return on equity. For definitions of these ratios see the publication entitled "Benchmarking Profitability and Financial Efficiency" which can be found on the web site for the Center for Commercial Agriculture. I recommend using the operating profit margin to gauge profitability. This measure is computed by adding interest expense and subtracting family living expenditures from net farm income and dividing the result by gross revenue or value of farm production. A commonly used benchmark for the operating profit margin ratio is 20 percent or higher. Using the FINBIN database (Center for Farm Financial Management, 2020), the average operating profit margin from 2007 to 2019 was 14.9 percent. Based on profitability, the 2007 to 2019 period can be broken into two distinct periods: 2007 to 2013 and 2014 to 2019. From 2007 to 2013, the average profit margin was 21.3 percent. In contrast, from 2014 to 2019, the average profit margin was only 7.3 percent. Notice that the 20 percent profit margin target is above the long-run average. Moreover, it is important

to examine the feasibility of adding another operator or employee using long-run profitability rather than short-run profitability.

Using gross revenue and the operating profit margin, along with information on family living expenditures and machinery and equipment needs, we can come up with a benchmark feasibility measure. Most of our machinery and equipment needs are covered using depreciation, which is a non-cash item. We are including machinery and equipment needs in our computation of the benchmark to reflect the fact that our farm is growing. If a farm was not growing, we could rely on depreciation to replace machinery and equipment. Continuing our computation of the benchmark, if we need $100,000 to pay an additional operator or employee, and to help purchase machinery and equipment needed to expand and we had a long-run average operating profit margin of 20 percent, our farm would need at least $500,000 to cover this additional person. Another way of stating this benchmark, is to say that our farm needs at least $500,000 of gross revenue per worker to fully cover labor expenses. So, if our farm currently has two operators, and an average gross revenue of $1,350,000 over the last several years, adding another operator or full-time employee does not appear to be feasible because after adding the individual to our operation average gross revenue per worker declines to $450,000, which is below the benchmark. Note that without the addition of another individual gross revenue per worker is $675,000.

A couple of caveats to the analysis above should be noted. First, it is important to include seasonal or part-time workers to our gross revenue per worker computations. If the farm above has two part-time employees that work one-quarter of the year (i.e., during planting and harvesting seasons), these two employees should be included in the computation. In this case, instead of just dividing by 2 operators before the addition of another person, we need to divide by 2.5 workers (2 operators plus 0.5 full-time equivalent workers). Second, if long-term profitability is not 20 percent, the gross revenue benchmark needs to be adjusted accordingly For example, if the long-term profit margin is 10 percent, instead of 20 percent, our benchmark becomes $1,000,000 per worker ($100,000 divided by 10 percent).

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Developing Effective Job Descriptions for Small Businesses and Farms

Craig Dobbins, Cole Ehmke, and Renee Wiatt

Department of Agricultural Economics

Purdue University

Expectations in recent years have changed in regards to the formality of job descriptions in farm, family, and small businesses. In some instances, businesses are no longer keeping up with today's standards. There is a clear and obvious need to develop fitting, fair, and concise job descriptions in any business, regardless of business size and if the employees are related. Let's examine some scenarios.

Example 1: Danny works in the family's printing business alongside his father. He worked part-time for some extra money throughout college, but has since graduated and has entered the firm fulltime. While Danny was in college, he performed odd jobs around the printing business such as sweeping, tidying up the storefront, restocking products, and cashing out customers. He assumed that after he graduated, he would take on more of a management role. Danny wants to consult with customers and design products for them, especially since he got his degree in graphic design. However, he finds his father asking him to do more menial tasks such as tidying up and operating the cash register; these were responsibilities that Danny had as a part-time employee in college. No job description was developed, but a salary was agreed upon when Danny entered the firm fulltime. He now feels as though he has no ground to stand on when discussing his frustration with his father.

Example 2: While walking through the finishing barn one day, the owner stopped to inform Rita that she was neglecting to properly monitor the feeders. The owner also added that she would need to stay late to finish a project another employee had started but did not have time to complete. Rita was shocked. Because she had

never been told that monitoring feeders was one of her responsibilities, she didn't know why she was being blamed for not doing it. This was the third additional duty she had been assigned in her first week on the job, and now she was also being asked to work well past what she had been told was the normal quitting time for the third day in a row. Rita wondered, "Why didn't they tell me when they hired me what my job really was? If this how I'll be treated in this business, maybe I should begin looking for employment somewhere else."

Unfortunately, the previous examples are not unusual. Difficulties with defining and communicating job expectations occur frequently. Developing effective and pointed job descriptions is critical, no matter where you work. The communication of job expectations is especially critical when adding employees. In the hiring process, besides helping you communicate job expectations, clearly written job descriptions can help you attract well-qualified applicants and make it easier to eliminate applicants who will not perform well on the job.

Job descriptions are also useful beyond the hiring process. A well-developed job description identifies the position's essential tasks. Combining these tasks with performance standards can provide criteria useful in reviewing an employee's performance. Your chances of successfully attracting and keeping a new employee will be much greater if you have given careful thought to the duties of the job and communicated these expectations to a prospective employee. Written job descriptions are an important aid to this communication. This publication explains the components of effective job descriptions and provides a suggested format for a job description and a few examples to illustrate how completed job descriptions might look.

Job Analysis and Design

A written job description can take many different forms. The purpose of the job description influences what will be contained in the document. If it is being used for an employee's existing position, it will likely contain a position title, a summary of the position, the responsibilities or duties of the position, the areas of authority, and supervision. If the job description is to be used to hire a new employee, it will likely contain these items plus information about the working conditions, the qualifications required to succeed in the position, and the compensation (range) provided for the position.

Job Analysis

Job analysis is the process of developing a thorough understanding of the various attributes of the position. You can use Worksheet 1, Job Analysis Form (pp. 6-9), to help guide the job analysis process and organize your results. A complete job analysis should provide you with information on the:

1. Duties or responsibilities of the job: those tasks that are performed, the types of decisions the person in the position will make, and responsibility for record-keeping.
2. The qualifications needed to carry out the work: the physical abilities; general skills; previous experience; and special training, knowledge, or licenses required.
3. Work environment: the location and work conditions under which the job is performed and supervision and contacts with other business personnel, customers, and input suppliers.

Discussing the position with current employees, if there are any, can often be a useful way to gather job analysis information. In doing a job analysis, be sure to think in terms of what work needs to be done, not just the work that is currently being done.

Job Design

As you develop a job description, you also need to consider how the position will relate to other positions in the business. This is part of the job design. In addition to considering how the position relates to other positions in the business, job design also addresses the organization of the work flow, how the position will help meet your business requirements, and the personal needs of the job holder. As you think about job design, ask yourself questions such as:

1. Can you find ways to make the flow of work more efficient?
2. Is more than one person capable of performing

a critical job?

3. Can you find a way to make jobs more rewarding or give employees a greater sense of accomplishment?
4. Is there a way to organize work so that employees can vary activities according to personal needs, work habits, and the circumstances in the workplace?
5. Is there a training program that helps employees understand what they need to know in order to satisfactorily perform their duties?
6. Are there changes that can be made to address any negative stereotypes associated with the position?

Answering these questions may result in tasks being eliminated or moved from one position to another.

