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Getting Established in Farming

Part V in the six-part part series:

Business Management for Farmers

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Getting Established In Farming

Part V in the six-part part series:

Business Management for Farmers

Kenneth H. Thomas
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About the author

Kenneth H. Thomas was an extension economist in Farm Management at the University of Minnesota from 1959 to 1992. That this was a very dynamic period in U.S. agriculture is reflected in the wide range of management issues he worked on and wrote about.

During the 1960s and early 1970s he was very involved in helping farm families develop longer range plans for their businesses. In 1973, he coauthored a North Central Region publication that integrated profitability and financial soundness aspects into business planning and analysis.

Beginning in the mid-1970s he began working in, and writing about, land rental arrangements and the buying and selling of farmland. He also began working in the areas of getting started in farming, business arrangements, and farm estate planning and transfers, coauthoring four regional bulletins on these topics.

As businesses became larger, he began working on personnel management issues and coauthored a regional bulletin on farm personnel management. He also team-taught an agricultural law course at the University of Minnesota, which led to the inclusion of a number of the legal aspects in this series.

As a capstone of his career and as a transition into retirement, he began writing this six-part series, *Business Management for Farmers*. It is his hope that this six year "labor of love" will prove helpful to present and future generations of farmers.

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Preface

> ***Dream on!***
>
> *One young person to another:*
> *"Eventually, I'd like to have a business where the money rolls in and I wouldn't have to be there much".*
>
> –Anonymous

About the series

This publication is the fifth in a six-part series written for, and dedicated to, farm operators and managers in the U.S. Parts I, II, III and IV deal with managing an established farm business. Part V focuses on the issue of getting established in farming, while Part VI deals with planning the late career/retirement years. The series should prove useful not only to managers, but to educators, lenders, consultants and others, including persons considering farming as a career. **A list of chapter titles for the other parts in the series is on the inside back cover of this publication.**

Part I, *Developing a Longer Range Strategic Farm Business Plan*, first provides an introduction to the planning process. It then covers evaluating a present business situation and setting tentative life-style and business goals. This is followed by a discussion of the development of a longer range business plan. Information is then provided on how to develop, gain acceptance of, and implement a workable transition plan. Restructuring and/or liquidation of a financially stressed farm business are also addressed.

Part II, *Managing the Overall Business*, is divided into three sections. Section I focuses on people skills and legal aspects. Section II discusses financial management including financial planning, security agreements, income tax management, and the use of insurance. Section III discusses the development and/or updating of business arrangements and retirement and estate plans.

Part III, *Managing Crop and Livestock Systems*, discusses production and marketing, and the use of production contracts.

Part IV, *Acquiring and Managing Resources*, focuses on the acquisition of land via lease and purchase; the management of machinery systems; and personnel planning and management.

Part VI, *Planning the Late-Career, Retirement Years*, focuses on life-style planning, financial security, and the transfer of farm assets.

About Part V

This part, Part V, focuses on the process of deciding *whether* to farm, and if so, how *best* to get started and established in farming. Chapter 1 focuses on assessing the situation as one attempts to decide whether to choose farming as a career or not. Topics include making a general assessment of one's resource situation; matching entry options with that resource situation; and getting better prepared for future employment, which may include farming.

Chapter 2 takes this assessment one step further, laying out a procedure for deciding whether one should farm with someone else—a family member or an unrelated party. Particular emphasis is placed on: (1) assessing one's business and financial situation, and (2) assessing one's "people" situation, including a recommended "testing stage."

Chapter 3 focuses on getting established via a multi-owner/operator situation. Major emphasis is placed on the transfer of farm assets and management responsibility during: (1) the early years, (2) the transition years, and (3) the senior partner's (often a parent) pre-retirement years. Development of an appropriate partnership agreement is also discussed.

Chapter 4 deals with the task of establishing one's own farm business. Particular emphasis is placed on some keys to establishing a full-time farm business as well as requirements and options in establishing a crop or livestock-oriented farm business.

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Finally, the author wishes to thank the North Central Farm Management Extension Committee for their support of this series. Thanks also to the staff at MidWest Plan Service for their expertise in editing and designing this series.

Choosing farming as a career

1

- **Assessing of one's general situation**
- **Matching farm entry options with present resource situation**
- **Getting better prepared for future employment**

Each year a substantial number of people consider entering farming on a full-time or part-time basis. Some look at farming as a means of earning a living; some see it as a way to achieve a preferred way of life; while others are looking for a combination of the two.

These prospective farmers have a wide range of backgrounds. Some are just entering the work force; others have been working for some time either in a farm or non-farm occupation. Some have grown up on a farm or have worked on one; others have no farming experience. They also have differing expectations relative to farming. Many (particularly city people) often seek out farming as a way of life, or as a way out of their present job or life-style. Their objectives include "to be their own boss" and "to grow things." They may also be enthralled with the idea of sharing with their families the experiences of working and living together on a farm.

But most prospective full-time farmers view farming as a business and as an alternative source of employment. They expect a farm to provide an income that will permit them to live comfortably, raise and educate their family, and build a sizable estate for their retirement years and heirs. For them, the farm business must be competitive with alternative occupations and be able to keep up with the competition of other farmers. The problem is, more people want to become full-time farmers than are capable of doing so, or who have sufficient farming opportunities available to them. This chapter will help to objectively explore farming as a career option.

To be successful, a prospective full-time farmer must be:

- Motivated—really want to farm.
- Able to gain control of sufficient land, labor, and capital resources.
- Able to develop a workable, longer-range plan, and progress toward its implementation.

The following discussion is divided into three major segments: (1) making a general assessment of one's suitability for farming and one's present resource situation, (2) the major options for entry into farming, and (3) the process of getting better prepared for life and for farming, if that is to be the career choice.

Assessing one's general situation

This segment is designed to help assess whether one is suited for farming and whether or not the necessary resources to make a successful entry into farming are available. This assessment addresses a preliminary, tentative decision relative to one's opportunities in farming. If it appears that one shouldn't even try to start farming, all is not lost, as a lot of lost time and possible disappointment will have been avoided. If it appears that "yes," or at least "maybe" is the answer, then one will be in a much better position to determine preparation needs and to evaluate entry alternatives.

To provide some criteria for assessing the situation, some generalizations are put forth about the entry requirements of modern-day farming, and a procedure for making a general assessment is given.

Requirements for entry into farming—a brief look

There are no legal obstacles to becoming a farmer in the United States: no examinations, no set educational requirements, no licenses. Anyone who wishes, may try. Substantial barriers to an entry into farming do exist, however. These barriers include the ever-increasing amounts of land, machinery, and other capital that are required; plus exceptional managerial ability to put these resources together into an efficient, profitable and financially sound farm unit.

Capital requirements rising

Farming in the United States has undergone many marked changes in recent years and is still changing rapidly (See Chapter 1, Part I). As late as 1940, labor still accounted for over half of the resources used in farming. Today, labor accounts for less than 20% of farm resources, being replaced by a sharp increase in the use of capital. This shift accounts for the trend to much larger farms and larger investments in land and equipment, as well as higher operating capital needs. Thus, would-be farmers who are short of capital must look for an opportunity that will make the most efficient use of their labor when combined with their usually limited capital base.

Two key questions come to the fore: (1) how much land and/or facilities is/are required to provide full and efficient employment of one person's labor? and (2) how much capital must be invested in machinery, breeding livestock, equipment and other items to make an efficient operation? Obviously, the exact amounts vary by types of farms and areas of the country. Amounts also vary by family: the levels of efficiency the farm operator attains in the use of resources, and the income required to support the family's desired level of living and meet debt repayment obligations.

Managerial requirements rising

As farms have become larger and more complex, the managerial requirements have risen sharply and the emphasis on qualifications have changed. Successful use of modern farming methods requires a high degree of technical knowledge and skill. Successful handling of large investments and cash flows in the face of high and rising costs, uncertain product prices, coupled with weather and other production risks, requires expert business and financial skills. For most crop and selected livestock enterprises, marketing skills—both on the input and output sides—are also very important. With larger units, effective personnel management is a must. See Table 1 in the Preface of Part II of this series for a snapshot of the range of responsibilities of a modern-day farm manager.

Rewards: improving, but variable

Like any industry where the entry requirements are rising, the economic rewards of farming are improving on average. But with the increased size and risks have come greater variations in the rewards received by the owner/manager. Some farm managers have been very successful; others have fared poorly. Furthermore, new entrants and their families must be willing to take risks and adapt their life-styles to the inevitable variations in income that are a part of farming.

The need to piggyback

Because of the marked shift from a land/labor oriented farming industry to one dominated by high capital and managerial requirements, entry requirements have risen to the point where successful entry into farming almost requires a prospective farmer to piggyback on an existing farming operation—at least in the early stages. Such arrangements may involve assistance from a family member, e.g. use of machinery or their co-signature on a note. Certainly there are exceptions to this rule, but it takes an exceptional manager or a favorable business situation to gain entry into farming strictly on one's own. Some may be lucky enough to inherit or marry into a farming operation. But it will still take top-notch management to make it a lifelong career.

Assessing the present: self and situation

An effective assessment must consider all resources. In farming the owner/manager is a key resource so begin with: (1) a personal assessment (are you suited for farming?) and (2) a management assessment (what is your present level of work experience and management know-how?) Then, make a resource assessment (can you gain control of the resources required for a successful entry?)

Personal assessment

There is no one test that can definitively identify individuals who are suited for farming. Trying may be the only way to find out for certain. But, answering a few basic questions, such as the following, may help make an initial tentative decision as to the suitability of farming and farm life for a given individual.

- **Do you like farm work and farm life?** Do you like to work on an uncertain schedule that often involves long hours and hard work? Do you like to work alone and make your own decisions, or do you need a committee? Are you a self-starter who can see things to do and get them done, and on time? Can you stand uncertainty and setbacks? Do you have the patience to operate in a situation controlled largely by someone else, i.e., a banker/lender, a landlord, an established farmer—at least in the early years of your farming career?

  Farming is usually a family effort. Do your spouse and children like farming as a life-style? Does your spouse realize that farming is not an 8 a.m. to 5 p.m. job? Does your spouse realize that weekends often become part of the work week, and the usual work week becomes part of the weekend? Will your family members be willing to make financial and other sacrifices in the early years so that a profitable, financially sound business can be established?

- **Do you like rural living?** Do you mind living where "next door" may be a mile away? Do you like small towns: (1) where everybody knows everybody, as well as their business and personal affairs? (2) where schools, health services, shopping centers, and cultural events are often less adequate than those available in a major city? (3) where community decisions are often made on a consensus basis? (4) where needed change may require the passing of an older generation?

- **Some more questions:** (1) Are you highly motivated toward farming as a career, or are you at the "I'll give it a try" stage? (2) Will your spouse provide: moral support? labor or management? off-farm income? (3) Do you have a realistic understanding of farm work and farm life or is it more of a romantic notion? You certainly could and should add to this list of questions. Take the time necessary to ponder these questions and to answer them as fully and honestly—to yourself and with others who are affected by your choices—as possible.

Assessing managerial skills

To be successful over time in modern-day farming, one must have managerial potential as well as training and experience. One should have an initial basic knowledge as well as a drive to keep learning, changing and adapting. Making a careful, realistic appraisal of one's management capabilities and work experience can avert some costly lessons.

- **Do you have the necessary managerial potential?** Try to determine whether you have some of the general characteristics of a good manager. Do you like to manage, or are you strictly a doer? It takes a lot of both in farming these days. But to be a successful manager, you will have to be able to answer an honest "yes" to questions like:

  - Do you like to work? Are you ambitious and aggressive? Are you willing to face uncertainty and risk and accept responsibility for your success and failure?

  - Are you goal oriented? Are you disciplined? Can you set priorities? Are you able to set realistic goals? Do you feel as though you can achieve whatever you put your mind to?

  - Do you like to solve problems? Make decisions? Are you able to anticipate problems? Are you willing to take time to think through problems, keep up with new developments, and seek the best advice possible? Are you willing to make a decision and take action, even though you're not 100% sure of the outcome?

  - Can you set your own pace? Can you decide how much you want to accomplish and when? Do you work hard when you work; play hard when you play?

  - Do you have a positive attitude toward the future of farming as a career opportunity?

- **Have you had adequate managerial training and work experience?** It isn't enough to have managerial *potential*. To ensure a reasonable chance for success in farming, you need some prior farm-related training and experience before attempting to operate a farm. Therefore, you must be honest with yourself. Can you effectively manage a farm unit at this time? Or do you need some further formal training or on-the-job experience in order to learn more about the production, financial and marketing dimensions of the type of farming you are considering?

  Again, there is no test that can decisively indicate whether you are ready to start farming. But remember, managerial requirements are high today. Lenders and landlords will be looking at your management credentials. Of course, there may be a trade-off between the amount of resources you have (or can gain control of) and your management skills. The problem is that unskilled managers can lose control of these resources in a hurry. Therefore, when in doubt, get more preparation—preferably at someone else's expense.

Describing capital resources

There are at least three dimensions to consider in appraising capital resources: (1) the capital required by the farming situation being considered, (2) the capital available or accessible, and (3) one's ability to borrow and service debt.

- **Capital requirements and capital availability.** Capital requirements vary widely among the entry alternatives one may consider. For example, capital requirements are much lower when starting as an employee of a "super-firm" than if one were to start farming independently from scratch. Likewise, the way resources are acquired (renting versus buying) and utilized (dairy versus beef cows) influences the amount of capital required. Therefore, explore carefully the capital requirements for various types of farming and the opportunity for gaining control of resources such as by leasing and share renting.

Available capital includes personal equity (net worth) and any family or other financial support or assistance. The latter may include a family member co-signing for a loan. The assistance may also take the form of property, such as exchanging one's labor for the use of someone else's machinery.

- **Ability to borrow money and service debt.** Credit worthiness depends on one's character, equity position, and ability to service debt. Since most beginning farmers have limited equity, they must rely more heavily on character and their ability to repay debt, often from a limited income when justifying a credit request. Consequently, a history of meeting financial obligations on time and an ability to develop realistic projections of income and expenses (cash flows) will be key attributes for a beginning farmer.

  In present day farming, acquiring resources is an on-going challenge. Therefore, one's ability to use scarce resources effectively in generating needed cash flows, and evidence of success in keeping family living demands in check, will affect the amount of money a lender may be willing to loan and the amount of debt one can service. Income from off-farm employment is often an important source of cash for debt servicing for the beginning farmer—whether this off-farm employment involves the farm operator, spouse, or both.

- **Meshing one's financial situation and capital requirements — a brief look.** Meshing the financial situation and the capital requirements of various entry alternatives will be discussed in the next segment of this chapter. Suffice it to say, if available financial resources are very limited, then look for ways to use management capabilities to the full extent without incurring undue financial risks. If one's financial position is considerably better, a much broader range of entry options may be open.

- **Do you have access to sufficient capital resources?** Key questions include: What entry alternatives are you willing to consider? Do you have the character and track record that appeal to lenders or partners? What risks are you and your family willing to take? Can you gain access to sufficient financial resources now or in the foreseeable future?

  You may decide that the entry requirements are just too high, or you are not willing to make the necessary sacrifices involved with a given entry option. Or, you may say, "yes, we can make it," or at least say, "maybe we can."

Adding up the score

After answering each question fully and honestly, you must "add up the score" so to speak. Have you made the first cut? Are you (and your family) suited for farm work and rural living? Are you well suited for a career in farming? Do you feel that you have sufficient management potential to compete in the farming industry described above? Do you have access to sufficient capital? If the answers are predominantly "no", then explore other career opportunities and prepare as needed. (See the discussion of other career opportunities in agriculture in the next segment.)

If the answers favor "yes", or at least "maybe", then begin exploring the alternatives for entry that best match your work experience, management know-how, and capital availability situation. Also consider ways of better preparing for a career in farming, which might broaden entry options. These aspects will be discussed in the next two segments of this chapter.

Matching farm entry options with present resource situation

Even though the ultimate objective is to own and operate one's own farm business, today's high entry requirements may mean ownership control of a farm may be many years down the road for most entry-level farmers.

Therefore, this segment describes major options for gaining entry into farming and helps match one's present resource situation with these entry options. The segment closes with a brief look at other career opportunities in commercial agriculture if one decides not to pursue a career in farming per se.

Entry options—a brief look

There are basically four entry options into farming: (1) employee in a large, super-firm type farm business, (2) employee/partner in a moderate to large farm business, (3) farming partly independently in a spin-off or joint venture arrangement, and (4) independent full- or part-time farming.

Entry option #1. Employee of a large, super-firm farm business

When considering full-time farming as a career, most people think of establishing their own farming operation. But with the wide range of sizes of commercial farm businesses today, keep in mind that there will be increased opportunities to enter farming as an employee of an established, so-called super-firm business. Depending on one's training and experience, it may be feasible to enter farming as a semi-skilled or skilled employee, a supervisor, or even a resident manager. Any of these routes may evolve into permanent employment in a large, existing operation, or may lead to establishment of one's own farming operation.

Entry into farming as an employee may be particularly appealing to those with little farming experience since they can acquire knowledge and skill on the job. It may be necessary to first start as a semi-skilled worker and progress to positions of increasing responsibility, such as a herdsman for the livestock component of a business, and eventually to the overall management of the entire farm business—under the watchful eye of the owner(s). A possible advantage of being an employee of such a business is the experience gained in using the latest farm technology, marketing techniques, and financial strategies in farming. Therefore, it is important to choose a well-run operation that is up-to-date and uses current farming methods.

Proper compensation is an important issue that must be faced to successfully start a career in farming as an employee, supervisor, or resident manager. An individual with managerial capabilities should expect to receive more compensation than one who is a semi-skilled worker charged with carrying out day-to-day farming activities. If the incentive payments are made in cash, problems usually are not encountered when the entering worker eventually uses the cash to start his or her own operation. However, in some cases incentive payments are not made in cash. Instead, incentives may be allocated as shares of ownership in the farming operation. In this situation, a prearranged equitable agreement for liquidating shares of ownership is necessary should one decide to begin one's own farm business.

For some, the role of supervisor or resident manager will be so challenging and rewarding that they may decide to remain in this role throughout their farming careers. But for others, the questions will eventually arise as to when to resign and how best to establish their own farm businesses. One approach is to accumulate sufficient funds to acquire a smaller established farming operation when the opportunity arises.

A second alternative is a phase-out approach where the prospective farmer purchases land and/or key machinery as the financial situation permits, and leases it to the operation he/she manages until it is feasible to start an independent operation. The advantage of this approach is that if the value of assets such as land were to rise, it may be possible to acquire some of these resources earlier at a lower price than if purchases are delayed until enough money is saved to begin one's own operation.

Entry option #2. Employee/partner in a moderate to large established business

Quite often a prospective farmer has an opportunity to become a co-owner of a moderate to large farming unit that is fully equipped and operational. This may involve a family business or that of an unrelated party, and may offer even more opportunity for independent decision-making and eventual ownership and control.

In this case, make sure that the unit is large enough to offer a reasonable chance of financial progress and that there will be an opportunity to buy into the operation—at least into the machinery, equipment, and breeding stock. If, after a short testing period, it appears that this is a good business unit and the parties can work and manage well together, develop longer-range objectives and plan for business development and partial transfer to the junior partner. The assessment process for this entry option is discussed in detail in the next chapter.

Entry option #3. The joint venture/spin-off approach

This option involves getting started in farming partly on one's own and partly meshed with another established business. The spin-off approach is often used in a family business that is not adequate for two or more people. It often involves an exchange of labor for machinery.

It may also result from a super-firm situation where the manager/owner is willing to help a young person get started in farming by renting them some land and/or permitting them to use the machinery. Or, it could result in a joint venture arrangement involving part of the overall super-firm business. The next chapter contains a discussion and worksheet for determining whether this is a viable option.

Entry option #4. Independent full time or dual career farming

The "starting from scratch" alternative involves acquiring all (or much) of the resources by oneself, with assistance from a lender and/or friendly landowner. Under today's conditions, this option is generally feasible only for the exceptional manager with considerable equity of his/her own. Occasionally, the exceptional manager (and family) can do it with limited equity, utilizing the part-time farming or part-time off-farm work approach. If the family is serious about farming, then the latter emphasis is preferred—part-time off-farm employment to augment family and business income needs.

It might also involve starting on a part-time basis and becoming acquainted with a good neighboring farmer who is willing to share equipment and management know-how to get someone else started. It may also represent an outgrowth of a super-firm situation, as described earlier. These last two entry options are discussed in some detail in Chapter 4.

Matching one's resource situation with various farm entry options

Table 1-1 provides a brief summary of four possible resource situations, and indicates the entry options that might best apply.

