

SUCCESSION PLANNING

Michael Langemeier
Tonganoxie, Kansas
February 17, 2011

1

Introduction

- Most people are interesting in learning more about:
 - Maintaining or improving their current lifestyle
 - Preparing their family and their farm for whatever may come
 - Providing reassurance that unforeseen catastrophe will not destroy the operation
 - Preparing the next generation for a leadership role in the operation
 - Creating a lasting legacy that will endow the family for generations

2

Getting Started

- “We can’t solve problems by using the same kind of thinking we used when we created them.”
 - Albert Einstein

3

Getting Started

- The objective of a succession plan is to create a business that will endure beyond the current generation.
- Through the planning process, an owner defines specific business objectives, retirement aspirations, and financial goals as well as compensates for estate planning obligations.

4

Getting Started

- Only 30% of all farms and agribusinesses successfully transition from the first to second generation.
- Of those that do survive, 10% transition to the third, and of the few remaining, less than 4% make it to the fourth.

5

Getting Started

- Reasons why family operations do not successfully transition:
 - incompatible estate planning
 - insufficient capitalization
 - failure to prepare the next generation for a leadership role

6

Open Communication

- **Five Keys to Good Communication**
 - Clearly define your objectives or the intent of each interaction.
 - Seek first to understand the other person's point of view.
 - Discussions are more productive when we remember that there is no single right way to do anything.
 - Acknowledge that it takes complementary qualities to create a successful operation that can stand the test of time.
 - Know that it is okay to disagree.

7

By Design or Default

- A sound succession plan addresses the goals that business owners have for themselves and their family.
- It can also enhance the value of the business by making it less dependent on the talents of the owner.

8

By Design or Default

- **Common Goals of Owners**
 - Keeping business ownership in the family
 - Maintaining profitability
 - Expanding the operation
 - Providing liquidity to the owner or estate
 - Providing financial security
 - Maintaining family harmony

9

Steps Toward Transition

- Owners typically want:
 - To leave a thriving business to their family members
 - A strong leader to assume control
 - Well-handed capital management
 - A retirement option date with a plan for implementation
 - An estate plan that minimizes costs and maximizes transfer value

10

Steps Toward Transition

- **Six Step Process**
 - Consultation
 - Discovery
 - Preliminary Plan
 - Final Plan Design
 - Implementation
 - Annual Review

11

The Right Foundation

- Producers typically go through the business planning process to:
 - Evaluate production alternatives
 - Identify new market opportunities
 - Communicate their ideas to lenders, business partners, and family

12

The Right Foundation

- **Components of a Business Plan**
 - Vision or Mission Statement
 - Clearly Defined Goals and Objectives
 - Company History and Guiding Values
 - SWOT Analysis
 - System Changes and Improvements
 - Management Responsibilities
 - Budget to Project Income and Expenses
 - Review and Evaluation

13

The Right Foundation

- If the exit stage of one operator coincides with the entry stage of the next operator, the transfer process may be relatively simple.
- In many family farming situations, however, the next generation is ready to enter the business while the current generation is still in the growth or consolidation stage.

14

The Right Foundation

- **Questions that Need to be Addressed**
 - Is the business large enough to productively employ another operator?
 - Is the business profitable enough to support another operator?
 - Can management responsibilities be shared?

15

Leadership Preparation

- Leadership is the ability to set objectives, explore alternatives, take action, and change course when appropriate.
- The best transition for you and your successor is a gradual transfer of responsibility.

16

Leadership Preparation

- **Stages in Transferring the Business**

- A testing stage of 1 to 5 years is recommended, during which the entering operator is employed and receives a salary and bonus or incentive and begins to own or rent some additional assets.
- Forms of business organization and acquisition of assets that would be difficult to liquidate should be avoided until both parties determine their ultimate goals, and whether they can work together.

17

Leadership Preparation

- Following the testing stage, at least **three alternative types of arrangements** are possible:
 - The **spin-off option** involves the separation of the operators into their own operations.
 - The **takeover option** occurs when the older generation phases out of active labor and management, usually to retire or enter another occupation.
 - A **joint operation** may be developed when both generations wish to continue farming together.

18

A Key to Continuity

- A well-written buy-sell agreement will:
 - Prevent inactive owners from gaining ownership interest
 - Ensure ownership continues after death, disability, dissolution, or divorce
 - Provide a ready market for a closely held business interest

19

A Key to Continuity

- A buy-sell agreement may include the following common provisions:
 - Right of first refusal
 - Mandatory purchase option
 - Option to purchase
 - Push-pull clause
 - Tag-along clause

20

A Key to Continuity

- Triggering Events in Buy-Sell Agreement
 - Death
 - Disability
 - Retirement or withdrawal from the business
 - Divorce
 - Dissolution, insolvency, or bankruptcy
 - Adverse legal action

21

Ready for Retirement?