Components of a Job Description

Using information from your job analysis and job design, you will be in a better position to develop a short (usually one to two page) job description containing the following components:

1. Title
2. Job Summary
3. Job Tasks, Responsibilities, and Authorities
4. Job Qualifications
5. Supervision
6. Working Conditions
7. Salary and Benefits

Worksheet 2, Job Description Form (pp. 10-12), will help you to organize your job description. Remember, a job description can take many forms. These categories are ones generally used.

1. Job Title

Be sure that the job title is something that an employee can be proud of. The job title is often the first thing a prospective employee sees. Whatever title you select must accurately reflect the duties of the job and should indicate the skill level of the employee (i.e. senior or assistant). Be aware of your verbiage. For instance, there is a difference in undertone between the titles of "herdsman" or "herd manager" and "secretary" or "office manager", even though the jobs' descriptions might be identical.

2. Job Summary

The job summary should be limited to four or five sentences containing essential duties, specific skills or licenses needed, special equipment used in the position, and physical abilities necessary to perform the job. The summary may also include information about interactions with other business employees as well as the kind of customers or suppliers with whom the employee will likely interact.

The job summary is often used when advertising for new employees, so it should be concise and clear. Summaries can be easier to write after completing other sections of the job description.

3. Job Tasks, Responsibilities, and Authorities

So, what exactly will each employee do? In the job responsibilities section, state the major tasks and sub-tasks that are essential for the position. You may also want to indicate the amount of time or percentage of an employee's time that may be devoted to each of the major tasks.

Tasks are observable actions. The list of tasks usually starts with the most important or most time-consuming task. For example, if the position requires maintaining financial records for the business, you would expect to observe that employee entering receipt and expense data into the accounting program. Providing percentage estimates of the time to be spent on important tasks can give employees a sense of how to prioritize the different components of their job.

From your job analysis, you may have developed a long list of tasks and responsibilities. Group like tasks together by responsibility. Once grouped, there should be no more than eight main responsibilities. Any more than this number can result in an overly complicated document that could potentially confuse future and current employees. Each major responsibility can have sub-duties, but limit these to four.

Describe each task in a short statement. Beginning each statement with an action verb makes the responsibilities seem more real to potential candidates. Examples of action verbs include: performs, drives, cooks, coaches, monitors, plans,

Table 1. Examples of Specific Language for Use in Job Descriptions

Too General	Better
Keeps the Books	Enter revenue and expense transactions; prepare income statements, balance sheets, and projected cash flows
Keeps Machinery in Good Working Order	Conduct regular inspections of farm equipment, make needed repairs, and provide advice on replacement of machinery
Handles	Receive, sort, and file monthly personnel action reports

inputs, supervises, recommends, analyzes, paints, weeds, answers, changes, trains, verifies, sells, organizes, files, plays, examines, and orders. Using specific language will help you and the employee define the job. For examples, see Table 1.

Again, keep the list of duties focused on the major tasks. Including a statement such as "assists with other duties for the good of co-workers and the business" as one of the duties provides flexibility to adjust the job description at any time.

In areas of authority, list the areas in which your job analysis indicates that the person will have decision-making power. For example, a person may have the authority to make purchases for repairs totaling $500 or less.

4. Job Qualifications

In this area, indicate the knowledge, skills, abilities, and other characteristics that an individual must have to perform the job duties. Knowledge is factual or procedural information that is necessary for successfully performing a task. A skill is an individual's level of proficiency at performing a particular task. Ability refers to a more general enduring capability that an individual possesses. Finally, other characteristics might be personality traits such as one's motivation, persistence, work ethic, or willingness to be a team player. Licenses and certifications should also be listed under job qualifications.

To help you write the job qualifications section, refer back to your job analysis, and ask yourself what knowledge, skills, or abilities and what work experience are required. You do not need to include every possible qualification, but you do need to be clear about what is essential.

If there are special physical requirements needed to perform the job, job qualifications would be the place to note them. As an example, it is often necessary for a farm employee to be able to lift such things as sacks of seed, fertilizer, feed, or bales of hay. Therefore, one of the tasks that the person must be able to perform is to lift 50 pounds. Another example could be that the job requires standing for long time periods. This should be indicated as well.

5. Supervision

In this section, indicate how this position is supervised. Indicate to whom the person in this position will report. If applicable, this section can also include whom reports to this employee (i.e. if he or she is in charge of supervising other employees).

6. Working Conditions

Here, give applicants an idea of the hours of work and overtime requirements, how much work is performed inside or outside, and the type and condition of equipment and machinery to be used. Also included could be any out-of-the-ordinary conditions in which an employee may work, such as a hot mill or in freezing temperatures. In this section, include the working relationship expected with other employees. Is this position part of a broader team, like a sales team? Also, are there special circumstances that may require work at night or on holidays?

7. Salary and Benefits

If you are using the job description to fill a new position, you will need to determine what you feel the job is worth to your business. There continues to be a debate about including salary as part of a job description. Setting a salary or other rate of compensation is a delicate process. Using the term "starting salary" implies that employees will obtain raises as they acquire time on the job. Including the statement "salary is negotiable" without giving

a pay range may waste the time of both employer and applicant if their wage expectations differ considerably.

Some employers do not like to advertise that a starting salary is negotiable because they feel doing so may encourage applicants to ask for higher wages. On the plus side, however, if the starting salary is negotiable, you have the flexibility to adjust the pay to the qualifications of the applicant. Many job descriptions advertise "salary commensurate with qualifications."

The salary and benefits section should also detail information about benefits such as paid vacation, sick leave, personal days, health insurance coverage, possible bonuses and retirement programs. Any special benefits provided should also be noted. For example, housing is often provided to farm employees. The location and condition of any housing provided should be described. Other benefits might include opportunities to participate in additional training, leadership development, or even tuition assistance for higher education.

Final Comment

When putting together a job description, focus on what the position needs to be in light of your business's current needs and long-term objectives. Each job task should contribute to the achievement of a desired goal or output. Note that the job you describe must be doable. When combining tasks into a job description, make sure a job has not been created that is unfillable.

A job description is generally regarded as a legal document, so anything that is seen to be discriminatory based on religious preference, sex, race, age, nationality, or physical or mental disability is illegal. This does not mean that you are required to hire someone who cannot do the job. The job description's status as a legal document also makes it important to keep your business's job descriptions up to date. Do not wait until you are recruiting new employees to update them. Also, do not forget your own position, as business owner or manager, when you are writing or updating job descriptions. Finally, Worksheet 2, Job Description Form (pp. 7-8), can provide guidance in organizing the material for your job descriptions. Use those sections that will help solve the problem at hand. The example job descriptions at the end of this publication illustrate various ways that job descriptions can be organized. As these examples illustrate, it is not necessary to have something for every section of the Job Description Form to create useful job descriptions.

Finally, Worksheet 2, Job Description Form (pp. 10-12), can provide guidance in organizing the material for your job descriptions. The example job descriptions at the end of this publication illustrate various ways that job descriptions can be organized. As these examples illustrate, it is not necessary to have something for every section of the Job Description Form to create useful job descriptions.

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WORKSHEET 1 - JOB ANALYSIS FORM

Name _____ Job Title _____

Department _____ Job Number _____

Supervisor's Name _____ Supervisor's Title _____

1. SUMMARY OF DUTIES: State in your own words briefly the main duties. If the position is responsible for filling out reports/records, also complete Section 8.

_____

_____

2. SPECIAL QUALIFCATIONS: List any licenses, permits, certifications, etc. required to perform duties assigned to the position.