Table 1-1. Entry routes best suited to selected resources situations.

	Work experience/ management knowhow	Capital available (equity & borrowing capacity)	Entry route best suited to situation
Situation #1	Some	Little or none	Employee in super- firm or in a large, well-run business
Situation #2	Moderate	Little to some	Supervisor in super-firm; partner in larger operation
Situation #3	Considerable	Some	Same as #2 above or joint venture or spin-off
Situation #4	Considerable	Moderate	Same as #2 and #3 above or establish own business

Other career opportunities in agriculture

If farming per se doesn't seem to be an option, there are numerous careers and jobs related to the agricultural industry. A 1995 USDA study[1] estimated that one in every six jobs in the U.S. is in food and agricultural-related enterprises. The study provides insight as to the career opportunities that would likely have been available to graduates of U.S. colleges of agriculture, natural resources, and veterinary medicine between 1995 and the year 2000, Table 1-2. Though these findings are dated, they suggest where future employment opportunities may exist and the competition for such jobs.

The authors of this study summarized their findings as follows:

- "The employment market for U.S. agriculture, natural resources, and veterinary medicine college graduates will continue to be strong in the late 1990s. However, new college graduates with food and agricultural science and business expertise will face an increasingly competitive employment market during the next five years as compared to graduates of the early 1990s."

- "During 1995-2000, average annual employment opportunities for college graduates with expertise in the food and agricultural sciences are projected to be 47,918. In contrast, some 45,675 graduates with expertise in agricultural, natural resources, and veterinary medicine are expected to be available to compete each year for the available positions."

- "The 4.7% aggregate shortage of graduates is expected to be concentrated in several employment specialties. Nearly three-fourths of the total projected shortage is in the **marketing, merchandising**, and **sales employment** cluster. Also, excellent employment opportunities are forecasted for graduates having **scientific and technical** expertise in developing new consumer products from raw agricultural and forest materials. And, there will be strong demand for individuals with expertise in **managing water, land, and other natural resources** that are used in the U.S. food system."

- "One major supply factor which underscores the more competitive employment market in the late 1990s is the significant enrollment growth experienced during the past five years by most U.S. colleges producing graduates in the food and agricultural sciences. Another is increased competition from the expanding number of graduates in many allied fields who are capable of competing with food and agricultural science graduates for the same positions in the employment market."

- "Colleges of agriculture, natural resources, and veterinary medicine will produce about 55% of the total qualified graduates with expertise in the food and agricultural sciences. Allied fields such as engineering, business, biology, health sciences, economics, and computer technology will contribute about 45% of the qualified graduates."

This study focused on career opportunities for college graduates. Thus, persons without advanced training in some of the technical and other expanding needs of the agricultural industry will be competing with college graduates in overcrowded areas such as production agriculture. This situation should be considered carefully as one begins exploring ways to become better prepared for a career in farming or elsewhere.

[1] Allan D. Goecher, K. J. Coulter, and M. Stanton, *Employment Opportunities for College Graduates in Food and Agricultural Sciences, 1995-2000.* Prepared and Published by School of Agriculture, Purdue University, Nov. 1995 (unnumbered publication.)

Table 1-2. Distribution of employment opportunities for graduates in food and agriculture.

	Total	Agricultural production specialists	Communication & education specialists	Social services professionals	Managers and financial specialists	Scientists, engineers, & related specs.	Marketing, merchandising and sales reps
Job opportunities	47,918	3,873	5,295	4,862	5,613	13,922	14,353
% of total opportunities	100	8%	11%	10%	12%	29%	30%
Food/ag grads	25,287	2,201	2,584	2,688	2,238	9,458	6,118
Surplus/shortage (%)	-47%	-43%	-52%	-45%	-60%	-32%	-57%
Allied grads	20,388	1,930	2,926	1,876	3,231	3,841	6,584
Total grads	45,675	4,131	5,510	4,564	5,469	13,299	12,702
Surplus/shortage (%)	-5%	+6%	+4%	-6%	-3%	-5%	-13%
		Careers Aquaculturist Farmer Farm Manager Feedlot Manager Forest Res. Mgmt. Fruit/Veg. Grower Greenhouse Mgr. Nursery Grower Rancher Turf Producer Viticulturist Wildlife Manager	**Careers** College Teacher Comp Soft. Designer Comp. Sys. Analyst Conference Mgr. Coop. Ext. Agent Editor Educ. Specialist High School Teacher Illustrator Information Spec. Journalist Personnel Dev. Spec. Pub. Rel. Rep. Radio/TV Broadcaster Training Manager	**Careers** Career Counselor Caseworker Comm. Dev. Spec. Conservation Consumer Counselor Food Inspector Labor Rel. Spec. Naturalist Nutrition Counselor Outdoor Rec. Spec. Park Manager Peace Corps Rep. Population Control Regional Planner Regulatory Agent Rural Sociologist Youth Program Dir.	**Careers** Accountant Appraiser Auditor Bank Officer Business Mgr. Consultant Contract Mgr. Credit Analyst Customer Service Manager Economist Financial Analyst Food Service Mgr. Gov. Program Mgr. Grants Manager Human Reso. Mgr. Ins. Agency Mgr. Insurance Risk Mgr. Landscape Mgr. Policy Analyst Res. & Devel. Mgr. Retail Manager Wholesale Mgr.	**Careers** Agricultural Engineer Animal Scientist Biochemist Cell Biologist Entomologist Environ. Science Food Engineer Food Scientist Forest Scientist Geneticist Landscape Architect Microbiologist Molecular Biologist Natural Res. Sci. Nutritionist Pathologist Physiologist Plant Scientist Quality Assurance Regional Scientist Research Technician Resource Economist Soil Scientist Statistician Toxicologist Veterinarian Waste Mgmt. Water Quality Spec. Weed Scientist	**Careers** Account Executive Advertising Mgr. Commodity Broker Consumer Info Mgr. Export Sales Mgr. Food Broker Forest Prod. Merch. Grain Merch. Insurance Agent Landscape Contractor Market Analyst Marketing Mgr. Purchasing Mgr. Real Estate Broker Sales Rep. Tech. Service Rep.

Getting better prepared for future employment

Before zeroing in on entry options, most young prospective farmers should consider getting some additional education and training beyond high school. This will not only increase chances for a successful entry into farming, but also increase future flexibility and employability should a farming career not pan out.

The need for broad-based education; training beyond high school

In facing the rapidly changing, uncertain future, it is important that prospective farmers make themselves as flexible and employable as possible. Young people today face the likely prospect of having at least five different career changes and will likely experience at least 10 job changes over their working years. Farming is a very competitive industry. Therefore, there is no assurance that prospective farmers will always be farmers just because they started out that way.

This suggests the need for some additional general **formal education** beyond high school. This might involve at least two years of college. By focusing on the basic courses, one would be in a position to get a degree later on in an area of choice. Vocational training in such areas as computer science, business management, agricultural production, and mechanics would provide training that would also be useful in either farming or other related endeavors.

Informal, on-the-job training could help develop skills that would be saleable in several employment areas. It would also help identify what kinds of work one really likes.

Making better preparations for farming

When taking the first step toward entering farming, keep two objectives in mind: (1) become better prepared, and (2) become known as a good, hard working, prospective farmer. This preparation stage may include formal and on-the-job training.

Formal training

Formal preparation for farming may include some formal training at an agricultural college or vocational school first. To be most useful, such training should be broad-based, involving the production, mechanical, financial management, marketing, personnel and legal aspects of farming. A local county agent, vocational agriculture instructor or state agricultural college can help assess the best options. Supplement formal training by attending local Extension Service sponsored meetings, schools and workshops, as well as educational events sponsored by other public and private groups.

Parts I through IV of this series provide a very basic study guide for preparing for a career in farming.

On-the-farm training

In attempting to secure more on-the-farm training, there are two routes that might be followed: (1) as a farm employee and (2) in a dual career situation.

- **Farm employee**. Select the farming area and farming situation carefully. First, select a good farming *area*—one that has good resources and markets and will likely be competitive over time. Then, select a good farm business situation—learn from a successful manager on a well-run farm, preferably in the type of operation being considered. The farm should be run by a respected manager who is willing to assign some managerial responsibility to qualified employees.

It isn't always possible to find the perfect situation. However, keep in mind that there are at least four objectives of on-the-farm training. To:

- Become better trained as a manager.
- Become better known in the community as a hard worker and an effective manager.
- Accumulate some savings, primarily to demonstrate effective money management.
- Decide whether one really wants to farm.

Becoming a "hired man" on just "any old farm" will not necessarily do the job.

- **Dual career.** Part-time farming may serve as an alternative route for achieving the objectives noted above. It may also serve as a hedge or a bridge: one can keep a non-farm job and still do some farming. However, one will have to work hard to establish a reputation as a skilled manager and a good farmer. Many times part-time farmers remain part-time farmers rather than becoming full-time farmers with a part-time off-farm job. They get accustomed to a good family life-style and hesitate to give up the job security they have acquired in their non-farm job.

Since the full time farming situation may never materialize, it is important to seek an off-farm job that has a future and will provide a reasonable income and job security.

Farming with someone else?

2

- Deciding whether to farm together: A road map and overview
- Assessing the business/financial situation
- Assessing the people situation: A testing stage
- Gaining entry via a large/super-firm business situation: a brief look

The family-sized farm is a basic institution in much of U.S. agriculture. Many parents want their business to continue over time and a major objective is to pass their farm on to the next generation. At the same time, many young people are considering farming as a career, attracted by the challenge of farming compared to other occupations. Because of the high capital and management requirements of modern agriculture however, they recognize that initially they will likely have to piggyback, i.e., join forces with, or be aided by, an existing farm operator.

Thus, many farm families are confronted with the decision of how best to get a son or daughter started and established in farming and to successfully transfer both assets and management control to them over time. This chapter first provides a "road map" by which a farm family can determine whether the two generations should even try to farm together.[1] Remaining segments of the chapter present considerations and procedures for making a decision for one's specific situation.

[1] This chapter emphasizes merging two generations of the same family. Merging businesses of unrelated parties involving two generations or from the same generation, should be approached in a similar fashion.

Deciding whether to farm together: A road map and overview

Merging the career cycles of a younger family member (the junior partner) with the typical career cycle of the parents (senior partner) is a complex task that must be approached with caution and candor and be explored carefully. This segment first covers the complex nature of this task. Then, a "road map" focuses on a series of key questions to be answered about one's business, financial, and people situations.

Merging two generations' life cycles/careers

The individually operated farm business has a traditional life cycle paralleling the farming career of the farm operator. These farm operators and their firms tend to pass through at least three stages: (1) an establishment phase, (2) a transition, often growth-oriented phase, and (3) a pre-retirement phase. (See bottom portion of Figure 2-1.)

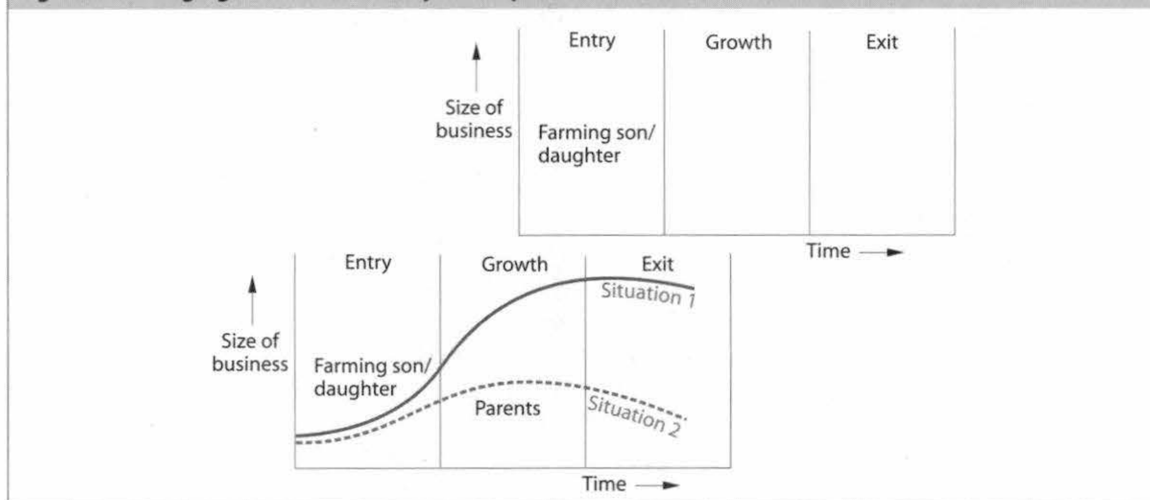
When parents attempt to bring a younger family member into the farming business, they are essentially superimposing a second life- or career-cycle on top of theirs. Figure 2-1 shows how the respective career cycles are likely to have the same general pattern, but they do not mesh as they are off-set by age differences and by timing, i.e., when will the younger family member be ready to join the parents in business.

But each farm business and family situation is different for at least three sets of reasons/factors. One factor is the *parent's level of financial success and their objectives*. Some parents have put together a very substantial business that could easily accommodate one or more "next generation" farmers (situation 1, Figure 2-1). Others have provided adequately for their families, but find themselves with a business that provides employment for little more than one family unit (Situation 2, Figure 2-1).

Parents' goals, objectives, values, and priorities also vary. Some may want their businesses to grow and prosper; others may want to consolidate their gains and slow down. Some may want to begin transferring large amounts of property, while others are primarily concerned with enjoying the fruits of their own labor—now and in retirement. Some will want to favor the farming son or daughter financially, while others will want to treat all of their heirs "equally."

A second factor relates to *the younger generation's managerial ability and the timing of his/her entrance into farming* relative to the parent's eventual retirement. Prospective farmers tend to vary widely in their present managerial skills as well as their commitment to farming as a career. Also, the timing of their entrance into a farming situation, where the parents plan to farm for 20

Figure 2-1. Merging career/farm life cycles of parents and children—an illustration.



more years, creates a much more complex situation than one where the parents are within five years of retirement. On the other hand, the 20 years or more situation provides more time for a prospective farmer to gain greater financial control of the business, as well as develop necessary managerial skills and farming experience.

A third factor is the *number of other children in the family* involved and the degree of interest they have in the farming enterprise. The situation is much easier to deal with when there is only one child than if there are eight children and three want to farm.

Merging career cycles of two farming generations can be quite simple under the right set of circumstances. Such a case might be one in which parents are five years from retirement, have a very good business, and have only one child who has considerable managerial skill and farm experience. At the other extreme is the 45 year old father with a less-than-adequate two-family business, two children who want to farm, and five other children to consider.

Deciding whether to farm together: A road map

Figure 2-2 presents a step-by-step process for deciding whether to farm together. It is built around a series of key questions that need to be answered relative to one's own **business/financial situation** and the **"people" situation**.

Key questions about the business/financial situation

The top portion of Figure 2-2 addresses the **business/financial** situation. Options and decisions are closely linked to the financial soundness of the parents' business. Use objective facts to determine profitability and financial realities. Then follow the course of decision-making as facts and preferences dictate.

Key questions relating to the "people" situation

The bottom half of Figure 2-2 illustrates questions that relate to the "people" situation. Much is involved in gauging one's commitment to farming and the ability to work together. Family members must be candid and honest, willing to listen as well as to speak. Consider spouses of children, and other children who choose not to farm. Deal with expectations of quality of life (e.g. free time, housing, personal boundaries). How will decisions be made? Who makes the final decision when disagreement occurs? Is commitment measured in hours, dollars, or attitude?

If answers to the questions in Figure 2-2 result in a "not really" response, then explore other options. If the answers are "maybe", then try a testing stage to better answer these questions. If the answers point to a definite "yes", consider farming together in a partnership or corporation, or in a joint venture or spin-off arrangement.

Overview of remaining sections of this chapter

The remainder of this chapter helps answer the key business/financial and people-related questions for one's specific situation. Three worksheets located at the end of the chapter aid this process and should help families decide whether to farm together or not.

This decision process begins by first assessing one's business and financial situation and then the "people" situation. There are several reasons for this ordering:

- It is assumed that if the potential partners are in the process of exploring whether they should try to farm together: (1) the younger party is at least somewhat committed to farming, and (2) the potential partners get along reasonably well together **as individuals**.

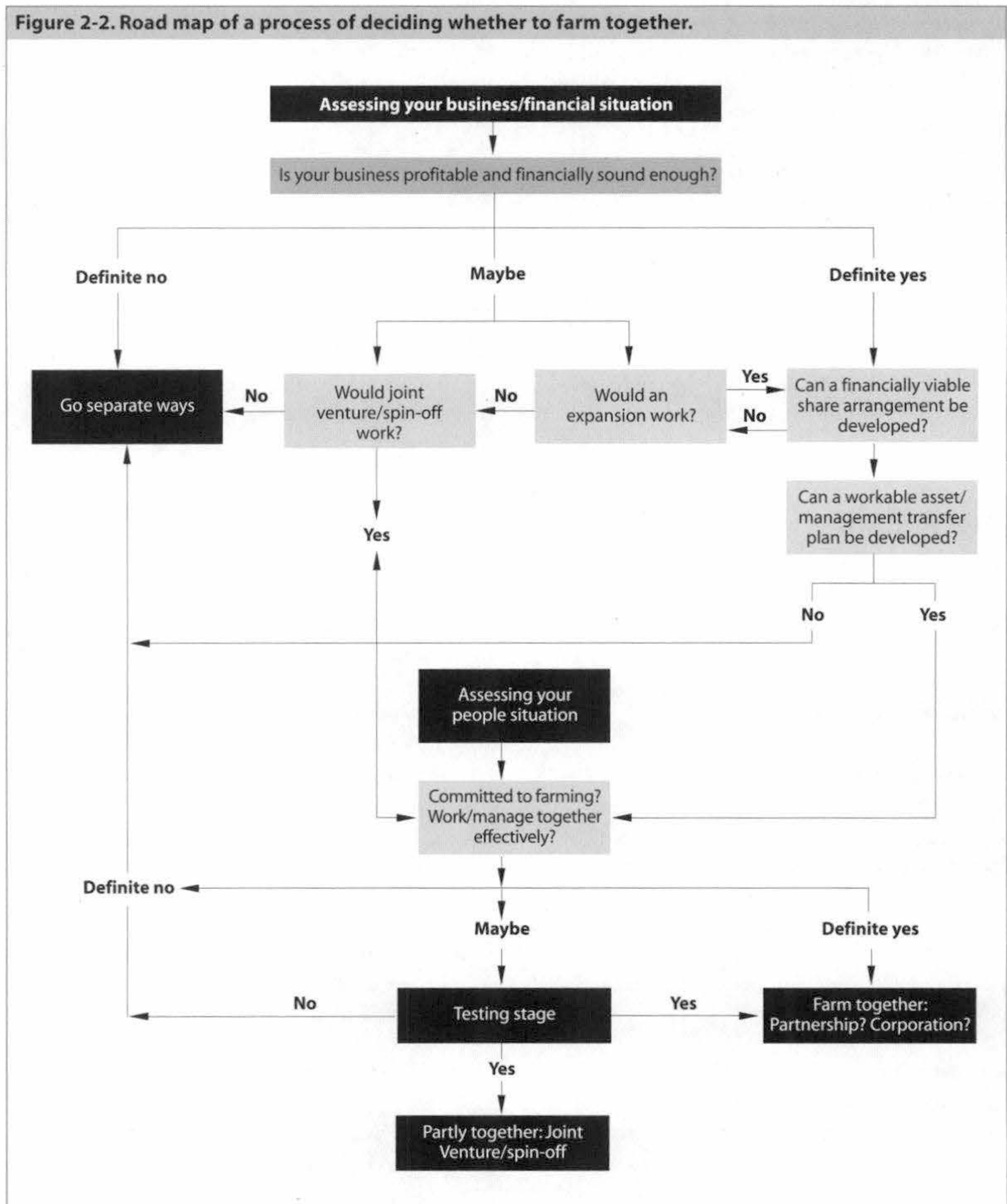
- Assessing one's business and financial situation is a factual endeavor. If the business isn't adequate, then there is no need to assess one's people situation on paper or in a testing stage.

- Finally, one can learn a lot about the people involved and their likely compatibility while answering the various business and financial questions involved.

There isn't anything to prevent one from analyzing their "people situation" first. But, regardless of how one makes this analysis, it is essential that considerable time and money be spent to get the job done right. The consequences of not doing so may include:

- Jeopardizing the parents' business or retirement.
- Incurring excessive taxes and other costs.
- Delaying the careers of the younger generation.
- Damaging family relationships.

Figure 2-2. Road map of a process of deciding whether to farm together.