- When farmers discuss retirement, there is often a hesitation in their voice.
- Is this hesitation due to their love of their occupation or due to the failure to plan?
- One possible suggestion is to set up a retirement option, where the owner establishes a time line for transition and then builds a succession plan based on the chosen date.

22

Ready for Retirement?

- **When is it Time?**
 - Will I continue to work in the business or in a completely new venture?
 - As I prepare for retirement, how do I want to develop my business?
 - Have I considered alternatives to complete retirement?
 - Are the rest of my family interested in continued expansion?
 - Do I see a financially sound retirement?

23

Estate Plan Essentials

- In any business, coming together as partners is the easy part. The hard part is working together to achieve success.
- Family farms that remain a cohesive unit through several generations typically exhibit a competitive advantage over time.

24

Estate Plan Essentials

- **Essential Elements of Comprehensive Plans**
 - Financial Security
 - Management Continuity/Ownership Transition
 - Leadership Development
 - Estate Planning

25

Draft Your Team

- **Build a Strong Network**
 - Project Manager
 - Financial Planner
 - Accountant
 - Estate Planning Attorney
 - Trust Officer
 - Banker
 - Insurance Professional

26

The Miracle of Commitment

- Commit today to ensure future business and family success!

27

Additional Information

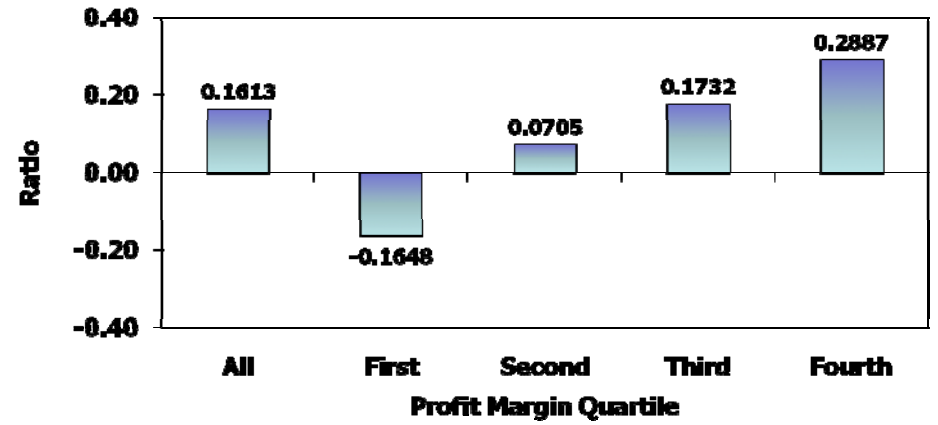
- Web Site: Farm Journal Legacy Project
 - www.FarmJournalLegacyProject.com
- Software
 - FINPACK