_____

_____

3. EQUIPMENT: List any equipment, machines, or tools (e.g., computer, motor vehicles, lathes, fork lifts, drill presses, etc.) normally operated as a part of the position's duties.

MACHINE *AVERAGE NO. HOURS PER WEEK*

_____

_____

4. REGULAR DUTIES: In general terms, describe duties regularly performed. Please list these duties in descending order of importance and percent of time spent on them per month. List as many duties as possible and attach additional sheets, if necessary.

_____

_____

WORKSHEET 1 - JOB ANALYSIS FORM CONT.

5. CONTACTS: Does position require any contacts with other department personnel, other departments, outside companies or agencies? If yes, please define the duties requiring contacts and how often.

_____

_____

6. SUPERVISION: Does position have supervisory responsibilities? ☐ YES ☐ NO

If there is responsibility for the work of others but no direct supervision, please explain.

_____

_____

7. DECISION MAKING: Please explain the decisions the person in this position will make while performing the regular duties of the job.

_____

_____

What would be the probable result of making (a) poor judgment(s) or decision(s), or (b) improper actions?

_____

_____

WORKSHEET 1 - JOB ANALYSIS FORM CONT.

8. RESPONSIBILITY FOR RECORDS: List the reports and files the person would be required to prepare or maintain. State, in general, for whom each report is intended.

REPORT *INTENDED FOR*

_____

_____

FILES MAINTAINED:

_____

9. FREQUENCY OF SUPERVISION: How frequently must the person confer with a supervisor or other personnel in making decisions or in determining the proper course of action to be taken?

☐ *FREQUENTLY* ☐ *OCCASSIONALLY* ☐ *SELDOM* ☐ *NEVER*

10. WORKING CONDITIONS: Please describe the conditions under which the person in this position works: inside, outside, air-conditioned area, etc. Be sure to list any disagreeable or unusual working conditions.

_____

_____

11. JOB REQUIREMENTS: Please indicate the minimum requirements necessary to perform satisfactorily in the position.

EDUCATION:

Minimum Schooling _____ Number of Years _____

Specialization or Major _____

EXPERIENCE:

Type _____ Number of Years _____

Type _____ Number of Years _____

REQUIRED LICENSES:

_____

WORKSHEET 1 - JOB ANALYSIS FORM CONT.

12. ADDITIONAL INFORMATION: Please provide additional information, not included in any of the previous items, which would be important in a description of the position.

_____

_____

_____

_____

_____

_____

_____

_____

WORKSHEET 2 - JOB DESCRIPTION FORM

JOB TITLE _____

SUPERVISOR _____

1. JOB SUMMARY:

_____

_____

_____

_____

2. JOB TASKS AND RESPONSIBILITIES REGULARLY PERFORMED:

_____

_____

_____

_____

_____

_____

_____

_____

3. AUTHORITY/DECISIONS MADE AS PART OF REGULAR DUTIES:

_____

_____

_____

_____

_____

WORKSHEET 2 - JOB DESCRIPTION FORM CONT.

4. JOB QUALIFICATIONS:

   a. Education Background:

      Field _____ Number of Years _____

      Field _____ Number of Years _____

   b. Experience:

      Type _____ Number of Years _____

      Type _____ Number of Years _____

   c. Special Training or Licenses:

      _____

      _____

   d. Physical Requirements:

      _____

      _____

5. SUPERVISION:

   _____

   _____

WORKSHEET 2 - JOB DESCRIPTION FORM CONT.

6. WORKING CONDITIONS: Describe the conditions under which the work will be performed—inside, outside, air-conditioned area, etc. Be sure to list any disagreeable or unusual working conditions.

Work Hours: _____ Average Hours Per Week: _____

Days Off Per Week: _____ Holidays Per Year: _____

Overtime: ☐ Never ☐ Seldom ☐ Often ☐ Pay

Work Environment: _____

_____

7. SALARY AND BENEFITS:

Beginning Salary $: _____ per _____ Range _____

Other Benefits: _____

_____

_____

EXAMPLE JOB DESCRIPTION - MECHANIC

General Description of Job

General maintenance and repair of all equipment used in the business. Includes the servicing of vehicles, shop equipment, and machinery used.

1. Essential Duty (40%): Maintanence of Equipment

Tasks: Keep a log of all maintenance performed on equipment. Replace parts and fluids according to maintenance schedule. Regularly check gauges and loads for deviances that may indicate problems with equipment. Perform non-routine maintenance as required. May involve limited supervision and training of operators performing maintenance.

2. Essential Duty (40%): Repair of Equipment

Tasks: Requires inspection of equipment and a recommendation that a piece be scrapped or repaired. If equipment is to be repaired, mechanic will take whatever steps are necessary to return the piece to working order. This may include a partial or total rebuilding of the piece using various hand tools and equipment. Will primarily involve the overhaul and troubleshooting of diesel engines and hydraulic equipment.

3. Essential Duty (10%): Testing and Approval

Tasks: Ensure that all required maintenance and repair has been performed and that it was performed according to manufacturer specifications. Approve or reject equipment, as being ready for use on a job.

4. Essential Duty (10%): Maintain Stock

Tasks: Maintain inventory of parts needed for the maintenance and repair of equipment. Responsible for ordering satisfactory parts and supplies at the lowest possible cost.

Nonessential Functions: Other Duties as Assigned

Qualifications: Experience in vehicle and machinery maintenance

EXAMPLE JOB DESCRIPTION - CROP PRODUCTION ASSOCIATE

Physical Requirements: Must be able to lift at least 50 pounds on a regular basis.

The main goals of this position are as follows:

I. Perform all field operations in the most timely manner possible.
II. Keep crop production costs within the established budgets.
III. Maintain all equipment in top working order.
IV. Keep stored grains in top quality. Keep storage losses less than _____ %.

1. It is the overall goal of this position to perform crop operations in the most timely, cost-effective and efficient manner possible.
2. Do your part to provide an atmosphere of teamwork, camaraderie, and an enjoyable work environment for everyone at the operation.
3. Manage any employees in your area in accordance with guidelines established by the management.
4. Follow all operating procedures and policies established by the management.
5. Monitor quality of stored grains throughout the year.
6. Spring and Fall operations are particularly time sensitive—a) Have equipment ready ahead of time, b) Remember that every delay in planting and harvesting results in yield losses, c.) Be prepared to work longer hours to accommodate weather, breakdowns and other factors that are beyond our control.
7. Equipment maintenance is one of your highest priorities—a) Keep safety shields in place, b) Keep fluids at the optimum levels, c) Perform maintenance procedures on time. Lubricate, change fluids, check tire pressures, watch for unusual wear, fix minor problems before they become major expenses, d) Use off-season time to do major maintenance and repair, e) Have all equipment ready for the field ahead of time. Planters and harvesters are particularly time sensitive and need thorough preparation ahead of their season.
8. Safety is extremely important—a) Maintain safety equipment, b) Use goggles, gloves and other body protection when using chemicals, c) Use support stands and jacks when working under equipment, d) Wear safety glasses and other protective gear when working around torches, welders, drills and other equipment that creates heat, sparks or projectiles, e) Be extremely careful around PTOs and other chains, gear, belts, etc.
9. Remember that in crop production, there are many factors beyond our control—weather, breakdowns, market swings, etc. As a result we must do everything we can to perform our best in the areas within our control.
10. Perform all data collection and record-keeping duties as defined by management.
11. Keep waste to a minimum and be constantly evaluating additional ways to reduce costs.
12. Keep facilities neat and presentable.
13. Show respect to any and all visitors and/or customers of the operation.
14. Enjoy what you do and provide suggestions to make working here more satisfying for everyone.