Assessing the business/financial situation

There are three interrelated questions to address when determining whether a business/financial situation provides an opportunity to farm together: (1) Is the business profitable and financially sound enough? (2) Can a financially viable share arrangement be developed? (3) Can a workable asset and management transfer plan be developed over time?

Worksheets 2-1, page 27, and 2-2, page 36, at the end of the chapter, help answer these questions. Instructions for completing the worksheets are provided.

Question #1. Is the present business profitable and financially sound enough?

No matter how well the parties get along, a joint farming arrangement will not likely succeed if business earnings are inadequate, or if the business is not financially sound. The business must be adequate to provide the parents (senior partners) with a desired level of living at present, as well as provide for their financial security in their retirement years. In addition, it should meet the junior partner's living needs, as well as permit adequate debt servicing and growth in his/her business equity. Often some financial subsidies from the parents are required to accomplish this latter goal, which can place additional stress on the parents' financial position.

To answer this question of financial ability, complete Sections I through III of Worksheet 2-1 on pages 27-34. This process includes describing the present family situation; recording the general size of the present business and its potential for further expansion; estimating and evaluating the profitability of the present business; and documenting and evaluating the financial soundness of the business.

Next, assess business profitability and financial soundness and reach some conclusions.

Assessing the business' earning capacity

Section III of Worksheet 2-1 allows for a "windshield appraisal" of business profitability. If there is any question about the adequacy of farm earnings, make a more detailed analysis of the business as described in Chapters 2 and 3, Part I of this series.

Assessing financial soundness

Filling out Section IIIB of Worksheet 2-1, helps determine if the business is in a strong, financially solvent position. Are debts being serviced in a timely fashion? Refer to Chapter 2, Part I of this series to complement this assessment. Also, review balance sheets for prior years to determine net worth and various financial ratios over time.

An important related question is whether the senior partner is in a position to "subsidize" the junior partner's entrance into farming. Usually, some financial "subsidies" must be provided by the parents in order for a farming heir to gain a foothold in farming and eventually be in a position to control the business. These subsidies may take the form of "breaks" on the sale of property to the farming heir or actual gifts of property. They may also take the form of "breaks" on annual charges for the use of machinery and land. The larger the business is and/or the shorter the time until the parents' retirement, the larger these subsidies will have to be, if the farming heir is to gain control of the business. **Special Note: Gaining control of larger farm businesses may not be possible in the lifetime of a junior partner. This raises a whole set of new issues to be addressed relative to capital structure and business organization.**

Conclusions: Where to from here?

Having completed Sections I-III of Worksheet 2-1, one has now reached an important decision point in Figure 2-2: is the business profitable and financially sound enough?

- If the answer is a definite "no," then explore other entry options such as being employed on a larger farm, going into partnership with an unrelated party, or developing one's own business.
- If the answer is "maybe," consider a business expansion, joint venture or a spin-off

arrangement. More on these options later in this chapter.

- If the answer a is definite "yes," determine whether a workable share arrangement and transfer plan can be developed. See the right-center portion of Figure 2-2.

Question #2. Can a financially viable income share arrangement be developed?

Answering this question involves the process provided in Section IV of Worksheet 2-1: (1) project the expected net cash income from the partnership; (2) determine how partnership net cash income will be shared and how resources are to be contributed; and (3) determine whether each partner can meet his/her respective financial commitments.

Instructions for completing these steps accompany the worksheet. A similar analysis should be made in the corporate setting or a situation involving a combination of business arrangements. With answers to these questions in hand, another crossroad appears.

- If a financially viable share arrangement can be developed, then proceed to determine whether a longer-term asset and management transfer plan can be developed and whether the people situation is a "go."
- If the senior partner's financial situation is a "go," but the junior partner's is not, then consider: (1) adjusting the share arrangement and/or (2) the junior partner supplementing farm income with off-farm income.
- If the present sharing plan is not workable for either party, then explore other possibilities. This might include a business expansion, a spin-off or joint venture arrangement, or going separate ways.

More on these options later in this segment.

Question #3. Can a workable longer term transfer plan be developed?

If a financially viable share arrangement can be developed for the early years, the next question is important, yet difficult to answer: will the junior partner be provided the opportunity to gain sufficient control of the business over time and be in a position to manage it effectively? (See Section V, Worksheet 2-1 for a series of questions to address.)

Some key aspects need to be faced in regards to a longer-term transfer process:

1. Is the senior partner(s) willing to share management responsibility, and is there likely to be sufficient time to effectively transfer this responsibility before the senior partner retires?
2. Will the junior partner be given the opportunity to invest in the business—"get a piece of the action" —and receive a fair share of the profits? (See the above discussion of the business/financial plan).
3. After a reasonable period of time, will the senior partner be willing and/or able to shift major pieces of property to the junior partner(s)?
4. Will estate plans and insurance programs be put in place to reflect the senior partner's desire to get the junior partner(s) established in farming and to eventually control the business?
5. Can this transfer process be done so that the junior partner(s) can eventually gain control of the business, while protecting the senior partner's financial security, *and maintaining good relations with other heirs?*

Because of the critical importance of transferring assets and management, the next chapter focuses on the need for a staged progression of asset and management transfer over the early, transition, and parents' pre-retirement years.

Conclusions: Where to from here?

Return to the original questions: can a workable financial sharing and transfer plan be developed for the situation? The previous analysis should lead to one of two conclusions:

1. Yes, a workable financial sharing and asset/ management transfer plan has been/can be developed.

   If this is the case, there is still a major area to evaluate, namely, the "people" situation. This topic is discussed in the next segment of this chapter.

2. No, a workable financial share arrangement or longer-term asset and management transfer plan does not appear to be feasible.

If this is the situation, then consider other options such as: (1) making a business expansion; (2) farming together in a joint venture or spin-off arrangement; or (3) going separate ways. These first two options will be discussed briefly.

Would a business expansion be feasible? desirable?

If the present business is not profitable enough to meet income needs, then consider a business expansion. Before going this route, the prospective partners must first determine whether a business expansion would meet the income needs of both families. Such a move should be analyzed carefully using the analysis procedure discussed in Part I of this series.

Two other aspects must also be assessed carefully before deciding to expand the business:

1. The senior partner should feel comfortable with the decision, making sure the financial position is adequate to take on this added risk, and that such a move would not unduly jeopardize the financial security of pending retirement years. For example, a major investment in livestock facilities, can cause a major decline in the senior partner's liquidity and equity positions. A $500,000 investment may result in a 30%-40% drop in ones equity or net worth position due to the "lost capital" effect. If a lender then permits them to borrow only 65% of the remaining $300,000-$350,000, it would cause a major liquidity crunch as the senior partner would have to cover the difference between the original investment cost and the loan amount.

2. The people side of the business must have been well tested in terms of the desire of both parties to farm together, and that they can live, work and manage together effectively on a continuing basis. There should be no doubt as to the junior partner's commitment to farming. If he/she is not married, do not rush into such an important business change. That "fourth" partner could jeopardize the whole deal.

Would a joint venture or spin-off be preferable?

Two other options that allow parent/child farming, at least in part, are the joint venture and spin-off arrangements.

Evaluating a joint venture

With this entry route, the parties involved explore the possibility of developing a joint arrangement involving one or more enterprises while maintaining or developing other enterprises on an individual or separate farm basis. Such a joint arrangement might involve a livestock enterprise such as dairy.

Determine whether a fair sharing arrangement could be developed and whether the parties involved can develop sufficient income via this arrangement or via having other separate farm enterprises that would complement the joint arrangement. Use Section VII of Worksheet 2-1 on page 33 to analyze a joint venture. Such an approach would tend to reduce the level of risk assumed by the senior partner. It may seem particularly attractive to parents who are rapidly approaching their retirement years.

Evaluating a spin-off arrangement

Taking this route, the junior partner would plan to eventually be farming on a separate farm unit. A joint arrangement with a senior partner may be used to begin the process. The junior partner

may rent a separate farm unit and exchange labor and machinery with the senior. The two parties may actually operate part of the business together, such as a joint livestock operation, but the spin-off is basically a situation in which the senior partner helps the junior partner build equity in personally owned machinery, livestock, and other business assets. Use Section VIII of Worksheet 2-1 on page 34 to analyze a spin-off arrangement.

Under this arrangement, the transfer of assets is not generally a big issue because each partner controls his/her own asset base—the senior for retirement, the junior for building equity. The longer-term future of the original farm business is often open to question. It may be dissolved/sold when the senior partner retires, or it may be taken over by the "spin-off" junior partner, or by another family member.

Getting established in farming via these latter two routes is discussed in Chapter 4.

Assessing the people situation: A testing stage

People and their relationships are critical to the success of any joint business arrangement, particularly when partners are in the same family. Therefore, carefully assess the people situation before deciding to farm together. Read this section even though past experiences may indicate a positive people situation.

There are two key questions to address when evaluating a people situation: (1) is the potential junior partner (and spouse) committed to farming? and (2) can the potential partners work and manage well together? See the bottom half of Figure 2-2 on page 16.

Making a general assessment of the people situation

First make a "windshield" assessment of the present people situation, focusing on the two main questions noted above.

Is the potential junior partner (and spouse) committed to farming?

Is the answer to this question a definite yes? Or is it more like "I'll give it a try"? If married, does the spouse really like farm life? If the junior partner is not married, exercise caution and don't get involved in a detailed arrangement since all the business partners are not yet known. There is always a chance a new spouse would not really like farm life. To get a better sense of the people situation, fill in Sections I and II of Worksheet 2-3 on page 40.

If there is some doubt regarding the junior partner's commitment to farming, avoid getting into a partnership or corporation at the present time. Likewise, parents should delay any major business changes. A testing stage, where the parties operate under an employer/employee arrangement, is highly recommended. (See the discussion of the testing stage later in this segment).

Can the potential partners live, work, and manage together?

The same kind of analytical reasoning used in buying a farm or major piece of equipment should go into selecting a partner. Often good partners are people who complement each other, rather than being too alike. A mutual respect must be present between successful partners. It is important that partners relate well to each other, both in a personal and business sense.

From a *personal relationship* standpoint, all parties need to be tolerant, understanding, and have the ability to overlook each other's faults. Many partnerships break up because of disagreements over trivial things rather than over major issues. No type of business arrangement will work if the partners and families can't work together in a spirit of harmony and cooperation. The partners must also have the ability to compromise. Senior partners are often conservative, having spent many years putting the business together. Junior partners tend to be more venturesome, particularly when operating on someone else's capital. Finally, the spouses must be kept informed and be

interested in the business. Problems can arise with regard to housing, spendable income, time commitments, and respective partner's lifestyles. Spouses need to be involved in discussions relating to these issues. A written agreement should indicate how these issues have been or will be resolved.

From a *business relationship* standpoint, all parties should be working towards similar objectives for the business to succeed. Where goals and values differ, take care to arrive at a reasonable compromise. Joint participation in managerial decisions is another "must" if a partnership is to succeed. The junior partner needs to be given an increasingly important role in management. This growth will not occur if the senior partner always "pulls rank" or persists in saying "I decided" rather than "we decided." When partners' capabilities complement each other, take advantage of the situation. It should also be conceded that each partner will make some mistakes.

A self-test for each party involved in a family farm partnership helps gauge the ability to live, work, and manage in a joint business arrangement. See Worksheet 2-3, pages 41 and 42.

Conclusions: general assessment of the people situation

If the response to the questions regarding the potential partner's commitment to farming and whether potential partners can get along:

- Is "no" or "very doubtful," then plan to go your separate ways.
- Is a "maybe," then definitely enter a testing stage to further evaluate the situation.
- Is a definite "yes," then options include: (1) entering a partnership or corporation if the business is adequate for two or more families; or (2) a joint venture or spin-off, if the business is inadequate to support more than one family or other factors warrant such a choice.

Taking a closer look: A testing stage and beyond

Most farm families can benefit from a testing stage. The main objectives are to: (1) determine whether the son or daughter really wants to farm, and (2) determine whether the parties can work well together. To organize a testing stage and determine its potential for success, complete Worksheet 2-4, Business arrangements for a testing stage, page 43.

Business arrangements for the testing stage

In the testing stage, the parties will actually farm together, but use relatively simple business arrangements. The junior partner usually contributes primarily labor and possibly some management. The arrangements to be considered include: (1) a wage agreement, (2) a wage-incentive plan, and (3) a wage plus income-share arrangement.

- **Wage agreement.** Many farm families find the easiest way to start a potential partner in the business is to pay wages. This plan may also include a year-end bonus and benefits provision. This is normally a good place to start the testing process. However, two notes of caution are in order. First, the wage rate should be reasonable. Second, this type of arrangement should be very temporary.

  Since the potential partner does not have a direct interest in the success of the business, he or she will tend to lose interest in farming if forced to work on a modest wage basis for an extended period of time. One approach is to pay the potential partner well in excess of a hired worker's wage. This should keep the potential partner motivated, test the financial adequacy of the business, and ensure that the senior partner will not prolong the arrangement unduly. By paying a higher wage, the senior partner will also have a better understanding of how well the junior partner will be able to meet the needs of their family and to save money to buy the senior's assets. It also determines if the financial profitability of the farm business is sufficient to support the families in the operation.

- **Wage-incentive plans.** Wage-incentive plans often are used to encourage a junior partner to take a more active interest and exercise additional responsibility in the farm business. For the junior partner, the compensation should be in addition to his or her basic wage,

not a substitute for a reasonable wage, agreeable working conditions, and adequate housing. It is important that an incentive plan results in increased income to the senior as well as the junior partner, therefore it is linked with quantifiable production factors. Worksheet 2-4 on pages 43 and 44 provides space and guidelines to develop a wage-incentive plan.

In a sound incentive program, the worker should be able to influence the size of payment received by the work performed. Also, payments should be sufficiently large and attainable to encourage extra effort. Develop a written agreement describing the purpose of the arrangement, the junior partner's responsibilities, method of calculating and making the incentive payment, and provision for arbitration, should disagreements arise.

- **Wage plus profit-share plans.** A wage- and profit-sharing plan is particularly well adapted as a beginning agreement when the junior partner is not sure of continuing in business on the home farm, or does not want to become too involved financially. From a legal standpoint, a wage plus profit-sharing *but not loss-sharing initial plan* establishes an employer/employee relationship rather than a partnership. The employee (the potential partner) and employer (the parents), thus would avoid some of the liability aspects associated with the general partnership arrangement.

  Under this plan the senior partner typically furnishes the farm and housing for the junior partner, all farm personal property, and his/her own labor and management. He/she also pays all farm expenses. The junior partner works on the farm full-time and receives a guaranteed monthly wage and share of annual net farm income. The wage rate should be comparable to current wages for similar services provided by hired workers in the area. Space is provided in Worksheet 2-4 on pages 45 and 46 for determining a fair wage plus profit-share arrangement.

- **Advantages/disadvantages of these arrangements.** Some of the advantages of wage-based business arrangements include: (1) determining if the junior partner really wants to farm and if the senior and junior partners can get along well when farming together; (2) giving the junior partner experience and "know-how" about farming; and (3) opportunity to start and stop the arrangement easily, as there is no jointly held property. Among the disadvantages: (1) the junior partner's major interest in the farm may be his/her monthly paycheck; (2) payment in wages does not encourage savings nor does the arrangement permit the potential partner to gain an equity in the business; and (3) such plans are often kept in force long after the junior partner is ready to become a full-fledged member of the business.

The testing stage and beyond; selecting an entry option

The length of the testing period depends on the family's situation, objectives, and progress toward deciding which entry option to select. Two to three years normally should suffice for the testing period. Delaying a decision beyond this time should be viewed critically, particularly if the parties still are involved in a simple wage arrangement. Remember, the purpose of a testing period is to determine whether a junior partner really wants to farm and whether the parties can work together effectively. Once these issues have been resolved, be prepared to move out of the testing stage.

Eventually, another decision point arises: farm together, farm separately, or reach a compromise position such as the joint venture or spin-off. **Completely separate** is usually the desirable choice if: (1) the parties are unable to work together effectively; (2) the existing business is too small and it is impossible to establish a viable second business nearby; and/or (3) the junior partner has found a better business or employment opportunity elsewhere.

The more difficult choice is between the **spin-off situation** and the **multi-person operation.** Actually, the spin-off alternative might be chosen even if the business/financial and people situations are very positive relative to farming together in a multi-person operation. The following is a brief discussion of the pros and cons of these two alternative approaches to farming together.

- **Farming together but separately—advantages of a spin-off approach.** Operating successfully over time under any type of multi-person arrangement, such as a partnership, is a difficult task. As one person put it, "There probably isn't an easier way of turning good friends into enemies." The sage advice of one experienced farm management agent is: "If there is any other way you can operate a farm business, do it!" Often a viable alternative is that of "farming together but separately" or the "spin-off" option. Here, a junior partner might rent a separate farming unit nearby. Machinery might be owned jointly with the senior partner or owned separately and used jointly. Normally they would exchange work, and possibly operate a livestock operation separately.

  The key to this arrangement is often the junior partner's ability to develop a business profitable enough to provide an adequate standard of living and net worth improvement. Of course, if the senior partner's unit is quite large and can be subdivided, this problem is alleviated. The author knows of parents who have bought separate farm units for their children so that the children could establish their own operations.

  One of the key reasons for farming together today is to make efficient use of modern machinery. The spin-off alternative often provides this opportunity about as well as most multi-person operations. It often involves the exchange of the junior partner's labor for the senior partner's machinery. In addition, it provides several people-oriented advantages over the multi-person arrangement:

  - Fewer goal conflicts—the junior partner can expand his/her own unit; the parents can slow down with theirs.

  - Fewer joint decisions—each operator makes his/her own production and marketing decisions.

  - They can share management knowhow, but each is individually responsible for their decisions and the resultant successes and failures.

  - Each can preserve an independent nature and have pride in ownership.

  - They can avoid jeopardizing the parents' financial security if the parents' farm is not large enough.

  - It is easier for lenders to evaluate a beginning farmer's management ability. This may well be the key advantage of this option.

- **Farming together: Advantages of the multi-owner/multi-person approach.** The multi-person approach is a viable alternative any time there is a large business and the parties involved can get along well together. This approach often becomes a necessity where there is a large farm unit with specialized facilities, such as a dairy or hog operation. Such a unit would be difficult or impossible to subdivide. Likewise, it is often difficult for a junior partner to establish such a unit nearby.

  From the junior partner's standpoint, he/she would be starting in a viable business with probably less risk and more income in the early going. The junior partner would also have ready access to the advice of an experienced manager, plus he/she would have a chance to grow into the business without incurring excessive debt. In addition, the senior partner would be less confined by farm duties. The senior partner would probably be more comfortable and not feel as bound to the business. The senior partner can let up gradually, have built-in management to protect his/her investment and income in his/her later years, and have management assistance for a surviving spouse. Such an arrangement also provides opportunity to develop a management team approach, which permits each partner to specialize in what he/she does best.

- **Deciding on an entry option.** With the preceding discussion as a back drop, choose an entry option.

- Farming together in a relatively fully integrated way? Then go to Chapter 3, which focuses on getting the junior partner established in farming via the multi-owner/operator route.
- A joint venture, spin-off or split-off option seems best? Then proceed to Chapter 4, which focuses on establishing one's own farm business.

Gaining entry via a large/super-firm business situation—a brief look

To consider gaining entrance into farming via a large super-firm—a business grossing $1,000,000 or more—fosters an entirely different set of issues or approaches. For example, it will be extremely difficult, if not impossible, for a farming heir to gain sole control of such a business during the parents' or even the heir's farming lifetime. Primary reliance would likely be on the use of the corporate structure in doing business, with outside funding provided by the other heirs, use of debt securities and/or even shares of stock. The business will likely take on a life of its own, continuing as long as someone is willing to invest in it and someone is willing and able to manage it effectively.

This book does not discuss this entry option as each super-firm is unique, and decisions require the counsel of seasoned advisors, (e.g. a tax consultant, an attorney and a financial advisor). However, the reader is encouraged to read the next chapter plus the discussion of the corporate form of business organization found in Chapter 7, Part II of this series. Then put together an advisory team to determine how best to get established in farming via such a business situation.

Instructions for Worksheet 2-1, pages 27-34. Assessing the business/financial situation

This worksheet is designed to help assess one's business/financial situation and to decide whether to farm with someone else or not.

Section I. Describe the present family situation. List all members of the family, their ages, education, marital status and present employment. Also, make note of any special needs of family members. Note who has an interest in farming and the home farm.

Section II. Indicate the size and organization of the present business, as well as its potential for further expansion.