28

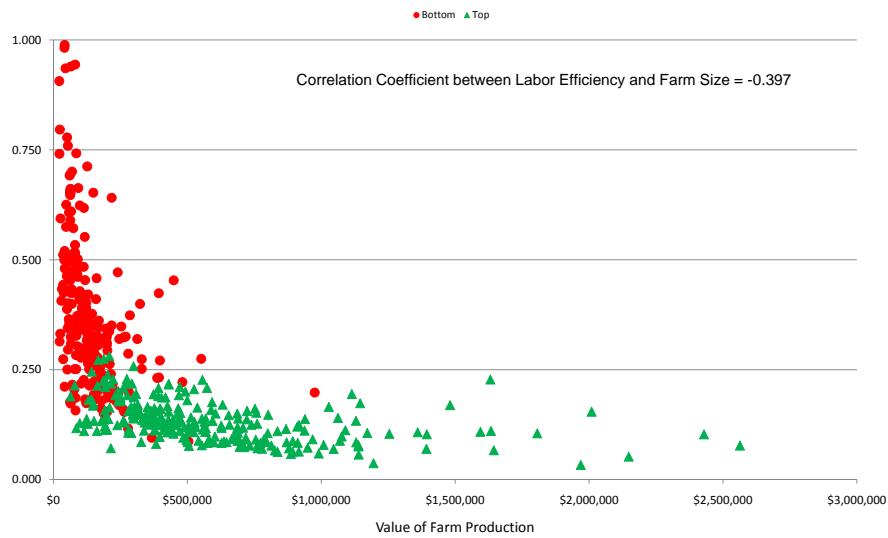
Financial Component Business Plan

- Benchmarking
 - Enterprise
 - Whole-Farm
- Pro-Forma Financial Statements

Profit Margin Ratio



Labor Efficiency



Labor Productivity



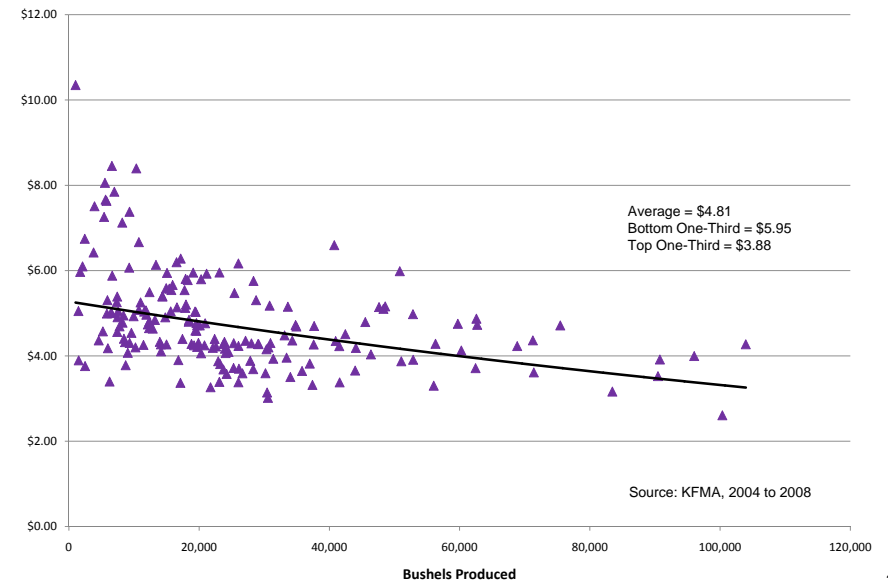
Kansas Farm Management Association: State Averages

2005-2009 Beef Cow Enterprise Sorted by Net Return to Management per Cow

	Profit Category			Difference between	
	High 1/3	Mid 1/3	Low 1/3	High 1/3 and Low 1/3	%
Number of Farms	20	21	20		
Number of Cows in Herd	165	128	111	54	49%
Number of Calves Sold	138	105	90	48	53%
Average Weight of Calves Sold	619	647	715	(96)	-13%
Sales Price / Cwt	\$107.03	\$103.42	\$99.99	\$7.04	7%
INCOME PER COW					
Gross Income	\$590.15	\$578.11	\$603.90	(\$13.75)	-2%
COSTS PER COW					
Feed	\$305.10	\$359.41	\$409.05	(\$103.95)	-25%
Interest	\$97.01	\$127.27	\$144.76	(\$47.74)	-33%
Vet Medicine / Drugs	\$15.09	\$14.63	\$25.41	(\$10.32)	-41%
Livestock Marketing / Breeding	\$9.16	\$9.83	\$21.75	(\$12.58)	-58%
Depreciation	\$34.39	\$25.41	\$33.06	\$1.33	4%
Machinery	\$44.20	\$61.38	\$72.41	(\$28.21)	-39%
Labor	\$66.16	\$86.39	\$114.11	(\$47.95)	-42%
Other	\$26.07	\$37.52	\$42.37	(\$16.30)	-38%
Total Cost	\$597.19	\$721.85	\$862.93	(\$265.73)	-31%
Net Return to Management / Cow	(\$7.04)	(\$143.74)	(\$259.03)	\$251.98	

33

Cost per Bushel of Wheat in Kansas



34

Financial Component Business Plan

- What do you need to include in your business plan to communicate financial viability?
- Financial viability is generally evaluated from three perspectives:
 - Solvency
 - Profitability
 - Liquidity

35

Financial Component Business Plan

- Solvency evaluates changes in net worth
 - growth in asset base (farm and non-farm)
- Profitability monitors earnings
 - ability to generate income
- Liquidity estimates cash flow and debt repayment ability
 - paying the bills when due

36

Contact Information

- **Michael Langemeier**

- mlange@agecon.ksu.edu

- Ag Manager Contributor Site (www.agmanager.info)

- KFMA Newsletter
 - Cattle Net Return Series