The Manager reserves the right to make any necessary changes to this job description and to request that the Crop Production Associate perform additional duties as the need arises. These additional requests will be reasonable and respectful of the Crop Production Associate's time and abilities.

Signed Employee _____ Date _____

Signed Supervisor _____ Date _____

Adapted from Tyler (2001).

EXAMPLE JOB DESCRIPTION - SECRETARY/OFFICE MANAGER

A. TITLE: Secretary/Office Manager

B. AREAS OF PRIMARY RESPONSIBILITY (Management reserves the right to change at any time.)

1. Manage corporate payroll
    a. Weekly labor payroll
    b. Monthly benefits to employees
    c. Monthly Social Security, Medicare, unemployment (federal, state) payments and reports
    d. Monthly payments for federal and state taxes withheld from employees
    e. Worker's compensation
    f. Prepare and send W-2 records at end of calendar year
    g. Prepare and send all federal and state labor tax forms
    h. Prepare annual wage benefit reports for each regular employee
    i. Keep records of vacation time, sick leave, personal time for all employees
2. Assist bookkeeper with:
    a. Entering data, verifying printouts, analyzing monthly printouts with farm manager, filing reports
    b. Sending farm records to CPA
    c. Preparing records for comparative analysis
    d. Preparing records for Farm Management Consultant
    e. Assist bookkeeper in preparing financial statements for corporation
3. Assist with grain enterprise
    a. Entering data concerning yields, drying charges, storage charges, inventory records
    b. Keep daily record or as necessary for managers' use on:
        i. Inventory and locations of landlords' and corporation's grain contracted
        ii. Corporation's and landlords' grains yet unsold
4. Banking
    a. Cross check canceled checks
    b. Bank reconciliation
5. Consult with corporation's Board of Directors
    a. Set and implement farm goals and objectives
    b. Set and implement personal short-, intermediate- and long-term goals and objectives

EXAMPLE JOB DESCRIPTION - SECRETARY/OFFICE MANAGER CONT.

C. AREAS OF SECONDARY RESPONSIBILITY
   1. Prepare job descriptions
      a. Annually for review
      b. Assist farm manager in completing for new employees
   2. Observe and learn corporate tax regulations
   3. Responsible for writing farm goals, employees' objectives annually for board approval
   4. Assist with errands during busy seasons

D. AUTHORITY
   1. Sign corporate checks
   2. Sign bank loans and repay them

E. IMMEDIATE SUPERVISOR: President/Farm Manager

President/Farm Manager _____

Secretary/Office Manager _____

EXAMPLE JOB DESCRIPTION - PRESIDENT/FARM MANAGER

A. TITLE: President/Farm Manager

B. AREAS OF PRIMARY RESPONSIBILITY

1. Responsibilities in grain production enterprise
    a. Planting
    b. Supervise post-emergent spraying of chemicals and sidedress ammonia
    c. Combine beans
    d. Manage grain handling system
        i. Maintenance of bins, scale, dryer, elevator
        ii. Oversee all handling of stored grains
    e. Transport grain from field to drying or storage centers
    f. Transport seed grains from field to grain company
    g. Supervise all field work
    h. Determine and order all inputs for crops
2. Responsible for health and comfort of livestock
    a. Maintain communication with Livestock supervisor
    b. Liaison officer between consulting veterinarian
    c. Do Sunday feeding every 4th and 5th week
3. Manage swine enterprise
    a. Authorized to purchase all inputs of swine operation
    b. Planning the swine production enterprise
    c. Selection and purchase of breeding and/or feeding stock
    d. Marketing of all livestock; pricing, transporting
    e. Feed formulation and determining rations
    f. Consult with Asst. Manager on operating plans, capital purchases
    g. Determine profitability of swine enterprise at regular intervals
    h. One year in advance, plan rotation of holiday feeding schedule
    i. Take inventory of livestock quarterly
    j. Meet with Feed Rep. quarterly and relay information to Asst. Sec.
4. Responsible for maintenance of equipment and farm buildings
    a. Feed center
    b. Outbuildings and improvements
    c. Portable equipment for livestock enterprise
    d. Shop facilities
5. Responsible for Corporate Budget
    a. Complete final fiscal budget by Jan. 15; preliminary by Dec. 1

EXAMPLE JOB DESCRIPTION - PRESIDENT/FARM MANAGER CONT.

b. Approve budget for the next year between Jan. 15-30 with Board of Directors

c. Maintain monthly reports: actual, year-to-date versus budgeted

d. Meet with Board of Directors to revise budget

6. Responsible for ordering and purchasing farm tools and equipment

7. Responsible for employee locating, training, and supervision

a. Hiring, firing and training

b. Evaluation semi-annually; reports to be filed with Board of Directors (secretary will assist with this)

c. Salaries, incentives, benefits

d. Meet annually with Board of Directors

8. Responsible for monthly inspection of all grain storage bins on all farms

a. First day of the month

b. At weather changes or times of stress

9. Consult with officers on the following:

a. Operating plans

b. Purchase of new equipment

c. Replacement of equipment

d. Short, intermediate, and long-range planning

C. AREAS OF SECONDARY RESPONSIBILITY

1. Joint responsibility for grain marketing

a. Discuss market trends on regular basis with bookkeeper

b. Approve marketing strategies

c. Help plan long-range grain marketing program annually

D. AUTHORITY

1. Responsible for day-to-day operational decisions

2. Authorized to sign corporation checks and bank loans

3. Authorized to purchase all inputs of swine enterprise, with budgeted limits

4. Authorized to market grains and livestock

E. IMMEDIATE SUPERVISOR: Board of Directors

Board Chairperson _____

President/Farm Manager _____

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Roadmapping Your Succession Transfer

Chapter 5

Renee Wiatt & Maria Marshall

Department of Agricultural Economics

Purdue University

Ownership and management are often passed to the next generation in farm businesses. However, ownership and management are not necessarily passed down in tandem. For example, farm businesses often start to transition management responsibilities before ownership is handed down. Succession in farm and family businesses can seem like an overwhelming task. Ownership and management transfer are similar to taking a family vacation; a roadmap can help to navigate the journey. Without having a destination and the correct steps in mind, getting where you intend to go can be difficult.

Management and Ownership Succession

Management and ownership succession can take place in subsequent steps, but the two processes have different components. For management succession, it is imperative that members of the incumbent and successor generations discuss the following: clarifying goals and responsibilities, acknowledging family dynamics that could affect the transfer process, and ultimately the incumbent generation handing over day-to-day operations (and planning how all of that will take place). Ownership succession can consist of: assessing the value of the farm business and its assets, evaluating different financing options to allow the transfer of the farm (if needed), and considering legal/tax implications for transfer.

Starting the Conversation

Starting the conversation about succession can be a daunting task. However, at the crux of management and ownership succession is communication. These important and impactful conversations are absolutely essential to a successful succession process. There is no correct answer to the question of "who should start the succession conversation?" but it could be advantageous for the incumbent generation to initiate the dialogue.

Why Roadmap Your Succession Process?