Section III. Determine whether the business is profitable and financially sound enough, page 28. Make a rough estimate of the earning capacity of the present business. If there appears to be any question as to the adequacy of earnings for two or more families, make a more detailed analysis as described in Chapters 2 and 3, Part I of this series.

IIIB. Summarize the current financial position of the senior partner and the potential junior partner(s). To make a more detailed listing of assets and liabilities, use the forms provided in Worksheet 2-2, pages 36-39. Also, review balance sheets for prior years to determine the trend in net worth and financial ratios. Refer to the discussion in Chapter 2, Part I of this series when assessing the financial soundness of the situation.

Section IV. Determine whether a financially viable profit share arrangement can be developed. This involves a four stage process:

Stage one. Project the expected net cash income available from the partnership.

Project the longer-term net cash earnings of the proposed partnership, page 30. Don't project the best year or worst year, but what can be reasonably expected to happen to production, prices and expenses for the next three to five years. Use past years' tax information from form Schedule F, and other business records as a starting point. Make adjustments for planned changes in operation as well as expected changes in production levels, prices, and costs. For a more complete analysis of the financial situation, refer to Chapters 2 and 3, Part I of this series.

Be sure to exclude any income that is not going to be considered as partnership income. Likewise, decisions must be made as to whether certain expense items, such as repairs and insurance, will be paid by the partnership. If the partnership is to incur a debt, subtract annual principal and interest payments as well. If the partnership is to be responsible for machinery replacement subtract an annual machinery replacement allowance, also. Of course, all of this depends upon how assets are contributed and the type of income share arrangement selected. Some adjustments in partnership income and expenses after completing the next stage, may be needed.

Stage two. Determine how net cash income will be shared; how assets are to be contributed

Determine how the net cash income available from the partnership (Section IV, Step 1, line 7) is to be shared, top of page 31. Generally, it is recommended that in the early years of a partnership, the net cash income be shared in the same proportion as the annual use value of real estate, machinery and labor and management are contributed by the partners (see Section IV, Step 2, lines 2-7).

To do this, first complete Worksheet 2-2, Inventory of Owned Assets and Liabilities of Partners and Partnership (pages 36-39). Then, insert the use value of crop and livestock, machinery and equipment at Section IV, Step 2, lines 3 and 4. A use charge–depreciation and interest–of 10%-15% is typical. A value must also be placed on the labor and management contributed by the partners (Step 2). Also insert the annual use charge for real estate from page 39 of Worksheet 2-2.

Add the total use value of these contributions at Step 2, line 7. Then divide the total contributions for each partner by the amount in the total column to arrive at each partner's percentage share of contributions percentages at line 8. Multiply the net cash income available (line 1) by the percentage for each partner (line 8) to determine the amount of partnership net cash income each partner will have available to meet their individual financial commitments (line 9).

Stage three. Determine whether each partner can meet their financial commitment.

After deciding how partnership net cash income is to be shared, determine whether each partner can meet their respective financial commitments, Section IV, Step 3. Typically, each partner would receive an earnings draw of this amount, which is then to be used to meet family living expenses, debt payments, and for possible savings or investments.

It is also recommended that the junior partner be permitted to buy into the feed supply and livestock in these same percentages. Therefore, at line 12, there may be principal and interest income for the senior partner coming from the junior partner to pay for these items. At Step 3, line 17, the junior partner should show a like amount as an expense to cover the purchase of feed and livestock.

Stage four. Identify and record any shifts in property ownership.

After deciding to go into partnership together, the next step is to reflect the asset ownership and liabilities for the partners and the partnership in the space provided on the right hand side of Worksheet 2-2.

Section V. Address asset and management transfer plans with the questions provided.

Section VI. Finally, what are the conclusions regarding the business and financial situation? Is it a "go" or are there some important questions to be answered or issues to be settled?

Section VII. and VIII. If, for financial reasons, it appears that the present business situation is not adequate for two of more families, look at other options. Sections VII and VIII provide procedures for assessing and/or developing a joint venture or spin-off arrangement.

Worksheet 2-1. Assessing the business/financial situation.

I. General description of the present family situation.

1. Father's Name ______________________ Age ________

Years to retirement ____________ Health ______________________

2. Mother's Name ______________________ Age ________

Years to retirement ____________ Health ______________________

3. Children

Name	Age	Education	Marital status	Present/future employment

4. Special needs of any family members.

____

____

____

5. If any of the other heirs want to farm, when might they start? Would they be brought into the present business?

____

____

____

II. General description of the present business situation.

Acres operated	Owned	Rented
Total		
Tillable		
Avail. of more land ...		

Livestock program		
Kind	No.	Efficiency

Machinery/capacity

Full line ..... yes________ no________

Custom work hired ______________

Custom work done ______________

____

Additional acres that could be operated with present machinery: ____________acres

Facilities: condition/capacity

____

____

____

____

____

____

____

Labor supply

Number of full-time family ______________

Number of full-time hired ______________

Hours of seasonal labor ______________

Housing situation

____

____

____

Worksheet 2-1 (continued). Assessing the business/financial situation.

III. Is the business profitable/financially sound enough?

A. Is the business profitable enough for two or more families?

1. Will it produce income sufficient to provide financial security for the senior partner and opportunity for the junior partner?

- Making a rough estimate (from schedule F; average the past 2-3 years).

Item	Amount	Line
Average gross income	______	1
Operating expenses (excluding depreciation)	______	2
Net cash farm income (1-2)	______	3
Net non-farm income	______	4
Cash available for debt servicing, living, replacement (3+4)	______	5
Family living and income taxes	______	6
Real estate principal payment	______	7
Cash available for non RE & replacement (5-6-7)	______	8
Annual non RE payment	______	9
Annual machinery replacement	______	10
Surplus/deficit (8-(9+10))	______	11

- To make a more detailed analysis, refer to Chapters 2 and 3, Part I of this series.

2. If the income is not sufficient, how might it be supplemented?

______
______
______
______

3. What future does the senior partner envision for the farm business and what is he/she willing to do to make it happen?

______
______
______
______

Worksheet 2-1 (continued). Assessing the business/financial situation.

B. Is the present business financially sound enough?

1. Present financial position of senior and junior partners.

Balance Sheet Summary			
Item	**Senior**	**Junior**	
Assets			
Current assets, farm	_____	_____	1
Intermediate assets, farm	_____	_____	2
Long-term assets, farm	_____	_____	3
Subtotal farm assets (1+2+3)	_____	_____	4
Non-farm assets	_____	_____	5
Total Assets (4+5)	_____	_____	6
Liabilities			
Current debt, farm	_____	_____	7
Intermediate debt, farm	_____	_____	8
Long-term debt, farm	_____	_____	9
Subtotal farm debt (7+8+9)	_____	_____	10
Non-farm debt	_____	_____	11
Total liabilities (10+11)	_____	_____	12
Farm net worth (4-10)	_____	_____	13
Total net worth (6-12)	_____	_____	14
Debt/Asset Ratios			
Current ratio, farm (7÷1)	_____	_____	15
Current/intermediate ratio, farm (7+8) ÷ (1+2)	_____	_____	16
Long-term ratio, farm (9÷3)	_____	_____	17
Total Ratio (12÷6)	_____	_____	18

2. Are debts being serviced in a timely fashion?

____

____

____

3. Is the senior partner in a position to subsidize the junior partner's entry into farming?

____

____

____

Worksheet 2-1 (continued). Assessing the business/financial situation.

IV. Can a financially viable profit share arrangement be developed?

Step #1. Determine the expected net cash income available from the partnership.

(Projected annual partnership net cash income over next 3-5 years)

Partnership cash farm income		
Livestock sales		
____________	______	
____________	______	
Crop sales		
____________	______	
____________	______	
Machine work done	______	
Patronage dividends	______	
Agricultural program payments	______	
Gas tax credits/refunds	______	
____________	______	
____________	______	
Total partnership cash farm income	______	1
Partnership cash operating expenses owed non-partners		
Labor hired	______	
Repairs, maintenance	______	
Rent on farm, pasture (non-partners)	______	
Feed purchased	______	
Seeds, plants purchased	______	
Fertilizer, lime, chemicals	______	
Machine hire, storage	______	
Supplies purchased	______	
Breeding fees	______	
Veterinary fees, medicine	______	
Gas, fuel, oil	______	
Insurance	______	
Utilities	______	
Freight, trucking	______	
Livestock purchases	______	
____________	______	
____________	______	
Total partnership cash operating expenses	______	2
Interest on operating expense	______	3
Principal & interest payments on partnership debt	______	4
Added machinery replacement allowance, if any	______	5
Total partnership outlays owed non-partners (2+3+4+5)	______	6
Net cash income available from partnership (1-6)	______	7

Worksheet 2-1 (continued). Assessing the business/financial situation.

Step #2. Determine each partner's share of partnership net cash income using the contributions approach.

[Partners share partnership net cash income (line 1) in the same proportion as the value of fixed contributions made by each partner (line 8)]

	Total	Partner	Partner	Partner	
Net cash income available (line 7, page 30)	$				1
Use value of fixed contributions of partners: Rental value of real estate	$	$	$	$	2
Use value of crop machinery					3
Use value of livestock equipment					4
Value labor and management					5
					6
Total value of fixed contributions (2+3+4+5+6)	$	$	$	$	7
Partner's share of total fixed contributions, Line 7	100%	%	%	%	8
Partner's share of net cash income (line 1 x 8)		$	$	$	9

Step #3. Determine each partner's ability to meet their own financial commitments.

	Partner	Partner	Partner	
Income				
Partner's share of net cash income (line 9)				10
Other net business and non-farm income				11
Principal & interest received from partner's and others				12
Partner's total net cash income available (10+11+12)				13
Outlays				
Real estate p & i payments				14
Real estate taxes				15
Insurance, if any				16
Non-real estate p & i payments				17
Additional machinery replacement allowance				18
Family spending & income tax				19
				20
Total cash outlays of partners (add 14 thru 20)				21
Balance: cash surplus (deficit) (13-21)				22

Worksheet 2-1 (continued). Assessing the business/financial situation.

V. Can a workable, longer-term asset and management transfer plan be developed?

1. Is senior partner willing to shift managerial responsibility over time? Yes ________ No ________

If yes, describe how it might happen ____

____

2. Will junior partner be able to handle the total managerial responsibility upon the senior partner's retirement?

____

3. Will junior partner be given the opportunity to invest in the business and receive a fair share of profits? ____

____

4. Is senior partner able/willing to shift property ownership over time? Yes ________ No ________

	Able	Willing
Personal property		
Sell portion while farming together?	________	________
Sell/lease balance to junior partner upon retirement?	________	________
Help finance sale?	________	________
Real estate		
Give junior partner favorable buy/sell options?	________	________
Sell portion while farming together?	________	________
Sell whole or portion of farm upon retirement?	________	________
Sell whole or portion of farm while living?	________	________
Help finance sale? Gifts?	________	________

5. What about other heirs?

a. How equitably have they been treated to date? ____

____

b. What is heirs' attitude toward junior partner's gaining ownership in the business?

____

____

c. Would they be willing to leave a portion of their inheritance in the business for a period of years in order to keep the farm business intact? ____

____

VI. General conclusions.

1. Is the business and financial situation a go? Yes ________ No ________

2. If not, what are some possible trouble spots that need further investigation?

____

____

Worksheet 2-1 (continued). Assessing the business/financial situation.

VII. Would a joint venture arrangement work?

General description	Example: Total	Example: John (name)	Example: Ben (name)	Actual: Total	Actual: (name)	Actual: (name)	
	72 dairy cows; 17,000# milk desired share – 75%/25%						
Desired share[a]		75%	25%		%	%	
Expected income							
Milk	$131,580						
Culls	17,160						
Total income[b]	$148,740	$111,555	$ 37,185				1
Value of contributions							
Land/rent	0	0	0				
Machinery & equipment	$ 4,320	$ 4,320	$ 0				
Home raised feed	50,400	50,400					
Buildings & equipment	10,800	10,800					
Labor and management	18,000	4,000	14,000				
Subtotal[a]	$ 83,520	$ 69,520	$ 14,000				2
Operating expenses							
Crop, if any	0	0	0				
Livestock, if any	32,400	24,300	8,100				
Total value contributions	$115,920	$ 93,820	$ 22,100				3
Value of contribution if shared on desired % basis	$115,920	$ 86,940	$ 28,980				4
Contribution adjust[a] (4-3)	0	-6,880	6,880				5
Total value adjusted contribution (4+5)	115,920	80,060	35,860				6
Sharing of net profits (1-6)	32,820	31,495	1,325				7
Total net profit + contributions (6+7)	$148,740	$111,555	$ 37,185				8

[a] If a desired share has not been chosen, calculate share by dividing each partner's non-operating contribution (line 2) by the total of these contributions. This should help quantify a desired share. (In the example, the calculated share is 83% to John and 17% to Ben. However, they had decided on a desired share of 75%/25%, thus the contribution adjustment at line 5).

[b] Total income and operating expenses are normally shared in the same percentage as the desired share. Breeding livestock should also be owned in that percentage.

Worksheet 2-1 (concluded). Assessing the business/financial situation.

VIII. Would a spin-off arrangement work?

This type of arrangement often involves some type of "trade-off" of machinery, facilities and labor—usually among family members. Describe the arrangement; then calculate the relative value of the contributions between the parties involved. Make compensation as needed.

Description of arrangement

____

____

____

____

Value of trade-offs

A. Net Machinery contributions

Machine/operation	Junior partner's (JP) machinery used on senior partner's (SP) land			SP's machinery used on JP's land		
	Cost/ Acres	Unit[1]	Cost	Cost/ Acres	Unit[1]	Cost
Total[a]			$			$

Adjustments:			
gas & oil supplied by SP	______	supplied by JP	______
labor supplied by SP	______	supplied by JP	______
Net machinery contribution	$ ______ **A**		$ ______ **A**

B. Other contributions by JP to SP's operation:

Other labor .... ______

______ ...... ______

______ ...... ______

______ **B**

C. Value of JP's contribution to SP's operation (A+B) .... $ ______ **C**

D. Other contributions by SP to JP operation:

Fringe benefits (housing, insurance, etc.) .... ______

JP's use of grain storage or livestock buildings .... ______

______ ...... ______

______ ...... ______

______ **D**

E. Value of SP contribution to JP's operation (A+D) .... $ ______ **E**

Compensation for excess contributions to SP/JP (C versus E) .... $ ______ **F**

[a] Use machine custom rates that include gas and oil and labor. Make adjustments for these items as needed in space provided.

Instructions for Worksheet 2-2, pages 36-39. Inventory of owned assets and liabilities of partners/partnership

This worksheet helps potential partners make an inventory of owned assets and associated liabilities of the partners and partnership. Space is also provided to determine the annual use or value lease cost of the assets involved. It requires that two inventories be taken: one describing the asset ownership pattern *before* the partnership is formed and one indicating the ownership pattern at the start or formation of the partnership. This will clearly indicate any shifts in ownership and values that occurred at the time the partnership was formed.

To use this form most effectively, complete the following steps:

Sections I-V. Inventory all cash and personal property presently owned by each of the existing or potential partners and any liabilities or debt associated with these properties, shaded column on pages 36 to 38.

Include only that supplied out of each partner's equity, not borrowed funds. Value *feed, supplies, and market livestock* inventories on a current market basis, less marketing charges. Assign relatively conservative and consistent market valuations to *breeding livestock and machinery*. Usually partners can agree on these values. However, to avoid disagreements and possible future problems with relatives or creditors, securing an outside appraisal is often desirable. Frequently there are local people who will value breeding livestock. With machinery, consider a local implement dealer. Also, indicate the year of purchase and the depreciated value of each machine. This will be useful in deciding which machines might be transferred between partners later on.

Section VI. List the liabilities or debt against these non-real estate items before the partnership is formed (shaded area). Also indicate the annual payments due and who the debt is owed to. There is likely to be some debt incurred by the junior partner when buying feed, breeding stock, and other items from the senior partner.

Section VII. Inventory real estate owned; estimate rental value.

List the real estate owned, by individual parcels, Subsection A. These properties are usually all owned by the senior partner, though on occasion a junior partner may own a parcel. Make an estimate of the value of the land portion and the buildings and facilities for each property. Also, indicate the amount of debt owed on each property, the annual payment due, and who it is owed to.

Estimate the rental value of each property, Subsection B. This would include cash rent on cropland and pasture, and the lease value of buildings and facilities, if any. These amounts will be used to determine the annual use value of the senior partner's contribution of real estate in determining how profits are to be shared, using the contribution approach. Check the reasonableness of these use charges by dividing the rental or contributed value (line 5) by the total value of the property (line 4).

Fill in the annual use value of these fixed contributions on Worksheet 2-1, lines 2-6. Complete the analysis of the proposed partnership plan(s). After choosing the desired arrangement, fill in the right-hand portion of Worksheet 2-2 indicating the actual ownership pattern at the start of the partnership.

Attach this detailed inventory to the written agreement as a record of the ownership pattern at the start of the partnership.

Worksheet 2-2. Inventory of owned assets and liabilities of partners/partnership.

	Amount or number	Price per unit	Ownership pattern before partnership			Ownership pattern at start of partnership			
			(name)	(name)	(name)	Partnership	(name)	(name)	(name)
I. Cash contributed to business			$	$	$	$	$	$	$
II. Crops and supplies									
			$	$	$	$	$	$	$
Supplies									
Total feed and supplies	XXXX	XXXX	$	$	$	$	$	$	$
III. Livestock									
Livestock held for sale									
			$	$	$	$	$	$	$
Subtotal	XXXX	XXXX	$	$	$	$	$	$	$
Total Livestock			$	$	$	$	$	$	$
IV. Power and machinery									
Vehicles and trucks	**Deprec. value**	**Year purch.**	$	$	$	$	$	$	$

	Deprec. value	Year purch.	Ownership pattern before partnership			Ownership pattern at start of partnership			
			(name)	(name)	(name)	Partnership	(name)	(name)	(name)
Power equipment									
			$	$	$	$	$	$	$
Planting and Tillage									
Harvest equipment									
Crop drying and storage									
Miscellaneous									
Total power machinery			$	$	$	$	$	$	$

Worksheet 2-2 (continued). Inventory of owned assets and liabilities of partners/partnership.

	Deprec. value	Year purch.	Ownership pattern before partnership			Ownership pattern at start of partnership				
			(name)	(name)	(name)	Partnership	(name)	(name)	(name)	
V. Livestock equipment and misc.										
Livestock equipment										
			$	$	$	$	$	$	$	
Materials handling and misc.										
Total livestock equip. and misc.	$	$	$	$	$	$	$	$	$	4
Total cash and personal property (lines 1 + 2 + 3 + 4)	$	$	$	$	$	$	$	$	$	5
VI. Liabilities–non-real estate										
Operating debt			$	$	$	$	$	$	$	
Total operating debt			$	$	$	$	$	$	$	6
intermediate debt										
Total intermediate debt			$	$	$	$	$	$	$	7
Total intermediate an pay			$	$	$	$	$	$	$	8
Total non-real estate debt (6 + 7)			$	$	$	$	$	$	$	9
Total annual pay (6 + 8)			$	$	$	$	$	$	$	10

Worksheet 2-2 (concluded). Inventory of owned assets and liabilities of partners/partnership.

VII.	Property 1	Property 2	Property 3	Property 4	
A. Farm land and buildings					
Name of owner					
Location of property					
Total acres in property	acres				1
Value of land portion only	$	$	$	$	2
Added value of buildings, if any	$	$	$	$	3
Total value of property (2 + 3)	$	$	$	$	4
Total debt on property	$	$	$	$	
Annual debt pay on property	$	$	$	$	
Debt owed to whom					
B. Rental/contributed value of property					
Cropland	acres				
Rent/acre	$	$	$	$	
Total rent	$	$	$	$	
Pasture rent	$	$	$	$	
Rental value of buildings/facilities	$	$	$	$	
Total rental/contributed value	$	$	$	$	5
Return on investment check (line 5 ÷ 4)	%	%	%	%	6

Worksheet 2-3. Assessing/testing the people situation.

I. Make a general assessment of the people situation.

A. Is the potential junior partner (and spouse) really committed to farming?

1. Does JP *really* want to farm? Why?

____

____

2. Is JP presently married? ____________ Expect to be soon? ____________

3. Does JP want to farm with SP for an extended period, or just to get started? ____________

____

4. What would JP/SP like to see happen to the farm business and what would JP/SP be willing to do to make it happen?

____

____

B. Can family members live, work and manage together effectively?

1. Have the potential partners worked and managed together before? If yes, describe situation and evaluate.

____

____

2. Self test: Would you be a good partner? (Use pages 41 and 42 of this worksheet for family members to rate themselves.)

C. General conclusions regarding the people situation. ____________

____

____

II. Take a closer look at the people situation: a testing stage. (See Worksheet 2-4 for details.)

A. Business arrangement options

- Option 1 - A wage arrangement, Section I.
- Option 2 - A wage-incentive arrangement, Section II and IIA.
- Option 3 - A wage plus profit-share arrangement, Section III.

B. Conclusions regarding the people situation: where to from here?

____

____

____

____

____

____

Rating Scale	
If your answer to the question is:	Give yourself these points:
A firm "yes"	10
Yes	9
Yes, but barely	8
Maybe, with "conditions"	7
Could live with it	6
Possibly	5
Very difficult	4
Isn't likely	3
Highly improbable	2
A firm "no"	1

Self Test...

Would you be a good partner?

Partnerships more often deteriorate over human relationships than over business arrangements. Use the rating scale at the right for responses.

After answering questions turn to page 42 to see how you rate. (Note: Although these questions reflect a very traditional concept of a farm family partnership, the questions can be useful to less traditional farms.)

Partnership test for fathers and fathers-in-law (see Rating Scale for points)

_____ Are you willing to work up a partnership agreement with your child or his/her spouse–now–and put it in writing?

_____ Can you usually "suggest" advice as a business partner–rather than giving commands or correcting this potential partner?

_____ Can you willingly "give in" even though it might cost you money?

_____ Are you willing to turn over definite areas of important responsibility for the junior partner to make the management decisions? And then live by those decisions without grumbling?

_____ Can you discuss family and business affairs without getting emotional, angry or upset?

_____ Are you willing to cut down on your personal spending a bit, or even go deeper into debt to expand your farm, or livestock operation, to provide money for two families?

_____ If the junior partner makes a mistake that you might honestly have made at the same age, can you mark it up as a "useful experience" rather than scolding or brooding about it?

_____ Are you willing to have a heart-to-heart talk with the junior partner so that the future on the farm is defined?

_____ Are you willing to accept the fact that the junior partner's spouse and family–and their future–are rightfully the No. 1 concern?

_____ Are you willing to make a contract now that protects the junior partner's investment of time and money in the farm in case of your untimely death?

_____ Your total score

For mothers and mothers-in-law (see Rating Scale for points)

_____ Can you accept the fact that your child has married a person of his or her choice and that their future together is his or her No. 1 concern?

_____ Can you willingly accept the fact that it may be necessary for you and your husband to go deeper into debt in order to provide more income for two families?

_____ Are you willing to go along with your husband now in giving a clear picture of the future of the farm to the potential junior partner and his/her family?

_____ Can you take pride in your daughter's, or daughter-in-law's, clothes and her home furnishings for the pleasure it brings her and her family–rather than comparing them with what you have, or being upset when yours are not new?

_____ Can you refrain from giving advice about raising the children–yet enjoy them as your grandchildren?

_____ Can you accept the fact that young couples are likely to be more carefree, spend money more lavishly and be more irresponsible than couples your age?

_____ Can you willingly compliment your son or daughter about his or her spouse's good qualities once in a while–and refrain from dwelling on their shortcomings?

_____ Can you let your young "in-laws" have their own life–with couples their own age–and be free to come and go without comment while you stay a reserved distance away, even though they live on the same farm (or even in the same house)?

_____ Do you believe that a farm partnership is a business arrangement with advantages to both families–rather than a favor for the young family?

_____ As you strive to get along in the partnership would other people say that you are kind and considerate; that you are discreet about what you say; and that you are a person who controls her anger?

_____ Your total score

Test continued on following page

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Worksheet 2-3 (concluded). Assessing/testing the people situation.

For sons and sons-in-law (see Rating Scale for points)

______ Can you accept advice from the senior partner with an open mind–believing that it might have merit? Are you willing to "give it a try" when it is important to your partner, even when you think the advice might not work?

______ Are you patient enough to take time to "grow into" the farm business that the senior partner has spent a lifetime building?

______ Since you have the advantage of youth, strength and stamina, are you willing to do more than your share of the physical work without complaining and feeling resentment?

______ Can you appreciate with understanding that the senior partner may have spent many years running a farm, making decisions, perhaps even dealing with you as a boy–and that it will take some time for him to get used to your coming in as a decision-making business partner?

______ Can you feel that you may be getting a much faster start in life, with much more certainty, as a result of the partnership–and that this "debt" is something that you owe to the partnership?

______ In return for the advantages that the partnership offers you, are you willing to take on the prospect that maybe you will be primarily responsible for caring for your parents or in-laws in later years?

______ Can you refrain from pressing your advice on your parents or in-laws regarding their personal or family affairs–keeping in mind that they may enjoy things that you wouldn't?

______ Can you willingly reserve for your father, or father-in-law, an important area of responsibility in the farm business, even in his advancing years? Can you avoid imposing your will on him, in this area, even though he may "hold back" the farm business some?

______ Are you willing to keep a good set of record books of partnership expenses and income so that you and the senior partner can see what is making money and what isn't?

______ In situations that call for judgement affecting the partnership and the senior partner, can you willingly lean over backward so that others would judge you as being calm, fair and considerate?

______ Your total score

For daughters and daughters-in-law (see Rating Scale for points)

______ Can you accept without resentment the fact that your mother, or mother-in-law has spent a lifetime raising a family and making the farm go, and that she is entitled to rest, travel, good furniture–things that you may not be able to afford at this stage of life?

______ Can you appreciate the faster start in life that you may be getting as a result of the partnership; and be truly thankful without resenting your dependence on the older couple?

______ Can you "make do" with the house you have, the furniture, the car, the conveniences–without complaining that the older couple is responsible?

______ Can you accept that married "spats" are normal and then keep them to yourself without burdening the older couple or expecting them to take your side; and without blaming them or "taking it out" on them because of the partnership?

______ Can you use good judgement in not imposing too much on your mother, or mother-in-law, to take care of the children, prepare meals, baby-sit, and the like?

______ Can you teach your children to enjoy the grandparents' attention and their home when the grandparents want the children; but otherwise keep the children from "having the run" of the grandparents' home?

______ Can you be discreet around your children so they aren't "carrying stories" between the two homes?

______ Are you willing to make and keep a budget of household expenses that will help you plan and get along on what may be "short funds" due to two families living on the same farm?

______ Can you refrain from "egging" on your husband to get him to make more farm decisions, ask for a bigger share of money, or do less of the work or chores–when this makes the partnership more difficult and your husband more uncomfortable?

______ If you're a daughter-in-law of the older farm couple, are you willing to take time to "grow into" your husband's family? If you are a daughter of the older couple, can you make your husband the "confidant" of your thoughts; work out your "troubles" with him; and not lean on your daughter/family relationships so that your husband feels like an outsider?

______ Your total score

If you find that you don't score as high as you thought you might, don't despair. The couples who helped set up the test say that a good partnership doesn't just happen–it is developed by people who "put themselves out" to make it work.

If you decide after the test that a farm partnership isn't for you, there's nothing wrong with that. After all, not everyone is cut out to be a business partner. Many successful farmers would not be happy in a partnership.

Chances for a successful farming partnership

Total points	
91-100	You're a fine partner
81-90	You should make it go
71-80	It may be rough
61-70	Barely "passable"
51-60	Think of another setup
41-50	You'll be very unhappy
31-40	You couldn't stand it
21-30	Please don't do it
10-20	Not a chance in the world

If the combined total points reach 320 or more for four people (two couples) in the partnership, it should be a success. If the combined total is 240 or less, the partnership could have major troubles.

Worksheet 2-4. Business arrangements for a testing stage.

I. Options 1 and 2. Wage or wage-incentive arrangement.

	Example		Actual Plan	
	Son, Ben, age 21, contributing only labor to the farm business. Provide labor where needed.			
Employee's responsibilities:	**Cash received per year**	**Value other benefits per year**	**Cash received per year**	**Value other benefits per year**
Cash wages	$ 10,000			
II. Bonus/incentive payments, page 44. See Subsection A for a guide.				
Crop				
Livestock				
Other/bonus	200			
Fringe Benefits				
Housing, room and board		$2,400		
Utilities				
Meat, milk and other produce				
Other (car, gasoline, etc.)		250		
Insurance (health, accident, and life)		900		
Social security paid by employer		750		
Worker's compensation paid by employer				
Total cash/benefits received	$ 10,200	$ 4,300		
Grand total	$ 14,500			

Worksheet 2-4 (continued). Business arrangements for a testing stage.

A. Bonus/incentive guide.

The following examples of incentive programs should be used only as guides and be adapted to the actual situation. Link incentives with work responsibilities carried out by the employee and over which he/she has some control.

Suggested incentives	Employee status		
	Semi-skilled	Skilled	Supervisory/management
Normal incentive should be:	2%-5% of cash wages	4%-10% of cash wages	5%-40% of cash wages
General farm	End of year bonus = $100-$400 per year plus $50 for each year of service	End of year bonus = $200-$600 per year plus $75 for each year of service	Put emphasis on incentive plans
Small farm	Pay 1 1/2 times cash wage rate for each hour worked over 60 hours per week		2% of net cash income
Large farm	Pay 1 1/2 times cash wage rate for each hour worked over 48 hours per week		1%-4% of net cash income
	$1-$2/hour tractor driven after 7:00 p.m. (paid weekly)	$1-$3/hour tractor and/or combine driven after 7:00 p.m. (paid weekly)	2-6 cents per bushel of corn produced over county average
Crop farm	$2-$3/hour tractor driven after 11:00 p.m. (paid weekly)	$2-$5/hour tractor and/or combine driven after 11:00 p.m. (paid weekly)	5-15 cents per bushel of soybeans produced over county average
Dairy	$1-3 for each cow detected in heat	<u>Calving Interval</u> 13.5 months = $100 13 months = $200 12.5 months = $400	<u>Herd milk production avg.</u> 14,000# = $100/year 16,000# = $400/year 18,000# = $800/year 20,000# $1600/year
	$3-$5 per calf weaned if death loss kept below 10% $5-$10 per calf weaned if death loss kept below 5 %		
Hogs	50-75 cents for each sow detected in heat	<u>Pigs saved per litter</u> 7.5 = $ 50 8.0 = $150 8.5 = $300 9.0 = $500 9.5 = $900	<u>Feed conversion farrow to finish</u> 400# = $ 100/year 375# = $ 200/year 350# = $ 400/year 325# = $ 700/year 300# = $1,100/year
Beef	$1-$2 for each feeder detected sick, treated and recovered	<u>Calf crop sold</u> 85% = $100 90% = $200 95% = $400 100% =$700	Same as other two categories

Worksheet 2-4 (continued). Business arrangements for a testing stage.

III. Option 3. A wage plus profit-share arrangement.

	Example		Actual Plan	
	Son, Ben, will manage dairy herd & will receive 8% of milk sales & benefits & share of net			
Arrangement/responsibilities:	**Cash received per year**	**Other benefits per year**	**Cash received per year**	**Other benefits per year**
Cash wages or equivalent				
e.g. 8% of milk sales $131,580	$ 10,525			
Fringe benefits				
Worker's compensation		N/A		
Housing, room and board		$ 2,400		
Utilities				
Farm produce		240		
Insurance		700		
Other		100		
Net profit-share[a]	$ 2,275			
Total wages/share	$ 16,240			

[a] Determination of net profit-share.

	Example	Actual Plan	
Total farm receipts for year (exclude machine sales)	$ 156,000		1
Farm expenses for year (exclude machinery & facility purchases, principal & interest pay, wages for employer/employee.)	82,000		2
Balance (line 1-2)	$ 74,000		3
Annual depreciation	18,000		4
Balance (line 3-4)	$ 56,000		5
Change in inventory: feed & supplies ± ______ livestock ± ______	+8,000		6
Net farm income (line 5 ± 6)	$ 64,000		7
Employee's share of net (%) (see below)	20%		8
Employee's share of net farm income (line 7 x 8)	12,800		9
Cash wage paid to employee during year[b]	10,525		10
Net profit-share, if any (insert above) (line 9-10)	$ 2,275		11

Worksheet 2-4 (concluded). Business arrangements for a testing stage.

[b] **Determining employee's share of net farm income** (line 8 in Determination of net profit-share).

Contribution	Amount	Interest rate	Total	Employer	Employee
Real estate	________	________%	________	________	________
Personal property	________	________%	________	________	________
Labor & management	________		________	________	________
Total			________		
Percent share (to line 8 above)			100%	________%	________%

Getting established: The multi-owner/operator route

3

- **Some key elements and assumptions regarding the establishment process**
- **Phase 1. Transferring farm assets and management, the early years**
- **Putting the partnership agreement in writing**
- **Phase 2: Adjusting business management and asset transfer plans, the "in between" years**
- **Phase 3: Making needed adjustments when the senior partner prepares to retire.**
- **Liquidate or Continue a Partnership?**

This chapter addresses the process of getting a junior partner, (son, daughter or unrelated party) established in a multi-person, possibly multi-generational family farm/business.[1] Getting them established in farming via this route should be viewed as a continuous, sequential process that requires careful planning and constant monitoring. It shouldn't be allowed to "just happen." Since in most cases the senior partner is at or beyond the midpoint of their farming career, a major goal or concern should be to ensure that the younger generation will be in a position to financially control the business and to manage it effectively when the senior member(s) decides to retire.

This chapter focuses on the operation and transfer of a farm business during three periods. The: (1) partnership's early-years, (2) "in between" years, and (3) late-career, pre-retirement years of the senior partner. Each period has its own major issues or concerns. A set of guidelines is presented relative to: (1) business planning and asset transfer (2) transfer of management and responsibilities, and (3) estate planning. Development of a partnership agreement and the eventual liquidation and/or continuation of a partnership arrangement are also discussed.

[1]While many examples and concepts of this chapter are explained in the context of a parent to child establishment, the general principles are valid for unrelated parties as well.

Some key elements and assumptions regarding the establishment process

Establishing a junior partner into an existing farm business is an important, complex process. There are three key elements involved that *will* affect the business and the families in a successful transition:

- The early transfer phase is the foundation of the establishment process and for the business. Carefully think through the plan's details and put them in writing.
- Consider how to transfer management responsibilities as well as farm assets. Management is often the most critical aspect!
- Considerable time and money will be expended to get the job done right. This involves:
  - Reviewing family and business goals and developing a proposed plan.
  - Checking out the plan with key people such as a management/tax consultant, an attorney and a lender.
  - Solidifying the plan and sharing it with other family members.
  - Putting the plan and agreements in writing.
  - Implementing, monitoring and adjusting the plan along the way.

A case example of a partnership arrangement illustrates this process. A corporation or even a combination of business arrangements could be used in a similar fashion. See Chapter 7, Part II for a discussion of these other options.

There are five key assumptions made for this example:

- The business *is* profitable and financially able to support two or more families.
- There are two generations of people—parents and children—who can live, work and manage together effectively.
- The junior partner(s) has the desire and ability to eventually take control *and* manage the business in the time available.
- The senior partner will be willing and able to transfer a major share of his/her farm assets and management responsibilities in the time available.
- There is a reasonable period of time in which to carry out the whole transfer process.

If prospective partners cannot make similar assumptions, then the situation is not conducive to a partnership. Refer back to Chapter 2.

Phase 1. Transferring farm assets and management, the early years

During the early years of a partnership the focus is on business management and asset transfers. This could also be called the "sweat-equity" phase, a time when the junior partner trades strength, energy, enthusiasm and perhaps knowledge for the use of the senior partner's assets and management experience. But, keep in mind that the business should be better off with the junior partner on board. This means that the senior partner should not spoil a good young business partner by giving too many financial breaks too soon. But, by the same token, the junior partner must be permitted sufficient investment opportunities and a reasonable share of profits to begin building net worth and ownership of personal property.

This period is often viewed by the senior partner as a second "testing" phase, where one of the key

concerns is whether the junior partner has the ability to manage the business. To accurately measure this, the senior partner needs to provide opportunities for the junior partner to develop and exhibit management skills. The main objective during these early years should be **beginning the transfer of personal property and management responsibility**. This section covers: (1) business planning and asset transfer; (2) the transfer of management responsibility; and (3) estate planning.

Business planning and asset transfer, early years

Table 3-1 uses the case example to illustrate business planning and asset transfer. Refer also to the section in Chapter 2 that shows how to analyze one's financial situation and to develop a desired share arrangement.

A key decision: Make it easy or hard to get assets out?

One of the key decisions to make early in the development of a partnership arrangement is: should the arrangement make it easy or difficult to get assets out of the business? The easy out approach means assets are largely held by the individual partners. The partnership is used largely as an operating unit, with assets either leased or contributed on a use value basis to the partnership.

But, as a business gets larger, the sudden removal of part or all of one partner's assets can have a negative impact on the future of a business. **With divorce becoming more prevalent, partners should consider an arrangement that would make it more difficult to get assets out of the business.**

Placing personal property assets in the partnership itself can provide such a means of protection. If a divorce were to occur, then the divorcee would have immediate access to only the income of the partnership. Even the income would not be available if the partners decided not to distribute the income of the partnership to the partners.

Paul D. Brutlag, attorney, suggests a broader view than just divorce; he calls this approach "protection against unwanted creditors." It is important to discuss this issue with an attorney and management consultant. One could ease into the "hard to get out" approach by placing purchases of machinery and possibly feed and livestock in the partnership. As the junior partner's assets grow, review this issue carefully and periodically.

Table 3-1. Determining the income share percentage and sharing of personal property using the contributed value approach.

		Annual Use Value	
	Total value	Senior partner (John)	Junior partner (Ben)
Fixed contributions			
Labor & management	$40,000	$20,000	$20,000
Present machinery	$125,000	$15,000[a]	0
Land owned	$275,000	$22,000[b]	0
Total fixed contributions		$60,000 (75%)	$20,000 (25%)
Shared ownership			
Forages & grain	$48,000	$36,000	$12,000
Dairy herd	$80,000	$60,000	$20,000
New machinery			
Total shared	**$128,000**	**$96,000**	**$32,000** (25%)

[a] Contributed value: A depreciation and interest charge of 12% of fair market value = $15,000/year. Partnership will pay all repair costs. Insurance on personal property items will be paid by owners.
[b] Contributed value: Tillable land has value of $60/acre, dairy facilities @ $120/year/dairy unit, plus machine shed and 2 houses = $22,000 or 8% of fair market value. Real estate taxes and insurance on buildings paid by owner (John).

A case example: Using the easy out approach.

Most partnerships use the easy out approach in the early years of the arrangement, as illustrated in Table 3-1.

Refer also to the segment in Chapter 2 that shows how to analyze a financial situation and develop a desired share arrangement.

From the example, John (senior partner) and Ben (junior partner) used the contributed value approach to determine the sharing of profits (in this case 75%/25%). Some possible "subsidies" that might be made to increase Ben's contributed share include: (1) reduced or no contributed value and annual use charge for the use of John's machinery, and/or (2) a reduced contributed value and annual use charge for the land and facilities. The extent of such subsidies should depend on the senior partner's financial situation and the financial position of the junior partner. **Remember that gifts or subsidies made earlier in the transfer process are much more valuable than financial breaks on a real estate transaction 20 years later.**

Net partnership income will be shared on a 75%/25% basis. Both John and Ben will receive a periodic draw against the projected partnership income. This income will be used for meeting family living and debt service needs, and for savings or additional investments in the business.

In terms of asset transfers, they have followed the recommendation that breeding stock and feed supply be owned on the same 75%/25% basis. For future accounting purposes, it is important that these items be owned in the same percentage as profits are being shared. The best time to start such a partnership would be either January 1 (for tax and financial planning reasons), or April 1 (when feed inventories would be lowest). The 25% share in the feed can be transferred by sale or gift. Breeding stock that is two years old or older can be transferred using an installment sale. Or, the junior partner could "grow" into herd ownership via herd replacements.

In terms of investment priorities, it is important that Ben invest first in productive livestock, then machinery, and finally real estate. Whether or not Ben purchases machinery during this early period depends on his financial situation and the cost of the items being considered. Ideally, he should buy in at the 25% level of any new machine purchased during a given year. Ben and John would record this on their respective depreciation schedules and make debt payments from their own income. Buying machinery at this stage would help increase Ben's ownership in the business. It may also temper a strong urge to have "new paint" around the place. Any transfers of machinery between partners should be reviewed by a tax consultant as there can be important tax ramifications such as depreciation recapture.

Management transfer/decision-making, early years

After deciding who's going to contribute which assets and how profits are to be shared, decide how management responsibility is to be shared so that the junior partner can be growing as a manager.