The succession process can take a LONG TIME! Even when owners plan to sell the business, the average time included in the process is 1.6 years (Zellweger, 2017). On average, intra-family transfers take 6.5 years and transferring to employees take 3.3 years (Zellweger, 2017). In a 2012 survey of farms and family businesses in the Midwest, Marshall et al. (2012) found that business owners had the following intentions:

- Business assets will be liquidated (roughly 27%),
- Business will be transferred to someone outside of the family (roughly 15%), and
- Business will be sold or given to family successors via intra-family succession (roughly 58%).

A small business values survey by Marshall and Wiatt (2019) found that what an owner *expected* to happen in their business transition did not always align with what that owner would *want*. Overwhelmingly, owners desired to give the business to family successors (48.2%), but slightly less expected that to happen (44.8%). Only 20.8% of owners wanted for business assets to be liquidated, 15.4% wanted to sell the business to family successors, and 15.6% of owners wanted to sell the business to someone outside of the family. Thus, the majority of business owners wanted to keep the business in the family, whether by sale or by gift.

When succession takes an extended amount of time, it allows for resentment and uncertainty to grow. By having a roadmap and plotting the path for your farm's succession, it defines the roles of the incumbent and the successor moving forward. The roadmap even takes that a step further by specifying who has the authority and responsibility on certain components of the business through the process. The successor and the incumbent can strategize how to finance the transfer, hire and fire employees as needed, and the overall projection of the farm as a whole (Zellweger, 2017).

By roadmapping your succession process, the incumbent and the successor(s) will know: who, what and when:

- Who is responsible,
- What the incumbent and successor are responsible for (respectively), and
- When the responsibilities are transferred on the way to the transfer of full control.

The succession process is about adapting roles for the incumbent and the successor. As both generations navigate this journey, they need to change their self-understanding as it relates to the farm. When the incumbent initiates the transition process, he or she is realizing that the farm would be enhanced through new managerial talent. The incumbent will transition from being the leader of the business and will eventually take on a consulting role. On the other hand, the successor will transition from being a helper in the business to a manager, and ultimately taking on the role of leader.

What Will Transition?

Many elements of the business will transition through the succession process, but the three in which the roadmap activity focuses on are: governance, functional responsibilities, and dividends. Governance transition includes ownership percentage and board management, while functional responsibilities include human resources, business strategy, and marketing (Zellweger, 2017).

How to Use the Roadmap

Every business is different. Thus, each business will have a different plan for transition. The roadmap activity is made to be adjustable and completely flexible. You can see an example on page 3 for a business that is already filled. Following that, there are two templates which you can personalize for your own farm (one successor case and multiple successor case). We have intentionally left some extra rows under each heading to allow for additions pertinent to your operation.

References

Marshall, M. I., C. Dobbins, W.A. Miller, R. Keeney, and J. Ayers. (2012). Family business succession survey.

Marshall, M.I. and R. Wiatt. (2019). Small business values survey.

Zellweger, T. (2017). "Managing the Family Business Theory and Practice", Cheltenham, UK: Edward Elgar Publishing.

Table 1. Sample Roadmap

Notes: View the roadmap below to understand how to complete your own roadmap.

Example Roadmap Scenario (Adapted from Zellweger, 2017)								
	Year	Year T	Year T+1	Year T+2	Year T+3	Year T+4	Year T+5	Year T+6
Age of Incumbent (Peter)		65	66	67	68	69	70	71
Age of Successor (Ruth)		35	36	37	38	39	40	41
Governance Transition								
Ownership Percentage	Incumbent	100	100	80	80	20	20	0
	Successor	0	0	20	20	80	80	100
Board Management	Incumbent	CEO	CEO	CEO	CEO	Advisor	Advisor	Advisor
	Successor	Manager	Manager	Manager	Manager	CEO	CEO	CEO
Transition of Functional Responsibilities								
Human Resources		Peter	Both	Both	Both	Ruth	Ruth	Ruth
Business Strategy		Peter	Both	Both	Both	Ruth	Ruth	Ruth
Marketing		Peter	Ruth	Ruth	Ruth	Ruth	Ruth	Ruth
Transition of Miscellaneous								
Dividend		100k to Peter	50k to Peter	0	0	0	0	0

Table 2. Fillable Roadmap (Single Successor Case)

Notes: Fill out the roadmap below to represent your expected succession situation. Fill in the blank categories as needed to better represent your operation's needs.

Succession Roadmap (One Successor Case) (Adapted from Zellweger, 2017)								
	Year							
Age of Incumbent: _____								
Age of Successor: _____								
Governance Transition								
Ownership Percentage	Incumbent							
	Successor							
Board Management	Incumbent							
	Successor							
Transition of Functional Responsibilities								
Human Resources								
Business Strategy								
Marketing								
Transition of Miscellaneous								
Dividend								

Table 3. Fillable Roadmap (Multiple Successor Case)

Notes: Fill out the roadmap below to represent your expected succession situation. Fill in the blank categories as needed to better represent your operation's needs.

Succession Roadmap (Multiple Successor Case) (Adapted from Zellweger, 2017)								
	Year							
Age of Incumbent: _____								
Age of Successor: _____								
Age of Successor: _____								
Age of Successor: _____								
Governance Transition								
Ownership Percentage	Incumbent							
	Successor							
Board Management	Incumbent							
	Successor							
Transition of Functional Responsibilities								
Human Resources								
Business Strategy								
Marketing								
Transition of Miscellaneous								
Dividend								

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CHAPTER 6

ESTATE PLANNING & OWNERSHIP (ASSET) TRANSFER

Farm asset transfer typically begins with the transfer of personal property (machinery, equipment and livestock). Leasing (for short term periods), gifting, and selling over time (installment sales) are all options to consider in evaluating the transfer of farm real estate, farm business, and personal property assets.

Until now, this workbook has focused on the orderly transfer of the business ownership from the current owner to the next generation. One component of succession planning we have not yet discussed is estate planning. Estate planning is a personal matter that can be difficult to comprehend, plan for, and communicate to others; however, it is important to do in order to ensure your wishes are followed at death. In this chapter, we indicate how tools and professionals can help you navigate through the estate planning process.

Jenna Nees
Purdue Extension, Putnam County
Purdue University

Ed Farris
Purdue Extension, Huntington County
Purdue University

Articles

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Transferring Farm Machinery through Lease Agreement

Chapter 6

Michael Langemeier

Department of Agricultural Economics

Purdue University

There are numerous methods to transfer the ownership of farm machinery. As outlined by Edwards and Hofstrand (2013), these methods include outright sale, installment sale, gradual sale over a period of years, lease agreement, and gift. These five methods have their own advantages and disadvantages pertaining to financial considerations and income tax considerations. The fourth method outlined by the authors, lease agreement, is appealing when dealing with a situation where an older generation on the farm is trying to transfer farm machinery to a younger generation. Lease agreements can include an option to buy or a gradual sale. Lease agreements often lower the cash flow requirements of the younger generation. Lease payments are taxed as they are received by the owner (typically, the older generation), and are a deductible expense to the younger generation. To meet IRS guidelines, lease payments must reasonably reflect the value of the farm machinery.

This article describes a conceptual approach that can be used to transfer farm machinery through a lease agreement, and provides an illustration of how this approach can be used in practice. The illustration also depicts how the lease payments may evolve over time.