Decision-making during the early years is often referred to as the "I decided" phase. The senior partner usually calls the shots on major decisions, because he/she has the most to lose. But it is important that the junior partner become involved in the big picture/big decision process along the way. This might include keeping the books for the business, analyzing the business, preparing reports or plans, as well as involvement in some major decisions.

It is also important to give the junior partner some part of the business to manage so he/she can feel responsible and grow as a manager. This will provide opportunity for some successes as well as some mistakes. This may involve a cropping or livestock enterprise, and/or some phase of the production or marketing process.

Transferring some management responsibility during this early phase is a must. Without it, a seemingly good asset transfer plan may turn into a disaster later on. Also, the junior partner will likely lose interest in the business. Since no one knows how long he/she will live and/or will be able to manage effectively, it is important to involve the junior partner in the management process as soon and as often as possible. In essence, "hope for the best, but prepare for the worst."

Partnership dissolution and estate planning, early years

Also consider the possible dissolution of the partnership and estate planning. Major emphasis needs to be placed on protecting the senior partner's interests. However, attention must also be given to protecting the junior partner's business and family interests.

Protecting the senior partner's interests

Of major concern at this stage should be the welfare and financial position of the senior partner (often parents). What provisions have been made if the junior partner should decide to leave during this early period? Under what conditions would the junior partner have a right to leave? What happens to the property the junior partner has acquired from the senior partner during and after formation of the partnership? Will the senior partner have first chance to buy the property back or will it remain in the junior partner's ownership? If major business changes were made to make room for the junior partner, should a financial penalty clause be included? What if the junior partner becomes disabled or divorced? Record your decision at Section IV A of Worksheet 3-1 on pages 68 and 69.

The senior partner should have his/her will and other estate plans reviewed at this time to be sure they are consistent with the partnership business plans. But again, dissolution plans involving the death or disability of the senior partner in the early years of the partnership should be relatively conservative and not too biased toward the junior partner. The senior partner is likely to view this time as somewhat of a trial period, so don't make plans to "give away the store". It may turn out that the junior partner doesn't want to be the "storekeeper." More detailed plans and commitments should be made later on in the life of the arrangement, as discussed later in this chapter.

Protecting the junior partner's business interests/family

At this point, the junior partner probably does not have a lot of time or money invested in the business. The major objective is to protect the junior partner's equity or contributions to the business should the senior partner become disabled, or die, or be divorced. Establish an accounting system that ensures that the junior partner will get proper credit for contributions made.

Beyond this, address the question of the future of the business if something should happen to the senior partner. That is, if the senior partner becomes disabled or dies, will the business be continued? Will the estate, the deceased's spouse, or other family members continue to operate as one of the partners? Consider having a buy/sell provision for both the personal property and real estate if something happens to both parents. This includes having some realistic way for the junior partner to exercise this option—either with an insurance policy on the senior partner or a realistic pay out schedule on the property.

The junior partner should also have an estate plan in place, particularly if he/she is married and has minor children. This would include a will with provision for a children's trust, the naming of their guardians, and the identification of a personal representative to settle the estate if something would happen to both the junior partner *and* his/her spouse. Record your decision at Section IV B of Worksheet 3-1 on page 69.

Putting the partnership agreement in writing

A handshake! That's about all it takes to become business partners under present law. However, it should be recognized that planning an effective, lasting farm business partnership arrangement is a complex process. First, carefully think through the ramifications and details of the plan. Then review the proposed plan with a financial consultant, an attorney, and creditors. Make needed adjustments. Finally, put the plan in writing instead of committing such an important event to the whims of memory.

When developing a partnership agreement, remember that every farm business and family situation is different as are the specific objectives of the parties involved. Therefore, do not copy a neighbor's plan nor rely upon a general partnership agreement an attorney has used with other farm partnerships. The parties involved have to do much of this early thinking and planning, with the possible assistance of a management consultant, tax consultant, and others. Worksheet 3-1, "Developing a Farm Partnership Agreement," pages 64-69 can be used to record one's decisions and/or agreements. A discussion of each aspect of the agreement accompanies the form.

Following is a brief discussion of the major components that should be in an initial partnership agreement. The topics include:

- Preliminary statements.
- Formation.
- Operation.
- Dissolution.
- Arbitration.

Preliminary statements

Written partnership agreements usually begin with preliminary statements that set the stage for later provisions relating to partnership formation, operation, and dissolution. The preliminary statements identify the document as a partnership agreement; indicate names and addresses of the partners; establish the name and place of business of the partnership; present the general purpose of the partnership; and indicate the beginning and ending dates of the partnership, if any. Use, Worksheet 3-1, pages 64-65 when developing these preliminary statements.

Partnership formation provisions

Worksheet 3-1 addresses three questions related to the formation of a partnership: (1) who's going to contribute which resources? (2) how will profits be shared? and (3) who will keep the records?

Contributions, profit sharing

The next major step in developing a partnership agreement involves recording (1) who is going to contribute which resources (cash, personal property, real estate, labor, and services); (2) how they are going to be contributed (outright to the partnership, on a use only basis, or lease basis); and (3) how earnings of the partnership are to be calculated and shared. Be sure to indicate how any off-farm income of the partners is to be treated — as partnership or as personal income of the partner.

Portions of two worksheets discussed in Chapter 2 should be attached to the Partnership Agreement. First, is an updated copy of Worksheet 2-1, Section IV. This includes how partnership net cash income is to be calculated and how this income is to be shared. The second item is the entire Worksheet 2-2, Inventory of Owned Assets and Liabilities of the Partners/Partnership.

As one enters a partnership, first update the inventory of assets and liabilities recorded in the shaded portion of Worksheet 2-2. Such an inventory should be complete and reasonably valued because it will serve as a benchmark as property ownership patterns change, and for settlement purposes upon the eventual dissolution of the partnership. It will also be useful in dealing with creditors and other family members.

Then, in the columns on the right side of Sections I through VI, Worksheet 2-2, indicate the ownership pattern as the partnership begins. This often involves a shift in the ownership of some of the crops and livestock and possibly machinery purchases. Additional issues to be resolved include additional contributions to the

partnership, the shifting of ownership shares, capital improvements, and capital withdrawals.

Keeping track: Records and checking accounts

Proper and accurate partnership records and accounts are essential for tax purposes, effective business management, and good partner relations. Therefore, decide which records will be needed for: (1) tax filing, (2) business management, (3) dissolution or reorganization of the partnership, and (4) tax basis purposes for future transfers. Also decide who will keep the records; whether the person will be reimbursed; and how and when others will have access to the records.

As for checking accounts, have a separate business checking account and each partner should also have a personal checking account. Each partner should also provide a personal net worth statement to alleviate any question about the solvency of any of the individual partners. If one of the partners becomes personally insolvent, creditors could present claims against that partner's interest in the partnership, which would, in turn, adversely affect the partnership business.

Partnership operation provisions; arbitration

After deciding who's going to contribute what and how profits are to be shared, consider: how are we going to operate together? A partnership has two potentially glaring weaknesses or problems in the operational area. First, it often has no clear lines of authority as far as decision-making is concerned, thus the lack of any final authority. *(The Uniform Partnership Act states that, lacking agreements to the contrary, each partner has an equal voice in the decision-making process)*. Second, the partners are subject to unlimited liability under the partnership. The partnership agreement should spell out very carefully how decisions are to be made, as well as various limitations on the activities of the partners, in order to adequately protect the remaining partners from undue financial liability. When developing this section of the agreement, review "management transfer" as discussed in a previous segment of this chapter.

The agreement should also indicate a plan for:

- Maintaining good communications among the partners and their families.
- What opportunities will be provided for the personal development of the partners.
- Provisions regarding housing and time off.
- Provisions for arbitrating disagreements.

Arbitration often involves each partner selecting an outside party as a representative, and the two designated arbitrators selecting a third party. Indicate which decisions will require the unanimous vote of the partners, such as the admittance of a new partner into the partnership.

Partnership dissolution: What will happen if...?

A partnership is a very fragile business arrangement. It is dissolved when one or more of the partners ceases to be associated with the partnership. Dissolution may be caused by mutual agreement or upon the withdrawal, retirement, disability, or death of a partner. Upon dissolution of the agreement, the partners have three choices regarding the partnership business: (1) end the partnership and liquidate the partnership business; (2) continue the business under a new partnership agreement; or (3) continue the business in a different business form, e.g., a corporation. For a more detailed discussion of these first two options, refer to the discussion found in the final segment of this chapter.

A dissolution agreement for the early years should not be too cumbersome, but it needs to provide protection for both the senior partner and the junior partner. When developing this segment of a partnership agreement, review the discussion of partnership dissolution and estate planning found in the previous section of this chapter. Use Worksheet 3-1, pages 68 and 69 to develop this aspect of the agreement.

Phase 2: Adjusting business management and asset transfer plans, the "in between" years

View the business operation and transfer arrangements as a living document which needs regular attention and periodic adjustments to fit a changing internal and external business environment. For example, adjustments will be needed as the junior partner matures and becomes more established. Review the situation and decide whether adjustments are needed in the: (1) contribution or profit share arrangement; (2) sharing of management responsibilities; and (3) existing dissolution provisions.

Adjusting business operation and asset transfer plans

After farming together for a period of years, make adjustments in the profit sharing arrangement and personal property ownership pattern. Plans for gaining control and/or ownership of at least part of the real estate need to be considered as well. This would also be a good time to review the earlier discussion of whether to make it easy or difficult to get assets out of the business. If partners are concerned about the future of the business if assets were to leave the business, then they should seriously consider placing personal property assets in the partnership entity.

Adjusting profit sharing and personal property ownership

Consider two key factors in preparing the next profit share arrangement: (1) how close is the senior partner to retirement? and (2) how is the junior partner progressing financially?

Obviously, the more years available before the senior partner(s) begins retirement, the better the chances are that the junior partner will gain equity in business assets and develop managerial skill. If time permits, a gradual shift in profit sharing and personal property transfers is usually the preferred (and safest) course. Whether one should go to a 2/3 - 1/3 or 60%/40% arrangement depends on the time available and the junior partner's financial position. In either case, the ownership of feed and livestock should be increased to the same percentage as partnership net income is to be shared. The junior partner should also become more involved in the purchase of machinery. Eventually, however, the share arrangement should reach a 50%/50% sharing of residual profits.

Returning to the case example, John is now 57 years old and his son, Ben, is 30 and the father of two children. Ben has expressed a strong desire to change the partnership to a 50%/50% arrangement.

Table 3-2. Contribution arrangement and asset ownership under 50%/50% share.

		Annual Use Value	
	Total Value	Senior Partner (John)	Junior Partner (Ben)
Fixed Contributions			
Machinery [a]	$100,000	0 (leased)	0
Land owned [b]	$280,000	0 (rented)	0
Labor & management	$32,000	$16,000	$16,000
Shared Ownership			
Forages & grain	$48,000	$24,000	$24,000
Dairy herd	$92,000	$46,000	$46,000
Total Shared	**$140,000**	**$70,000**	**$70,000**

[a] Lease value: depreciation and interest of 12% on $100,000 of machinery = $12,000 lease /year.
[b] Rent value: tillable land charge is $65/acre, dairy facilities = $132/year/dairy cow unit, plus machine shed and 2 houses = $22,400 year or 8% of fair market value.

Ben wants to take over all herdsman responsibilities. John likes this idea too. It will allow him and his wife to take longer winter vacations. They inventoried all the farm assets again and agreed upon the following asset ownership pattern and respective contribution values.

Ben will have to purchase $12,000 ($48,000 x 50% = $24,000) more forages and grain and $23,000 more dairy cattle from his father to move from 25% ownership to 50% ownership. The land and machinery will be rented/leased to the partnership. This change in the partnership agreement requires Ben and John to jointly purchase any new machinery. They will trade in John's old equipment for the new ones (John plans to give Ben half interest in value of trade-in equipment). To check the financial feasibility of this arrangement use Worksheet 3-2, on pages 70 and 71.

At age 57, John says that if any building improvements are made on his land, they must be paid for with partnership funds. In turn, he would not charge the partnership for their use.

John and his wife now take longer winter vacations. They hire help in the winter to compensate for their absence.

During the five years or so prior to John's retirement, Ben should consider buying all machinery replacements. This approach avoids depreciation recapture on any intra-family sales of machinery at John's retirement. It may also be desirable for Ben to own and raise all replacement breeding stock during the later years so that he will own most of the herd at John's retirement.

Gaining ownership/control of real estate

As time passes, Ben (the junior partner) will likely become increasingly interested in gaining ownership of at least some of the senior partner's real estate. The senior partner, John, should review his situation carefully with a management consultant and tax accountant to determine how this might affect the parent's financial security and tax position. Ben should also study his situation carefully to make sure he is in a financial position to make such a purchase. There are many factors to consider, so study it carefully. Also review the discussion of retirement aspects at the end of this chapter, and selected chapters in Part VI of this series.

If it is decided that Ben is in a position to enter the real estate market, the question is: should he be buying the home base unit or another farm nearby? In either case, Ben could begin the process by establishing an option-to-buy agreement. This would "freeze" the value of the property as well as ensure his having first chance of buying it.

If the decision is made to buy at least a portion of John's real estate, major decisions to be faced include how much property should be transferred as well as which property and how. As for the question of how much should be transferred, John should maintain ownership of enough property for future income needs and as an inflation hedge. Ben should check his cash flows carefully or have some assurance that John is in a position to subsidize him over the rough spots.

As to which property to transfer and how, again there are several options and numerous considerations. The transfer could be made using a split sale/gift, in which case some land and the buildings site would be sold to Ben so that he can claim depreciation on the buildings and improvements. Bare land, preferably that with a relatively high tax basis, could be gifted at the same time. Again, they should check out these alternatives with a tax consultant since there may be other tax implications. For example, it may be necessary for Ben to buy another property and execute an *exchange* with John to avoid depreciation recapture problems on a recently improved farmstead as well as a substantial capital gains tax.

With relatively large estates, it may be desirable to also establish a limited partnership for use in transferring some or most of the other real estate. Gifts and sales could again be used here. If there are several children in the family, this may be one of the better transfer tools. Placing real estate in a limited partnership, essentially makes it more difficult for assets to be taken out of the business. It can be particularly useful when assets are transferred to off-farm heirs. The other partners could have the right of first refusal. More on this possibility later. Also review the discussion of asset transfers contained in Chapter 4, Part VI of this series.

Adjusting management responsibilities

As the partnership progresses, review decision-making arrangements and how daily management duties are to be reallocated. By this time, the junior partner should be given a stronger voice in overall decision-making. The junior and senior partners need to be participating on as nearly an equal basis as possible in the planning and management of the farm business. This may mean changing from a senior partner/general manager arrangement toward a more equal management sharing situation. If conflicts arise, the final authority for decisions may need to rest exclusively with a board of arbitrators, rather than with the senior partner having the final say.

Another approach with a large, diverse operation would be to diffuse overall responsibilities by giving each partner responsibility over one or more major parts of the business. Similarly the daily, ongoing operations responsibilities should be reviewed and likely changed. The junior partner needs to be given increased responsibility whenever possible. This will be necessary to provide a smooth transition to the eventual retirement of the senior partner. **It will also improve the junior partner's managerial image with their lender.**

Adjusting dissolution plans

In the early years of a partnership, dissolution plans could be quite simple and somewhat tentative. The plan needed to err on the side of protecting the senior partner's situation, while providing reasonable protection of the junior partner's equity and family. But, as the junior partner becomes more established, dissolution plans need to be reviewed and likely will become more complex.

A partnership is dissolved when a partner ceases to be associated with the partnership. A partnership agreement should provide for the most likely causes of dissolution, including instructions as to whether the partnership business is to be continued or terminated. An agreement should also reflect how the junior partner can gain control of the business. More favorable treatment of the junior partner is often in order by this point, and this preferred status should be reflected in the revised dissolution plans and estate plans.

Provision for possible disability or death of the senior partner

By now, the junior partner has likely invested a considerable amount of his/her time and effort in the operation. He/she has become increasingly concerned about gaining control of the operation over the long term or under a crisis situation if something were to unexpectedly happen to the senior partner. One of the key adjustments concerns how things would be handled should the senior partner become disabled or die. For example, first decide whether the partnership business is to be terminated or continued if the senior partner becomes *mentally or physically disabled*. If the business is terminated, then a procedure will be needed for winding up the business. If the partnership is to be continued, then the agreement should indicate what adjustments in the sharing of profits or the guaranteed payments for labor and management will be.

The anticipated *death* of the senior partner requires a reworking of the agreement as well. Will the partnership be terminated or continued? Continuance of the partnership may be made where there are two or more surviving partners, or the *estate* of the deceased partner is retained as a partner.

Of greater concern to the junior partner is the question of how he/she would gain control of the business if something were to happen to the senior partner. Decide on a method of valuing the property and whether any buy-sell agreements will be made mandatory or on the basis of the right of first refusal. It is unlikely that the remaining partner(s) will have the means to pay a substantial sum in cash. After determining the appropriate provisions for liquidation or buying out upon death, those provisions should also be cleared with the spouses of the partners, as they have an important stake in assuring themselves an adequate future income and other provisions. In addition, they may be able to dispute the agreement later if it does not provide adequately for their well-being.

Provisions for possible withdrawal, disability, or death of the junior partner

By now the junior partner may have substantial personal property holdings and may even own a piece of the real estate. The agreement should,

therefore, have separate clauses relating to the partnership business and the disposition of the junior partner's partnership property should he/she withdraw, become disabled, or die.

If the junior partner withdraws, will he/she be permitted to retain his/her partnership property? If the junior partner wishes to divest his/her partnership interest, on what basis can the remaining partner(s) purchase said property? If the junior partner becomes disabled, will the partnership business be terminated or continued? If the business is to be continued, then the agreement should indicate how the sharing of profits will be adjusted. If the junior partner were to die, then it must be decided whether the partnership will be terminated or continued with the estate acting as one of the partners. If the senior partner does not wish to be managing with the junior partner's surviving spouse, then put buy-out provisions in the agreement. Provisions should also be included in the agreement for situations in which the partnership is dissolved through mutual consent or expiration of the agreement.

Bringing in a new partner; making needed business adjustments

By this time (or even before), the partners are sometimes faced with the question of whether to bring another partner into the business. In most situations, the first question to ask is whether the business is profitable enough for three or more families. Work with a tax or financial consultant and analyze the financial situation carefully. If the business is not adequate, go back to the three alternatives described in Chapter 2. They include a spin-off, a joint venture, or an expansion program. The option to choose depends largely on the age of the senior partner and how soon he/she plans to retire. If retirement is imminent, then a holding pattern would seem most feasible. With the retirement of the senior partner, there would be room for a second junior partner. If the senior partner is not ready to retire, two issues may surface: (1) should the business be expanded to make room? and (2) should incorporation be considered?

Should the business be expanded to make room?

If the senior partner is more than five years from retirement, then spin-off or expansion programs are viable alternatives. The parties involved should again go through a testing stage to determine whether the people are compatible—can the parties work, manage, and live together in reasonable fashion? (See Chapter 2.) Once this period is over, the senior partner must then decide whether to make room for another junior partner or merely help them get started on their own.

As indicated in Chapter 2, an expansion program should be analyzed carefully to determine whether the senior partner should incur this added debt and associated risks. Refer to Chapter 2 of this part, and Chapters 3 and 4, Part I of this series, to determine the financial feasibility of such an expansion.

Continue in a partnership or incorporate?

If the business is large enough and the original partners have determined that all the partners can get along well together, they must then decide whether to reform the partnership or incorporate. If they are to remain in a partnership, they will have to make adjustments in their partnership formation, operation, and dissolution provisions. In this case, there will likely be two junior partners at varying stages in their farming careers. Such an arrangement needs to be worked through very carefully to give the new junior partner a running start without "bending the nose" of the older junior partner unnecessarily. "Fairness" and "business-like" should be the guiding words.

If it appears that there is a very viable business situation and there will be two or more junior partners operating the business once the senior partner retires, give careful consideration to forming a corporation, at least for the operational aspect of the business. Review the discussion of forming, operating and dissolving a corporation in Chapter 7, Part II. Work closely with financial and tax advisors and an attorney to decide whether to incorporate and how.

Phase 3: Making needed adjustments when the senior partner prepares to retire

Once the senior partner has reached the late career/pre-retirement years, the attention needs to focus on how best to transfer overall control of the farm business to the junior partner(s). This segment first discusses some key considerations in transferring control of the business. It then presents a brief discussion of considerations and options in transferring control of business assets and management and the updating of the estate management, and transfer plans. These issues are discussed in more detail in Chapters 3 and 4, Part VI.