Components of Farm Lease Payments For Farm Machinery Rental Arrangements

A contributions model, typically used to divide farm business income (see Langemeier, 2017); can be used as a conceptual framework to compute lease payments. The contributions model recognizes the annual contribution of farm machinery for each party (e.g., younger and older generations). Here, we are interested in the net contribution between the two parties. For example, if the older

generation owns most of the machinery, there will be a net payment from the younger generation to the older generation. In the discussion below, the difference in annual contributions between the two parties is referred to as the "net lease payment."

Net lease payments are typically computed using economic depreciation and an opportunity interest charge, which is included regardless of whether the owner of farm machinery has debt obligations pertaining to the farm machinery. It is important to note that all machinery costs are typically not included in the net lease payment {see Langemeier (2015) for a discussion of machinery costs}. Specifically, in the example illustrated below, repairs, fuels and utilities, insurance, and property taxes are not included in the net lease payment. Repairs, insurance, and property taxes are assumed to be paid by the respective owners of the farm machinery. Fuel and utilities are an expense covered by the farm, and are thus not included in net lease payments.

Assuming an average machine life of 10 years, straight-line economic depreciation, and a 5 percent opportunity charge for interest, to obtain the annual contributions for each party we would multiply the farm machinery investment for each party by 15%. The annual contributions are then netted to obtain the net lease payment. Beginning, ending, or an average of the beginning and ending balance sheet values for farm machinery can be used to come up with the farm machinery investment for each party. This assumes that the balance sheet values for farm machinery accurately represent the true farm machinery values. In some cases, it may be prudent to use farm machinery values that are relatively lower than the balance sheet values. If interest rates increase in the next few years, an argument could be made for using a higher percentage than the 15 percent suggested above to compute the annual contributions.

Case Farm Illustration

The case farm has 3000 acres, of which 500 acres are owned by the older generation. In addition to owning land, the older generation owns the vast majority of machinery and equipment, which is the focus of this article. Tables 1-3 present the annual contributions of both parties and net lease payments over a three-year horizon.

Table 1 illustrates the annual value of the contributions for each party (younger and older generations) and net lease payment for the first year. The younger generation is just returning to the farm as a full time operator so they own only a small percentage of the machinery and equipment. Specifically, in this case, the younger generation has recently purchased one-half of a combine. The older generation paid for the remaining portion of the combine. At this time, this is the only asset they own. The machinery and equipment owned by the older generation is from one to ten years old. The annual contributions in the first year were $24,581 for the younger generation and $129,732 for the older generation. This yields a net lease payment of $105,152 for the younger generation ($129,732 minus $24,581).

In the second year, the younger and the older generation purchased a tractor together. The other assets were depreciated using straight-line depreciation and a salvage value of 20% of the original price. The annual contributions in the second year were $44,978 for the younger generation and $128,267 for the older generation, resulting in a net lease payment of $83,289 for the younger generation ($128,267 minus $44,978). Though not shown in the table, an older tractor was sold with the proceeds going to the older generation.

The younger generation purchased another tractor in the third year. In this instance, the tractor was purchased without the help of the older generation. Again, an older tractor was sold with the proceeds accruing to the older generation. The remaining assets were depreciated using straight-line depreciation and a salvage value of 20 percent of the original price. The annual contributions in the third year were $86,971 for the younger generation and $108,892 for the older generation. The net lease payment in the third year was $21,920 ($108,892 minus $86,971).

In the example discussed above, the net lease payment dropped substantially from the first to the third year. This was due to the large asset purchases in all three years, and in particular to the large asset purchased by the younger generation in the third year. If these large asset purchases would not have occurred, or occurred to a lesser extent, the net lease payment would not have dropped near as much as it did in the illustrations. It is also important to note that the approach used in this paper would need to be updated in the fourth and subsequent years as the percentage of machinery and buildings owned

by the respective generations change. If the younger generation continues to be responsible for purchasing assets in the fourth and subsequent years, eventually the older generation would not own any of the machinery.

Concluding Comments

This article described a conceptual approach that can be used to transfer farm machinery through a lease agreement, and provided an illustration of how this approach can be used in practice. The illustration assumed that there were two generations involved in the transfer of assets, and that the older generation started out with the vast majority of the owned machinery. The conceptual framework illustrated in this paper could easily be modified for situation where there are three or more parties involve in the farm machinery transfer.

References

Edwards, W. and Don Hofstrand. "Transferring Ownership of Farm Machinery." Ag Decision Maker, A3-32, Iowa State University, August 2013.

Langemeier, Michael. "How Should Farm Business Income be Divided?" Center for Commercial Agriculture, Purdue University, March 2017.

Langemeier, M. "Benchmarking Crop Machinery Investment and Cost per Acre." Center for Commercial Agriculture, Purdue University, September 2015.

Table 1. Annual Value of Contributions of Net Lease Payments for Year 1

Item	Younger Generation	Older Generation
Power Unit Complement		
Tractors	$0	$230,100
Combine	$163,870	$163,870
Trucks	$0	$35,000
SUB-TOTAL	$163,870	$428,970
Machinery Complement		
Anhydrous Applicator	$0	$10,115
Chisel	$0	$22,855
Combine Heads	$0	$115,385
Drill	$0	$25,380
Field Cultivator	$0	$14,270
Grain Cart	$0	$9,225
Planter	$0	$72,110
Sprayer	$0	$166,570
SUB-TOTAL	$0	$435,910
Contributions and Net Lease Payment		
CONTRIBUTIONS	$163,870	$864,880
ANNUAL CONTRIBUTIONS	$24,581	$129,732
NET LEASE PAYMENT	$105,152	

Table 2. Annual Value of Contributions of Net Lease Payments for Year 2

Item	Younger Generation	Older Generation
Power Unit Complement		
Tractors	$150,230	$294,565
Combine	$149,620	$149,620
Trucks	$0	$30,000
SUB-TOTAL	$299,850	$474,185
Machinery Complement		
Anhydrous Applicator	$0	$8,925
Chisel	$0	$20,450
Combine Heads	$0	$104,720
Drill	$0	$18,130
Field Cultivator	$0	$11,100
Grain Cart	$0	$7,550
Planter	$0	$61,015
Sprayer	$0	$149,035
SUB-TOTAL	$0	$380,925
Contributions and Net Lease Payment		
CONTRIBUTIONS	$299,850	$855,110
ANNUAL CONTRIBUTIONS	$44,978	$128,267
NET LEASE PAYMENT	$83,289	

Table 3. Annual Value of Contributions of Net Lease Payments for Year 3

Item	Younger Generation	Older Generation
Power Unit Complement		
Tractors	$444,439	$239,635
Combine	$135,370	$135,370
Trucks	$0	$25,000
SUB-TOTAL	$579,809	$400,005
Machinery Complement		
Anhydrous Applicator	$0	$7,735
Chisel	$0	$18,045
Combine Heads	$0	$94,055
Drill	$0	$10,880
Field Cultivator	$0	$7,930
Grain Cart	$0	$5,875
Planter	$0	$49,920
Sprayer	$0	$131,500
SUB-TOTAL	$0	$325,940
Contributions and Net Lease Payment		
CONTRIBUTIONS	$579,809	$725,945
ANNUAL CONTRIBUTIONS	$86,971	$108,892
NET LEASE PAYMENT	$21,920	

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Estate Planning - What Tools Are Available?

Chapter 6

Craig Dobbins

Department of Agricultural Economics

Purdue University

Introduction

For many people, the term "estate planning" brings to mind preparing plans for the transfer of property at the time of a person's death. While transfers of property at the time of death is an important consideration, the decisions we make at the time we are accumulating property, the gifts we receive and make during our lifetime, and the plans we put in place if we become disabled are also part of a comprehensive estate plan.