Transferring overall control of the business—some key considerations

The issue of transfer of the overall control of the farm business to a younger generation is often a difficult one for everyone concerned. The parents have owned the farm for years, working hard to build and maintain a viable business. It has become a part of their lives and, as such, is difficult to part with. A question of security and independence is also involved. As long as the parents have the farm, they have a means of supporting themselves, of being independent of others for their support.

Junior partners, on the other hand, are trying to build a place for themselves and their families. They are seeking opportunities to build a profitable business with a future and are anxious to try out their wings in farm management decision-making. Thus, one of the main objectives of a farm transfer plan should be to integrate these differing goals into a plan that will best meet the needs of all involved.

A sound transfer arrangement should be tested on several different points. First, and perhaps most importantly, does it provide the parents with a reasonable degree of security for the present and for their retirement years? Second, does it provide a reasonable degree of job security for the farming son or daughter? A third aspect of a sound transfer arrangement is the fair treatment of non-farm heirs. And fourth, the arrangement must be based on sound legal advice. Transfer problems are far too complex for farm families to draw up their own "legal" documents.

The timing of farm ownership transfer depends on the characteristics of both the parents and the farming heir(s) or partner(s). Ages of both the parents and the children are usually key factors. The farm transfer should be made when the senior partner partially or completely retires from the day-to-day work and other responsibilities of the farm operation, and/or when the senior partner has adequate sources of income. The farm transfer should be seriously considered when the junior partner: (1) has attained maturity with respect to farm experience, managerial competence, and business judgment; (2) is *certain* he or she will farm; and (3) has sufficient capital and income to support additional debt and other ownership responsibilities. A cash-flow budget should be prepared to determine whether the junior partner has the potential to take over major portions of the farm business. (See Chapter 4, Part I of this series).

Transferring control of business property: Partner and partnership interests

Retirement usually requires a shift in asset control with its accompanying tax and financial ramifications. Work closely with a tax consultant and lender during this time. Following is a brief description of transfer options to be considered. They are discussed more fully in Chapter 4, Part VI.

Buying/leasing the personal property

Normally, the senior partner's individual interest in feed and livestock should be sold or gifted to the junior partner(s). Machinery transfers need to be reviewed carefully because of possible depreciation recapture problems. Leasing the senior partner's machinery rather than buying it may solve that problem, but check first with a tax consultant. All new machinery should be bought by the junior partner, unless the senior partner is faced with a substantial income tax problem. As a general rule, the ownership of most, if not all, of the individually owned personal property should reside with the junior partner before or shortly after the senior partner's retirement.

If a major portion of the personal property is in the partnership entity, the junior partner should be purchasing some fractional share of the senior partner's interest in the personal property.

Shifting control of the real estate

At a minimum, the senior partner should be cash or crop share renting his/her real estate to the junior partner or to a reformed partnership operated by two or more partners. The junior partner(s) may also want to be entering into an option-to-buy arrangement on part of the real estate.

The parties may go beyond this and actually engage in a sale of all or part of the real estate from the retired senior partner to the junior partner(s). This sale can involve a contract for deed which may also involve some gifting. It may be desirable to place other real estate holdings in a limited partnership to ease the transfer process and to protect the interests of the non-farm heirs.

See Chapter 4, Part VI for a more detailed discussion of asset transfer considerations and tools that might be used during these late career/pre-retirement years.

Transferring management control and the parents' involvement

One of the more difficult aspects of retirement for most senior partners involves giving up management control of the operation. But the break must be made—the sooner the better. Otherwise, there will be continuing family relationship problems, as well as garbled signals to employees, creditors, suppliers, etc.

The ease with which this break can be accomplished varies by managers. When it is possible to make an effective break, the junior partner may want to reciprocate by asking the senior partner to be involved in some of the daily operations, thus providing some badly needed "retirement lifestyle therapy." If a smooth management transfer cannot be accomplished, then it is questionable whether the retired senior partner should be involved in the farming operations in any way.

Senior partners should plan their retirement carefully, find new interests and do the things that were postponed because of responsibilities. Otherwise, partners and spouses could be unhappy. Chapter 2, Part VI of this series addresses developing a satisfying retirement lifestyle.

Updating estate management and business transfer plans

Estate plans must also be updated since the parents may wish to provide certain financial breaks for the junior partner in their wills. Or, financial breaks given on transfers made at retirement may negate the need for further financial breaks which are already in the present will and can now be deleted. The junior partner(s) should also update their estate plans, as their present family and/or financial situation may call for some adjustments.

Chapters 3 and 4, Part VI of this series contain a comprehensive discussion of financial security issues and estate management and asset transfer aspects during this crucial period for the parents and the farm and non-farm heirs.

Liquidate or continue a partnership?

A partnership is dissolved when a partner ceases to be associated with it. Upon this dissolution, the partners have three choices regarding the business: (1) end the partnership and liquidate the business; (2) continue the business as a new partnership; or (3) continue the business under a different business arrangement, i.e., a sole proprietorship or a corporation. Since dissolution is the ultimate happening with any partnership, it is important to look closely at the considerations and procedures in liquidating or continuing a partnership business.

Liquidation; procedures for ending a partnership business

Under certain circumstances, the partners may prefer to liquidate the partnership business. In such cases, provision must be made for settling the affairs of the business. However, before beginning this process, the partners should be aware of the tax consequences of their possible actions. As a general rule, gain or loss is not recognized to either the partners or the partnership upon the distribution of property that liquidates the partnership. However, there are exceptions to this rule, so check this with an attorney and tax consultant. If there are any plans for liquidating the partnership business, also indicate who is to supervise the process. The Uniform Partnership Act has established the priorities for liquidating assets.

1. **Supervision of liquidation.** If it can be agreed to, one partner can settle the partnership affairs and supervise the liquidation. Without such an agreement, partners have equal rights to conclude the partnership affairs. If one partner is to supervise this process, the authority of the other partners to speak for and bind the partnership is ended with actual notice or notice of their lack of authority. A remaining partner is entitled to reasonable compensation for his/her services in settling the partnership affairs.

2. **Priority of distribution of liquidated assets.** The partners cannot alter the priorities established by law for the payment of creditors of the partnership. But among themselves they may agree to any order for the payment of liabilities owed to them by either the partnership or each other, and for the distribution of any surplus among them. *Generally, it is preferred to distribute the partnership assets in kind to the partners if it is feasible since the sale of property would result in a taxable event.*

Following is a sample clause providing for the distribution of partnership assets upon liquidation: "The business of the partnership shall be wound up and liquidated as rapidly as business circumstances and orderly business practice will permit. The assets shall be applied in the following order:

1. To the payment of all expenses of liquidation.

2. To the payment of the debts and liabilities of the partnership owing to creditors other than partners.

3. To the payment of all debts and liabilities owing to partners, other than for capital and profits;

4. To the repayment of the capital contributed by the partners, who will then share the remaining assets if they shall not be sufficient to repay such contributions.

5. The surplus, if any, of the assets remaining shall be divided among the partners in the same proportion as that to which they are entitled to share in the profits of the partnership."

Continuing the business as a partnership

When partners desire that the business continue as a partnership, the business need not be liquidated if an appropriate provision is contained in the partnership agreement. Following is a brief review of the income tax consequences of transferring property between partners. Then, some provisions for continuing the business due

to the withdrawal, incapacity, or death of a partner are explored.

Income tax consequences of transfers between partners

If a plan to continue the business following a retirement or death is to be included in the partnership agreement, the tax consequences of such a plan must be considered. Payments made in liquidation of the interest of a retiring or deceased partner in partnership property are treated as liquidating distributions. This means such a payment will result in capital gain or loss, measured by the difference between the amount of cash recovered and the basis of the partner's interest in the partnership.

However, payments which are attributed to unrealized receivables will result in ordinary income treatment. Payments for goodwill are also considered as ordinary income, except to the extent that the partnership agreement specifically provides for payment for goodwill. If any part of the payment results in ordinary income treatment to the recipient, the payments may be either excludable in computing the distributive shares of the other partners or be deductible. If the distribution to a retiring partner or a deceased partner's estate is a series of payments to be made over more than one year, each payment must be allocated between the portion which is in exchange for the partnership property and the ordinary income portion.

Provisions for continuing the business upon the withdrawal or disability of a partner

Provisions for continuing the business upon the withdrawal or disability of a partner may include the purchase of the former partner's assets by: (1) the other partner, and (2) a non-partner third party.

- **Purchase by other partners.** When a partner voluntarily withdraws from the partnership or retires, the partnership agreement should give the remaining partner(s) an option, not a binding agreement, to purchase the withdrawing partner's interest at a stated price or according to a formula. A similar procedure may be used in the event of the incapacity of a partner, if the parties desire to dissolve the partnership on the happening of such events.

  A common provision is to give the remaining partners an option to purchase at an agreed price or according to a formula, with payments made in installments over a period of years at an acceptable rate of interest. The method of determining the purchase price will be discussed below. The provision should certainly be stated as an option to purchase rather than as a binding agreement, since the remaining partner(s) may find it financially impossible or impractical to carry on the business upon the withdrawal of a certain partner. Should the remaining partner(s) fail to exercise an option to purchase, the partnership business would be liquidated.

  A variation of this provision would provide for the payment of a share of the business profits over a period of years as payment for the withdrawing partner's interest. However, if this method of payment is adopted, make provisions to compensate services of the active partner(s). Such compensation needs to be treated as an expense of the partnership in determining the withdrawing partner's share of profits.

  If there are prohibitions against withdrawal or limitations upon the right to withdraw, penalties may be provided for their breach. For example, the option to purchase may be cast in terms favorable to the remaining partner(s), or damages may actually be required.

- **Purchase by non-partner third party.** Rather than providing for the purchase of the interest of a withdrawing or retiring partner, the partners may agree to adopt a corporate method to provide for the continuity of the business. The partnership agreement may provide that a partner can sell or assign his/her partnership interest with or without the consent of the other partners. (The consent of all partners would be required for the buyer to become a partner, however.) This right to transfer may be absolute and unqualified. However, this purely corporate

approach would probably not be appropriate in a farm business partnership. A more suitable provision would allow the transfer of a partner's interest subject to restrictions on the purchaser's right to management or control. Or a limited partnership may be formed upon the transfer of a partner's interest, with the purchaser becoming a limited partner rather than a general partner.

Provisions for continuing the business upon the death of a partner

Death of a partner is probably the most common cause of a partnership termination. Continuation of the business may be provided for by giving the surviving partner(s) the right to continue the enterprise by purchasing the deceased partner's interest or by making the deceased partner's estate a partner.

- **Making the estate a partner.** In some cases it may be desirable to continue the partnership business by allowing the deceased partner's personal representative, and perhaps ultimately his/her heirs or beneficiaries, to retain the decedents interest in the partnership. To allow for this method of continuation of the partnership business, the partnership agreement should provide that the estate of the deceased partner will continue to participate in the profits and losses of the partnership. The deceased partner's legal will should also authorize participation in the partnership by his/her personal representative. While state law authorizes a personal representative to continue a partnership, it is preferable that the will expressly give the personal representative such power. Even with such a provision, many personal representatives would be reluctant to assume such duties.

  Making the estate a partner may be an equitable arrangement in many cases. It can be viewed as compensation for the past services of a deceased partner payable after his/her death. It also reflects the contribution to the profits of the business made by a deceased partner, even after death, through income received from his/her unfinished business. To reflect these contributions, the partner may wish to make the estate a partner for a limited period of time. However, in most cases these objectives may be met with less risk to the personal representative and the estate. For, if the estate is a partner, all estate assets may be subject to potential loss due to the unlimited liability of the partnership form. The personal representative may also be subject to both surcharge by the heirs or beneficiaries and be personally liable for partnership losses.

  There are other ways to retain the deceased partner's interest in the partnership. For example, the business may continue with the partnership interest retained in the business operated by the surviving partners. But since the personal representative or the heirs of the deceased partner will have neither management rights nor a right to share in profits, the only advantage of such a provision is in the accommodation of the surviving partner(s).

- **Buying a decedent's share by surviving partner(s).** In general, retention of the partnership interest after the death of a partner is likely to create difficulties. A partnership is usually a close personal relationship and may not bear the introduction of a stranger who has not "lived" with the partnership as it has grown and changed. There may then be several good reasons for arranging the sale of the decedent's interest to the surviving partner(s) by a prearranged agreement. Such an agreement assures a ready market, a source of funds, and the means of determining the purchase price.

  If the partners decide that, on the death of a partner, there should be an agreement providing for the acquisition of his/her interest by the survivors, they will have to make several decisions:

  1. Who will be permitted to purchase?
  2. To what degree will the agreement be binding on the various parties?
  3. What will be the price and the terms of the sale?
  4. How will the agreement be funded?

Consideration of the financial and physical status of the partners and of their goals for the agreement will allow for creating a plan best suited to their needs.

In the normal buy-sell arrangement, the parties will arrange to purchase a pro rata part of the withdrawing or deceased partner's interest so as to retain their relative participation with the survivors. Arrangements may be made for many variations on this approach. A younger partner may be allowed to increase his/her contribution to the partnership. An outsider, whose services will be needed if a particular partner should die, may be permitted to buy-in. In a family farm partnership, only a son or daughter may be allowed to purchase the parent's interest, in order to continue the business while providing funds for other heirs.

Once the purchase rights are determined, there must be a decision made as to whether the obligations on the buyer and seller should be mandatory or merely optional. Purchase plans generally take one of two forms: (1) an agreement that upon the death of a partner, his/her interest shall be owned by the surviving partner(s) who will pay a price determined in the agreement; or (2) an agreement that the remaining partner(s) shall have *the option* to purchase the interest of the deceased partner. In the first type of agreement, the interest of the deceased vests in the surviving partner(s) immediately upon the death and does not pass into the estate of the decedent. Such an agreement assures a market for the sale of the interest. However, if the survivors bind themselves to purchase the decedent's interest, they may be forced to do so even though it has become unprofitable to operate the business without the decedent.

The second arrangement, giving the surviving partner(s) an option to purchase the decedent's interest, provides more flexibility. It is impossible to accurately predict the future. An option approach allows the surviving partners to determine what is best after the death of a partner. However, the partners may prefer an absolute buy-sell arrangement to assure that their heirs will receive the fair value of their partnership interest.

Worksheet 3-1. Developing a farm partnership agreement.

Note to partners

One of the keys to a successful partnership is the development of a sound business arrangement. This worksheet is designed to help with the "homework" as to the type of arrangement that is preferred. However, to ensure that the agreement is complete and sound from a legal, tax, and accounting standpoint, secure the help of an attorney and management or tax consultant familiar with agriculture. The partnership is an extremely flexible tool, so get some good help and take maximum advantage of its flexibility.

Note to attorneys

This worksheet has been developed to facilitate preliminary decision-making regarding the type of agreement the partners would like to operate under. Obviously, they will be seeking advice and counsel regarding various legal aspects of their proposed agreement.

When finalizing their agreement, place the provisions which are not subject to change in the body of the agreement. Items which will likely change over time should be placed in a set of exhibits to be attached to the basic agreement. This might include an inventory of assets at the start, lease agreements, and the income, expense and profit share arrangement. It would be well to assist clients in obtaining specialized accounting help as well.

I. Preliminary statements

A. Introduction; names and addresses.

1. Is it your desire to form a general farm partnership? Yes______ No______

2. What are the names and addresses of the partners?

Name______________________ Address______________________

______________________ and

Name______________________ Address______________________

______________________ and

Name______________________ Address______________________

____

3. When will this partnership take effect? ______________________

4. What name (if any) has been selected for the partnership? ______________________

____

5. Where will the partnership have its principal place of business? ______________________

____

B. Purpose of partnership; nature of business activities.

1. What are your goals and objectives or reasons for entering into this partnership?

____

____

2. In general terms, what farming activities will the partnership engage in? (note any limits also)

____

____

3. Note any plans for becoming involved in other business activities. ______________________

____

Worksheet 3-1 (continued). Developing a farm partnership agreement.

C. Duration of agreement; provisions for review

1. How long will the agreement run? ____________________
2. Is it to be automatically renewable? ____________________
3. When and how must notice of termination be given? ____________________

____

4. A periodic review of the partnership, including progress, relationships, arrangements and future plans shall occur: ____________________

____

II. Formation: Who's going to contribute what? How? Share profits? Keep accounts?

A. Develop a workable financial plan.

From Chapter 2 attach Section IV, of Worksheet 2-1 and all of Worksheet 2-2 to the partnership agreement to indicate the ownership pattern at the start of the partnership and how income, expenses and profits are to be calculated and shared.

B. Initial contributions and related aspects

Summarize on a separate sheet of paper the agreements reached under **A** above with regard to initial contributions and related issues. The following questions should be addressed; other related agreements reached should also be noted.

1. **Real estate**. Who is providing the real estate? How is it being contributed—on a rental or use only basis? If it is rented, a rental agreement is needed. Also, note if the owners are paying selected expenses—repairs, insurance, and property taxes—or is the partnership responsible for some of these items?

2. **Machinery and equipment**. Who is contributing what equipment? How is it being contributed—on a lease or use only basis, or is it placed in the partnership? If it is leased, note that lease agreements will be needed. If it is leased or on use only, who will take care of repairs—the partnership or the owners? How will replacements be purchased—by the partnership or partners? Will it become partnership property or be owned jointly by the partners?

3. **Labor and management**. Will it be contributed on an equal basis or will one partner be contributing more than the other? Will the annual use value be treated as a guaranteed payment or as a draw against business profits? What non-partnership work, if any, may each partner engage in?

4. **Inventories.** What shifts in inventory ownership will be made—feed and supplies? What amount and how (sale or gift)? Market and young breeding stock? Breeding livestock? (See Worksheet 2.2)

C. Additional capital contributions/shifting ownership shares/withdrawals.

1. Under what conditions can a partner make additional capital contributions to the partnership?

____

____

Shall such additions: (1) call for a recalculation of contributions and profit shares (____) or (2) just compensation through the use of an interest bearing note (____)? Check one.
interest rate on notes shall be _____%.

2. Will there be any limitations on partners leaving undistributed profits or annual use charges in the partnership? ____________________

____

If the retained earnings exceed a partner's share of profits, such retention will: (1) call for a recalculation of contributions and profit shares (____) or (2) just compensation through the use of an interest bearing note (____)? Check one.
Interest rate on notes shall be ______%.

Worksheet 3-1 (continued). Developing a farm partnership agreement.

3. If major improvements or additions are made on a given partner's property, who will own them?

____

How will they be paid for? ______________________________

____

____

____

4. Under what conditions can any partner withdraw part of his/her contributions?

____

____

____

____

D. Partnership income, expenses and annual settlement.
(See Section IV of Worksheet 2-1 or Worksheet 3-2.)

1. Partnership income and expenses defined.

a. Except for the following, all other income shall be considered partnership income:

____

____

b. Except for the following, all other farm business expenses will be paid for by the partnership:

____

____

c. Cash withdrawals from the partnership by each partner shall be made on a__________ basis. The withdrawal amount shall be as follows:

______________________ $__________/__________
(name)

______________________ $__________/__________
(name)

______________________ $__________/__________
(name)

Withdrawal amounts may be changed at any time, but only after obtaining the consent of the other partner(s). Are these draws to be treated as guaranteed payments or as a drawing account against profits?

____

2. Inventory changes and annual settlement.

a. Are inventory changes to be considered on an annual basis or for the period of the agreement?

____

____

b. How shall inventory increases/decreases be shared? ______________________________

____

3. Indicate the priority for paying: partnership expense including debt service __________ labor and management charge __________; rent or interest on property leased or provided on a use-only basis __________; depreciation due partners __________; loans by partners__________.

Worksheet 3-1 (continued). Developing a farm partnership agreement.

4. How shall remaining profits be shared? ______

E. Records and accounts.

1. Where will partnership funds be deposited? ______
2. Who will be empowered to draw on the partnership account? ______
3. Who will be responsible for keeping accounts? ______
   a. Will they be reimbursed? ______
   b. Who will do the income tax work? ______
   c. When will the records be open to inspection? ______
4. What types of annual statements shall be provided?

   Net worth ______ P & L ______ Cash Flow ______ Other ______
5. What types of accounts shall be provided?

   Capital account? ______ Drawing accounts? ______
6. What accounting system (single/double entry) will be used? ______
7. Will records be kept on a cash or accrual basis? ______

III. Operation: How are you going to operate together?

A. Overall decision-making authority; new partners.

1. How are major decisions to be made?

   Option #1 With one partner as general manager with some delegation of authority?