Over the years, various tools have been developed to help a person express and execute their desires regarding who will be involved in decision making and executing a person's wishes if they become incapacitated or die. These tools have been developed to provide a common procedure for several people. Trusts are an example of this type of tool. Many people want to avoid the time, cost, and public examination associated with the probate process. Using trusts is one way to do this.

Other tools arise from revisions to laws associated with estate, gift, and income taxes. An example of this is the creation of the deceased spouse's unused exclusion amount (DSUEA) in the Tax Reform Act of 2010. Today this is commonly referred to as exemption portability, the ability to transfer the unused amount of the lifetime estate tax credit to the surviving spouse.

This article provides a condensed description of common tools available today for postponing or eliminating estate taxes, transferring property to survivors, and appointing the people responsible for protecting your interests. What general tools are available to help us structure our estate plan?

The Tools

Let's start with the **estate tax credit**. The 2018 Tax Cuts and Jobs Act (TCJA) increased the estate tax credit to $4,417,800 for 2018 and indexed this credit for inflation, which is likely to increase the size of the credit each year. This credit shields $11,180,000 of taxable estate asset value. Each taxpayer

receives this credit, so for a married couple this means an estate of $22,360,000 avoids estate taxes if each spouse owned one-half of the estate. This credit is large enough to remove concern about the need to pay estate taxes for the majority of estates. However, this provision, like many of the other provisions in the TCJA is only temporary and is set to expire January 1, 2026.

Related to the estate tax credit is the **portability** of the individual tax credit. If the first spouse does not have an estate large enough to use their entire credit, there is a deceased spouse's unused exemption amount available to pass to the surviving spouse. The transfer of the unused credit is accomplished by making an election on the estate tax return of the deceased spouse. Thus, the ported amount remains available until it is used at the death of the surviving spouse. However, if the surviving spouse should remarry, the ported credit amount available for use could be influenced.

Gifts are a way to transfer property to other people while the donor is still living. Giving away property is one way to reduce the size of an estate. A gift implies that the full rights associated with property are transferred from the donor to the donee. If the donor imposes limitations or restrictions on the gift, the transfer may not qualify as a gift and could be pulled back into the donor's estate at the time of their death.

While gifts are not subject to estate taxes, they are subject to gift taxes. Gift taxes are typically paid by the donor. As with estate taxes, there are tools that over time allow a significant amount of property to be transferred gift tax free. One such tool is the annual exclusion. Gifts made to a donee of $15,000 or less are excluded from gift taxes. Since the annual exclusion for each year is per donee, the total amount that can be excluded in any year depends on the number of donees. If a donor were to give 10 different donees a $15,000 gift tax free, the total tax-free transfer would be $150,000. A person can make a gift to as many donees as they desire. The donor has the ability to make these tax-free gifts every year.

A gift larger than $15,000 to any one donee in a year is a taxable gift, but that does not mean the donor will need to pay a gift tax. The reason no gift tax may be due is because there is a lifetime gift tax credit for each donor. As part of the Tax Cut and Jobs Act passed by Congress in 2017, the annual exclusion was set at $15,000 and the lifetime gift tax credit was set at $4,417,800. This lifetime gift tax credit allows each donor to gift $11,180,000 of property before gift taxes will need to be paid. Both the annual exclusion and the lifetime gift tax credit are indexed by inflation in this legislation. As a result, these limits will increase with time. However, these provisions and others in this legislation are only temporary and will expire January 1, 2026 unless Congress acts to extend these provisions or make them permanent.

While we all have a general idea about the definition of a gift, the law is more specific. Dalton and Langdon indicate that from a legal perspective a gift must have these features:

1. The donor must have the intent to make a donative voluntary transfer.
2. The donor must be competent to make the gift.
3. The donee must be capable of receiving the gift. This leaves out direct transfers to minors, but as long as guardian arrangements have been made for the minor gifts can still be made.
4. The donee must take delivery.
5. The donor must actually part with the dominium and control over the gifted property.

The **Unlimited Marital Deduction** is available to a married couple that are U.S. citizens. This is a deduction taken on the estate form that is filed. The deduction reduces the value of the gross estate for property transferred directly to a spouse. The property transferred to a spouse under the martial deduction must be included in the surviving spouse's estate. As a result, this tool only postpones the date in which any required estate tax will be paid.

Property titles directly influence what happens on the death of the property owner. If property is held in Sole Ownership/Fee Simple or as tenancy in common, the owner must provide instructions for the transfer of the property in a will or the property is transferred in accordance with the laws of the state in which the decedent lived. In order to provide a clear title, the property will go through probate. If property is held as joint tenancy with right of survivorship or tenancy by the entirety, the property will transfer on death of the owner to the remaining owners. In the case of joint tenancy,

the owners do not need to be related or married. To hold property as tenancy in in the entirety, the owners must be married. For joint tenancy and tenancy by the entirety, going through probate is not a requirement. This saves the time and cost of the probate process.

A **will** is a core document of most estate plans. A few items often found in a will include:

1. Specific bequests - Instructions of how to dispose of specific items of property.
2. General guidelines for property disposal – Instructions for disposing of various classes of property like tangible personal property or real property. This is similar to the specific bequests, but the heirs or the executor may play a role in deciding exactly how individual items in the group are distributed to specific individuals.
3. Appointment of Executor – This indicates the person responsible for executing the instructions contained in a will. This person is also responsible for making sure that any creditors are paid and that documents are filed in a timely manner. The will may also define the extent of the executor's powers.
4. Guardianship of minors – This identifies an individual or individuals to serve as guardians of minor children. Including this provision, relieves the court from the need to determine appropriate guardians.
5. Tax appointment – Directs which assets will be used to pay debts and estate taxes if there are any estate taxes.
6. Disclaimer instructions – Reminds the heirs that they can disclaim any bequest and describes the procedures to follow if property bequests are disclaimed.
7. A survivorship requirement – This requirement indicates the beneficiary/heir must survive the decedent for a specified period of time to receive a bequest. This helps to avoid the expense of two probate proceedings including identical assets.
8. Attestation – This provision is signed by at least two qualified witnesses who certify that the document is the person's will and bears their signature. It also certifies the person was competent to make decisions and was not under any type of duress at the time the will was signed.
9. Self-proving – This involves a notary signing a declaration that the notary witnessed the testator, person making the will, and witnesses sign the will. This item eliminates the need for the witnesses to testify during the opening of the probate process.