   ______ or

   Option #2 All partners equally involved in decisions, but with final authority delegated(1) to partner with majority interest, or (2) to arbitrators? ______

   ______ or

   Option #3 ______
2. In case of disagreements, provision will be made for arbitration as follows: ______
3. On what basis will new partners be admitted into the partnership? ______

Worksheet 3-1 (continued). Developing a farm partnership agreement.

B. Division of responsibility for daily operation.

1. How are duties to be divided for daily management of business, such as production and marketing activities, financial and business matters, personnel management, other?

____

____

2. What happens if a partner is unable to perform services assigned to them? ____________________

____

____

C. Limits on powers of partners.

Because partners have unlimited liability in a partnership, usually a substantial list of limits is placed on the personal and business activities of the partners. Discuss this aspect carefully with an attorney and make the resultant list part of the agreement.

D. Communications/personal development.

1. What provisions are to be made for maintaining good communication among the partners?

____

With their families? ____________________

____

2. What opportunities will be provided for the continued personal development of the partners?

____

____

____

E. Housing of partners/vacation and time-off.

1. How will partners' housing be handled? ____________________

____

____

2. How will partners' vacation and time-off be handled? ____________________

____

____

IV. Partnership dissolution: What will happen if...?

Special note: If you are concerned about assets leaving your business because one partner quits or becomes divorced then consider placing most of your personal property in the partnership. A limited partnership can serve a similar purpose in the case of real estate.

A. Protecting the senior partner's interest.

1. Under what conditions would the junior partner have a right to leave the partnership? (time of year, length of notice, other.) ____________________

____

2. Will there be any penalty assessed the junior partner if he/she violates this provision? If so, the extent of penalty?

____

____

Worksheet 3-1 (concluded). Developing a farm partnership agreement.

3. What would happen to the property the junior partner acquired from the senior partner during the formation or operation of the partnership? ______________________

4. Other restrictions, provisions? ______________________

B. Protecting the junior partner's interests and future in partnership and business.

1. What will happen to the partnership and farm business if the senior partner is disabled or dies?

____

2. How will the junior partner's equity in the business be protected? ______________________

3. Will there be any buy-sell agreements established and, if so, for what property? How will values be established and payments made? Will life insurance be used to fund part or all of it?

____

4. What adjustments, if any, need to be made in senior partners' wills and other estate plans to reflect desires relative to the junior partner? Other heirs? ______________________

Worksheet 3-2. Can a financially viable, desired share arrangement be developed?

Step #1. Determine the expected net cash income available from the partnership.

(Projected annual partnership net cash income over next 3-5 years)

Partnership cash farm income		
Livestock sales		
__________		
__________		
Crop sales		
__________		
__________		
Machine work done		
Patronage dividends		
Agricultural program payments		
Gas tax credits/refunds		
__________		
__________		
Total cash partnership farm income		1
Partnership cash operating expenses owed non-partners		
Labor hired		
Repairs, maintenance		
Rent on farm, pasture (non-partners)		
Feed purchased		
Seeds, plants purchased		
Fertilizer, lime, chemicals		
Machine hire, storage		
Supplies purchased		
Breeding fees		
Veterinary fees, medicine		
Gas, fuel, oil		
Insurance		
Utilities		
Freight, trucking		
Livestock purchases		
__________		
__________		
Total cash partnership operating expenses		2
Interest on operating expense		3
Principal & interest payments on partnership debt		4
Added machinery replacement allowance, if any		5
Total partnership outlays owed non-partners (2+3+4+5)		6
Net cash income available from partnership (1-6)		7

Worksheet 3-2. Can a financially viable, desired share arrangement be developed?

Step #2. Determine each partner's share of partnership income: The desired sharing of residual profits approach.

[Partners share residual profits (line 8) in a specified desired percentage (line 9), after making specified payments for the use of partner's resources (line 7)]

	Paid by partnership	Paid to Partner	Partner	Partner	
Net cash income available (line 7, page 70)					1
Cash payments due partners for resources used by partnership					
Net cash rent of real estate	$	$	$	$	2
Net lease of machinery					3
Net lease of livestock equipment					4
Value labor and management					5
______________					6
Total cash payment due partners					7
Residual profits: surplus (deficits) (line 1-7)					8
Desired allocation of surplus (deficit)	100%	%	%	%	9
Partner's share of surplus (deficit) (8 x 9)					10
Partner's share of total partnership income (7+10)					11

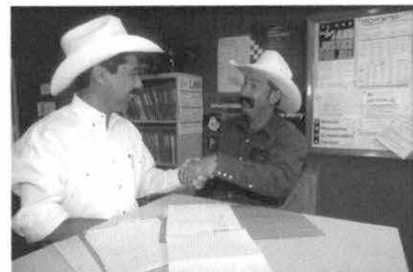
Step #3. Determine each partner's ability to meet their own financial commitments.

Income				
Partner's share of total partnership income (line 11)				12
Other net business and non-farm income				13
Principal & interest received from partner(s) and others				14
Partner's net cash income available (12+13+14)				15
Outlays				
Real estate P & I payments				16
Real estate taxes				17
Insurance, if any				18
Non-real estate P & I payments				19
Additional machinery replacement allowance				20
Family spending & income tax				21
______________				22
Total cash outlays of partners (add 16 thru 22)				23
Balance: cash surplus (deficit) (15-23)				24

Getting established partly/ mostly on one's own

4

- Options and keys to establishing one's own business
- Developing a crop-oriented farm business
- Developing a livestock-oriented farm business
- Lifestyle, health, and estate planning issues



The previous chapter addressed the process of getting established in farming via a multi owner/operator business. The focus now shifts to the process of a younger person establishing his/her own business. This can involve a continuum of arrangements, ranging from a joint venture arrangement with an established farm business or agribusiness firm, to starting independently with the aid of a knowledgeable lender and a supportive landlord.

This chapter first covers the various routes that a prospective farmer might follow in getting established. Then, some fundamental keys to the successful establishment of one's own business are noted. A discussion of the requirements and possible strategies for use in developing a crop-oriented or a livestock-oriented business follows. The chapter closes with a brief discussion of lifestyle, health, and estate planning aspects that should accompany the overall business plan of a beginning farmer.

(Note: Parts I through IV of this series will prove helpful to any farm business operator. Part I helps analyze the financial feasibility of such an undertaking. Parts II through IV deal with the on-going management of a business. Chapter headings for each of these parts are listed on the inside back cover of this publication.)

Options and keys to establishing one's own business

This section describes some of the alternatives for independently establishing one's own farm business. Then it outlines some of the fundamental keys to the successful establishment of a full time business.

Alternative routes to establishing one's own business

As indicated in Chapters 1 and 2, getting established in farming today is difficult because of the high capital and management requirements, and the risks involved. As a result, there are basically two broad options to consider when deciding how best to establish a business. These options include: (1) farming together, but separately and (2) the dual career.

Farming together, but separately

Successfully gaining entry into farming on a full time basis usually requires that the prospective farmer piggy back with an established business or become involved in some type of joint venture. Two such arrangements were analyzed and discussed in Chapter 2. One option is a spin-off arrangement where the beginning farmer rents land and exchanges labor for the use of an established farmer's machinery.

Another option is the development of a joint venture, e.g., with a livestock enterprise. Procedures for analyzing such arrangements are discussed in Chapter 2.

Production contracts with agribusiness firms may also provide another entry option. Chapter 4, Part III of this series contains a discussion of production contracts, including a checklist for evaluating the proposed arrangement.

The dual career route

One may also establish a farm business by opting for a dual-career or part-time farming endeavor. This approach usually involves a fairly substantial farming operation and a non-farm job. If organized properly, a farm enterprise can add to family net income and, most importantly, result in increased equity. Successful part-time farmers often have enterprises that give high returns to their limited labor supply. These enterprises must be managed efficiently, and overhead expenses (such as machinery) must be kept in bounds. A dual-career lifestyle may be maintained over a considerable period of time. In some cases, a decision may be made to continue this method of earning a living throughout one's working years.

Combining farming and off-farm employment may be a logical strategy. However, to use this strategy as a successful method of gaining entry into full-time farming, work at becoming a good farmer and at becoming known in the community as a good manager. For example, managing finances to build net worth would demonstrate to creditors an ability to manage money effectively. Also, recognize that taking the step to full-time farming may never happen. Often part-time farmers become accustomed to a relatively higher standard of living and hesitate to give up the security they have acquired in their non-farm jobs.

Some keys to establishing one's own full-time business

The following are some key principles that a young farmer should keep in mind when moving toward the establishment of a full-time farming operation:

Most successful business people did not start at the top, therefore:

- Do not try to get too big too soon. Develop over time, keeping business size consistent with management skills and financial position.
- Establish a good track record by showing an ability to generate and manage income.
- Have long-term goals and the plans to attain them.

Most beginning farmers have adequate labor but limited capital, therefore:

- Use scarce capital to purchase items that bring high returns, such as feed, fertilizer, breeding stock.
- When possible, piggy back with an established operator to reduce pressure for buying machinery and to have access to management help.
- When possible, substitute labor for capital. Use smaller equipment and existing buildings where feasible.
- When possible, select labor-intensive enterprises to make fuller, year-round use of labor supply, e.g., a dairy or farrow-to-finish hog operation.
- Gain control of resources in ways that will give good returns thus making effective use of leverage, yet protect the liquidity position of the business. This could include share rental of cropland, custom hiring or leasing machinery.
- Minimize cash flow demands, as well as the risk of large losses.
- Manage risks carefully. Employ insurance and risk-reducing marketing strategies, and consider developing a somewhat diversified operation.

Over time, capital availability will depend on one's own management capability, therefore:

- Establish a good production, marketing, and financial record. Do not try to grow too fast.
- Spend time becoming a better manager. Develop production, marketing, and financial skills.
- Secure management help when possible—from an extension agent, an adult vocational agricultural course, a creditor, a professional manager or consultant, or a good farmer.

Some other key thoughts include:

- Keep fully employed. While the unit is being developed, full employment may require off-farm employment.
- Keep family living costs in bounds. Usually the beginning farm family must sacrifice its standard of living to a substantial degree to achieve financial progress and establishment in farming.
- Supplement farm earnings with off-farm employment income from the farmer and/ or spouse which will help reduce the drag on business development caused by family living and debt interest outlays.

Developing a crop-oriented farm business

Developing a crop-oriented farm business is usually a less complex assignment than developing a livestock-oriented business. The latter usually involves development of both cropping and livestock systems. But, there are at least two major challenges in attempting to start such a business. First, it is often difficult to put together sufficient land and other resources to provide full employment because of the competition for land (whether on a rental or purchase basis) from established farmers who can usually bid more. The second challenge is, that in attempting to form a relatively specialized business, one is subjected to considerable price and yield risk, which could force one out of business.

This section briefly outlines the general requirements for successfully starting a crop-oriented business, then describes some possible ways of getting started.

General requirements for establishing a crop business

First, develop an overall farm plan as well as a cash flow plan as discussed in Part I of this series. Develop such a plan both for personal use and for the lender and landlord who will likely be supplying more resources and taking more risks than the farmer.

Since resources will likely be hard to come by, it is essential to continually sharpen production, marketing and cost control skills so that one can secure a reasonable level of net income. Also, keep up on various government farm programs that will help increase income and/or reduce risks.

In all likelihood a beginning farmer will need to work off the farm or exchange labor for the use of machinery with an established farmer. By doing so, one either increases the total income available or reduces costs. In either case, look to increase net income and as a result increase equity in the business.

Some possible ways of getting started

There are three ways of starting a cropping operation. These include: (1) a spin-off from the home farm; (2) part-time/dual career; and (3) delayed entry into full-time farming.

Spin-off from established operation

As discussed in Chapter 2, a common way of getting started in farming involves a spin-off from an established farm. It is a particularly viable option for persons starting a cropping operation because it can be a much simpler joint arrangement than with a livestock operation. In fact, in many cropping areas, this is the most common way of getting started.

A common arrangement is for the new farmer to rent some land nearby and exchange some labor for the use of the established farmer's machinery. Be sure to develop a sharing plan that is fair to both parties. It should detail how certain costs will be handled and how differences in the value of labor and machinery contributions will be compensated.

This arrangement may change over time, with possible joint ownership of some machinery. The arrangement may ultimately be changed to one where the beginning farmer rents the established farmer's land. All machinery is acquired via a lease, purchase or custom hire. The new farmer may eventually decide to buy the established base unit to provide machinery storage as well as crop storage and handling facilities.

Dual career

The extent to which a starting farmer can work off the farm depends on the size of the operation and the seasonal demands of the crops grown. In areas where corn, soybeans and/or small grains are grown, the starting farmer can often work full time off the farm, doing necessary cropping operations on weekends, and during vacations, along with some additional time off as needed.

Eventually the starting farmer will likely buy a farmstead and continue to rent most of the land operated. Machinery may be owned or share owned, leased or custom hired. The best approach depends on the size of operation and financial situation.

Delayed entry/full-time farming

Some prospective farmers will have had other careers prior to seeking entrance into farming. This may include working for a large, super-firm farm, an agribusiness firm or lender, or another business. Often these experiences have helped develop the person's commitment to farming, developed some business management skills, and built some equity. This situation is conducive to the development of a larger, full-time cropping operation. But again, the prospective farmer needs to develop a carefully conceived plan for entry with emphasis on production, marketing and cost management skills. Work off the farm may be required early on, as the farming operation will not likely involve full use of the operator's time.

Developing a livestock-oriented farm business

In contrast to a crop-oriented farm business, developing and managing a livestock-oriented farm business is usually much more complex. By the same token, this type of operation is more likely to provide the prospective farmer with relatively full employment, and will also likely spread production and marketing risks better.

General requirements for establishing a livestock operation

A livestock operation requires varying kinds and amounts of animal husbandry skills in addition to cropping skills. Since many livestock operations require the hiring of full-time labor or a partnership situation, the manager of this operation should have reasonable people skills as well. The amount of resources required vary by type of farm as well as whether the operation will be producing its own feed supply and whether the livestock part of the business involves a contractual arrangement on the production side.

Here again, make projections for the proposed operation, including transition and annual cash flow plans. This planning process is discussed in Chapters 3 and 4, Part I. Before entering into a contractual arrangement, review the contract carefully. See Chapter 4, Part III for a guide for analyzing contracts.

The need or desirability of off-farm employment varies with the type of operation and the prospective farmer's resources and management skills. Whether a spouse should work off the farm or not also depends on whether he/she could play a productive role in the business, as well as the other types of employment available. Certain types of farming operations, such as dairy and beef cattle, can require the use of considerable borrowed money. Off-farm income can help ensure that these debt commitments are repaid in a timely fashion.

Some possible ways of getting started

There are several ways to get started in a livestock business. These include spin-off, joint venture, and production contracts.

Spin-off

With this arrangement, the prospective farmer would have worked on an established farm. He/she should have gained management experience and accumulated some equity including ownership of some livestock. This may also involve renting a farmstead and cropland, possibly sharing the use of an established farmer's machinery, buying necessary livestock, and possibly custom hiring selected cropping operations.

Joint venture

Because many Midwest farm operations involve both crop and livestock enterprises, it may be possible to form part of the business independently, while the other part is developed as a joint venture. This may include a joint venture on the livestock side of the business, while the cropping operation is developed separately. Or, the cropping operation may involve joint ownership of machinery and/or working jointly on the crop side, while developing a livestock operation independently.

Production contract

More and more of the livestock industry is moving toward the use of production contracts. With this approach, a beginning farmer can develop a cropping system as needed or desired, and develop the livestock system with financial and managerial help of an agribusiness firm. Evaluate contractual arrangements carefully as to the returns the producer might receive. Consider potential risks from a variety of angles (e.g. investments in facilities; the agribusiness firm withdrawing the contract for specified reasons). See Chapter 4, Part III of this series, for an example process of evaluating production-related contractual arrangements.

Lifestyle, health, and estate planning issues

The main focus during the establishment years should be on: (1) developing a profitable, financially sound, adequately protected business, and (2) making wise use of business profits and other income. But one should also begin the process of developing a lifestyle that will give real meaning to life for the present as well as in later years.[1] And, because farming is both a stressful and often dangerous occupation, one needs to take appropriate measures to protect and even enhance one's health during the early years. Insurance provisions and estate plans need to be in place to provide adequate protection for spouse and children, should death or disability strike the farmer.

The saying: "Happiness is found along the way, not at the end of the road," is quite true. Modern-day farming is a demanding occupation, both physically and mentally. Diversions are necessary to "survive" such rigors. Many who postponed enjoyment until their long-awaited retirement have found that their plans never materialized because of a serious illness, financial problems, or the loss of a spouse/partner. It is important to note that the better job one does of developing a satisfying lifestyle along the way, the more likely one will be able to adapt that lifestyle to a retirement situation. But more importantly, enjoying a balanced life in the present reduces the chances of future regrets.

Lifestyle development

Allocate some time and money toward developing a meaningful lifestyle that enhances skills, interests, and relationships, and brings enjoyment to each day while providing a foundation for a fuller, more rewarding future.

[1] A line in the article "Dairy Farming Family-Style" reads: "They're trying to balance family needs with those of the cows". This suggests that at least one dairy family realizes this need and is doing something about it.

Health issues

Not only is farming a stressful occupation, it is a potentially dangerous one as well. Accidents with machinery, equipment and livestock are common. Physical illnesses growing out of dust, pollens and mishandling of chemicals are of real concern.

Therefore, during these early years, develop a work environment and work habits that will protect health. (Efforts benefit not only the pri-

mary farmer, but the family and other workers as well.) A good health insurance program and sufficient disability insurance are essential. Identify qualified and trustworthy health providers and get periodic health examinations before a crisis arises. One's farming career and eventual retirement are both heavily dependent upon the maintenance and protection of one's health right now.

Estate plans: Providing adequate protection for spouse and children

The greatest need for the economic protection of a farm family typically occurs when the family is young and can least afford to purchase that protection. Generally, the peak need for protection from the interruption of income occurs at the birth of the last child. Each day after that, each child is one day closer to being self-supporting. While a family is young, parents must place top priority on providing maximum security for the surviving spouse and minor children. At the same time, estate plans must be flexible since the chances of an untimely death are not great. The estate is likely to grow over time, presenting the parents with a possible estate tax problem later in their careers.

Therefore, consider these planning suggestions for the early stage of a farming career:

- **Explore ways of providing greater income protection for the family.** This may include more insurance to provide an immediate estate and resultant source of income. Normally insurance is concentrated on the main income generator and should be primarily term insurance. Also, evaluate health insurance programs relative to a lingering illness or disability. (See Chapter 6, Part II of this series.)

- **Develop plans for the future of the business and for the spouse.** Discuss what should be done with the farm business if something should happen to the farmer. Would the spouse want to continue farming? Who would help manage it? If not, should the farm be sold? If so, how: by contract or for cash? What might the surviving spouse do: work? go to school? Each spouse should become familiar with various social security and service benefit programs that would be available if an untimely death did occur.

- **Avoid dying without a will (intestate).** Death without a will could leave a young surviving spouse with total responsibility for the children and only a portion of the property (other than joint tenancy, homestead, insurance, and personal effects) at his/her disposal. A simple will would pass everything to the surviving spouse, which, in most cases, would be desirable at this early stage. This would also eliminate the problem of minor children receiving assets which would necessitate an accounting to the court.

- **A will should also contain provisions relative to any minor children, just in case something should happen to both parents.** It should provide a guardianship for their personal care and a children's trust to provide for the management and protection of the property they would receive at their young age.

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Part I
Developing a Longer Range Strategic Farm Business Plan

- Longer range business planning - an introduction
- Evaluating the present business situation; setting goals
- Developing a longer range business plan
- Developing a workable transition plan
- Managing the financially stressed farm business

Part II
Managing the Overall Business

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- Evaluating/improving "people skills"
- Contracts and property law; a guide to other legal aspects

Managing financial aspects of a business
- Developing/implementing/controlling annual financial plans
- Financing non-real estate aspects of a business
- Income tax planning and management
- Using insurance in managing business and family-related risks

Business arrangements; retirement and estate planning
- Developing/updating farm business arrangements
- Mid-career check of retirement and estate plans

Part III
Managing Production and Marketing Systems

- Economic fundamentals and related planning tools
- Managing crop enterprises and related systems
- Managing livestock enterprises/systems
- Evaluating/developing production contract arrangements

Part IV
Acquiring and Managing Resources

- Renting farmland and facilities
- Analyzing/financing farm real estate purchases
- Managing the machinery system
- Farm personnel—planning and staffing
- Managing the work force effectively

Part VI
Planning the Late-career, Retirement Years (available July 2002)

- The pre-retirement planning process: an overview
- Developing and testing the retirement lifestyle
- Managing financial security aspects; developing/updating estate plans
- Farm business continuation and the asset transfer process