A tool often used to help people avoid probate is a **trust**. Trusts have existed for centuries and today there are several kinds of trusts. A few of the types used in estate planning are listed below:

1. Revocable Trusts allow the grantor of a trust, the person that creates and initially funds the trust, the right to revoke the trust at any time prior to incapacity or death. At the time of death, the trust becomes irrevocable. These trusts are commonly used to avoid probate and to provide management of the assets should the grantor become incapacitated.
2. Irrevocable Trusts do not allow the grantor to take back the property transferred to a trust. To achieve estate and gift tax planning objectives, a trust must be irrevocable, but not all irrevocable trusts are effective estate planning tools. For example, if the grantor retains some rights over the property transferred to the irrevocable trust, the value of trust assets may be included in the grantor's gross estate.
3. Testamentary Trusts are created after the death of the grantor. The grantor typically leaves instruction in their will for the executor of the estate to create and fund the trust. Two of the most common types of testamentary trusts are a credit shelter (bypass) trust and marital deduction trusts (Qualified Terminal Interest Property, QTIP Trusts, General Power of Appointment Trusts, or Estate Trusts).
4. Standby Trusts are created during the grantor's lifetime but is either unfunded or minimally funded. The trust simply stands by and waits for a triggering event to activate it. The trust may be used during life, during times of incapacity, or at death.
5. A Pourover Trust is a trust that receives assets from another source, generally the grantor's estate at the grant's death. The trust is generally unfunded or minimally funded until the assets pour into the trust.
6. Grantor Trusts can be revocable or irrevocable trusts. To qualify for grantor trust status,

the trust must be created during the life of the grantor. When a trust is characterized as a grantor trust, the grantor of the trust, not the trust itself or the trust beneficiaries, is responsible for paying the income tax attributable to the trust's income.

Trusts provide a way to split the interests in property among different parties. As pointed out above, the grantor is the person establishing the trust. From the grantor perspective, trusts are helpful in reducing estate taxes and administration fees by avoiding probate and providing an increased level of privacy regarding financial matters. They also help discourage contesting the decedent's will. There is also a trustee. This is the person or entity responsible for managing the trust assets and carrying out the directions of the grantor expressed in the trust document. The beneficiary is the person (or persons) which hold the beneficial title or economic rights to the trust assets. The income beneficiary holds the right to current income or distributions from the trust or the right to use the trust assets. The remainder beneficiary is entitled to receive the assets that remain in the trust on the date of trust termination.

A **Side Instruction Letter** may accompany a will. This is the place to express wishes about the disposition of specific tangible possessions, provide wishes about funeral arrangements, burial, and other wishes the deceased may wish to convey to the heirs. Since these items are not in the will, these instructions are not binding on the probate process.

There is property that has a built-in **transfer on death** provision. Life insurance and retirement accounts are examples. Property of this type asks the owner to specify a beneficiary that will receive the property upon the death of the owner. Property of this type generally avoids the probate process and passes directly to the named beneficiary. However, if the owner of the property did not properly complete the beneficiary assignment or the owner's estate is the assigned beneficiary, the value of the property will be included in the decedent's gross estate. Transfer on Death procedures can be used with other types of financial property such as checking accounts.

Power of Attorney & Power of Appointment provide a way for a trusted person to make important decisions for the person granting these powers. These powers generally transfer when the person granting the power (principal) cannot make decisions or execute documents for themselves. The power of attorney authorizes another person to act on your behalf. This power can be general, allowing the person to act on your behalf in all areas, or it can be limited, allowing the person to act on your behalf in only one or a small number of areas. The power of appointment gives the person the power to determine the disposition of property (appoint). This power can again be broad or it can be limited. For both of these powers, it is common to find these powers tied to a triggering mechanism. With a triggering event, the grantor of the power retains the power until a specified event, such as becoming incapacitated, occurs.

Durable Power of Attorney for Health Care names a person to make health care decisions for the person granting the power. This is different than a Living Will or a Do Not Resuscitate (DNR) order. The Living Will and DNR are focused on taking special steps for sustaining life (what should be done when the heart stops beating). Durable Power of Attorney for Health Care is focused on making decisions with the objective of the patient getting better when you are not able to make those decisions.

Summary

This article provides a brief summary of general tools used in estate plans. There are additional tools available and there are some important tools for owners of closely held businesses that were not included with this list. This review should provide you with ideas of the tools available to help you achieve your estate plan goals, whatever they may be. This brings us to the most difficult issue in estate planning and the issue that prevents many estate plans from being developed – What do you want your estate plan to accomplish?

References

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Succession Planning Team
extension.purdue.edu
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The Succession Planning Team

Estate Planning - Key Considerations, Checklist, and Inventory of Documents

Chapter 6

Angela Gloy &
Renee Wiatt

Department of
Agricultural Economics

Purdue University

Estate planning can be a large task to undertake as a farm or family business. In order to help take some steps towards forming an estate plan, we have some key considerations in the form of a table to which you can answer yes or no to each. There is a checklist of information for management issues, property associated with the business, financials, and some other information as well. This checklist gives you some items to consider as you form your estate plan. Lastly, there is an inventory of documents page that allows you to note where documents are. It cannot be stressed enough how important it is to keep an inventory of documents and elements key to the business. This way, if something happens to any member of the family or the business, others can know where things are and how to keep the business in operation.

The Women in Ag team through Purdue Extension has a great resource that dives deeper into how to inventory information: Code Red. The Code Red tool includes important information such as passwords, bank account information, rental agreements, insurance papers, power of attorney documents and much more in one easy location. After completing the Code Red plan, it should become the "go to" tool if something happened to a key member of the management team. You can download the tool here: https://ag.purdue.edu/Extension/wia/Pages/CodeRed.aspx.

Table 1. Estate Planning Key Considerations

Do you have a will or trust?	Yes	No
Do you have a health care proxy or advanced directive?	Yes	No
Do you have a document detailing guardianship of your children?	Yes	No
Do you have a living will?	Yes	No
Do you have someone other than spouse named as power of attorney?	Yes	No
Do you have health insurance?	Yes	No
Do you have life insurance?	Yes	No
Have you reviewed and updated your documents and/or beneficiaries in the last 12 months?	Yes	No
Are you an organ donor or anatomical gift donor?	Yes	No
Have you communicated your funeral wishes to your family via discussion or documentation?	Yes	No
Do you have an emergency file containing all account numbers and companies, contact and key documents? (You can use Code Red for this.)	Yes	No
Do you own property as an individual?	Yes	No
Do you own property jointly?	Yes	No
Do you own property as a business entity?	Yes	No
Do you know your annual living expenses?	Yes	No
Do you have a formal estate plan?	Yes	No
Have you thoughtfully considered how you will spend your additional "leisure" time?	Yes	No
Are your retirement goals well defined?	Yes	No

Table 2. Estate Planning Checklist

Management

- ☐ Facts on your present estate situation and your planning objectives
- ☐ Vital statistics on all members of your family
- ☐ Management capability/desire of family members
- ☐ Mission statement or note of main objectives for the business
- ☐ List of specific financial goals such as college expenses, travel, capital, business and family investments

Property

- ☐ List of all real and personal property owned and whose name is on titles/deeds (joint or individual)
- ☐ Current market value- obtain written appraisals
- ☐ Current depreciation schedule
- ☐ Objectives regarding the management and disposition of your property

Financials

- ☐ Current financial information as provided to your creditor
- ☐ Debts owed, to whom, and contingent liabilities
- ☐ Gifts you have made, amount, when, and to whom
- ☐ Income and expense statements for the past 5 years

Other

- ☐ List your present advisors and their contact information
- ☐ Important documents and where they are kept, including wills, deeds, titles, tax records, mortgages, etc.

Table 3. Estate Planning: Inventory of Documents

Where possible, attach copies of documents or indicate where they are filed.

Document	File Location
Wills	
Deeds	
Income taxes	
Mortgages	
Promissory Notes	
Retirement Income Accounts	
Trust Accounts	
Advanced Directives: ▪ Living Will ▪ Do Not Resuscitate Order ▪ Durable Power of Attorney	

The Succession Planning Team

PERSISTENT INNOVATION.

COLLEGE OF AGRICULTURE
Purdue University
615 West State Street
West Lafayette, IN 47907