Transition Planning:

12 Steps to Keep the Family Farming

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While many family-owned businesses have the long-term objective of "passing the business on to the next generation," this is not an easy process. A great deal of planning, preparation and communication is needed in order to accomplish the feat of moving the business from one generation to the next. The aspirations of both generations need to be addressed, along with the financial feasibility of the operation supporting all involved. This article outlines 12 steps that can increase the possibility of a successful transition.

Step 1:

What matters most

Our families, friends, religious beliefs, experiences and exposure to media influence our core values. These values reflect the things we hold dear and also may identify what we are willing to sacrifice to achieve the things we hold dear. Our values may involve the desire to work with family members, the willingness to sacrifice money to achieve other goals, the standard of living that is important to us, the desire to be good stewards of resources given to us, as well as the desire to pass on some legacy to future generations.

The first step of this planning process is to identify the core values that lay the foundation for all the planning to follow. These core values reflect the things that are most important to the individuals involved.

Step 2:

Identify wants, needs, hopes and fears

Families often find it difficult to communicate their concerns when a successor plans to return to the farm family business. Often, it is even more difficult to discuss those concerns with family members. This exercise helps families explore their concerns. Each family member should answer the following questions on his or her own and then share with other family members.

- What do I **want** to happen when the family farm transitions to new management?
- What do I **need** to happen when the family farm transitions to new management?
- What do I **hope** happens when the family farm transitions to new management?
- What do I **fear** might happen when the family farm transitions to new management?

This exercise is helpful to facilitate the communication needed to develop a transition plan.

Step 3:

Establish vision/mission statements, objectives and goals

A vision is critical for a successful business, especially when in transition from one generation to another. A commonly shared vision holds the transition plan together. The vision statement provides the guiding philosophy for the operation and reflects the core values identified in Step 1.

A vision statement is broad and future-oriented, whereas a mission statement is more focused, contemporary, and includes what the business is today. Objectives move you toward your vision. They should be attainable, represent a positive challenge and be easy to visualize.

Goals should be more specific, measurable, attainable, rewarding, and have a deadline. Thinking strategically while developing objectives allows business decisions to be made that lead to realization of the vision for the business.

If you start planning with the farm's resource base in mind, without a common vision of how to maximize those resources, efficiencies may be lost. Conflict is common when business partners have differing ideas on how to use the same resources.

Think in terms of identifying the vision that leads to the mission, which in turn formulates longer-term objectives, which lead to short-term, well-defined and achievable goals. Then enterprises and activities can be selected that best use the resource base in the most efficient fashion. See the K-State Research and Extension *Farm Management Guide Farm and Ranch Strategic Planning, Visioning and Goal Setting*, MF2695, for more details.

Step 4:

Human resource evaluation

It is important to identify the strengths and weaknesses of the individuals involved in farm transitions. People must be in positions in which they can thrive and contribute to the operation's success.

Too many families expect a successor to maintain the operating procedures from the retiring generation. This may not fit the strengths of new individuals and may limit the operation's potential.

Without communicating the skills and desires of the successor, many transitions either continue in conflict or fail altogether. Discuss what tasks need to be accomplished and whether the existing or incoming human resource complement will be a good fit. If not, human resource adjustments may need to be made by acquiring additional help.

Step 5:

Who is in charge?

A common mistake the retiring generation makes is to not let go of the reins. The successor needs to make decisions, even if sometimes it becomes a learning experience. A simple organizational chart diagramming the current decision-making system — and another that changes when the successor is granted authority — is critically important to the success of transitioning the farm operation.

An organizational chart shows the structure of the organization and provides a framework for stakeholder interaction. This structure ensures that everyone understands what is expected and how decisions are made. Each stakeholder must be aware of the vision, mission, objectives and goals. Each stakeholder must understand the roles of the other stakeholders. Lines of authority and responsibility need to be clearly established.

Step 6:

Where do we stand financially?

This step answers critical questions about financial conditions. Is the business profitable, solvent, liquid and efficient? Can the business repay obligations? Are changes needed or will the current operation achieve the objectives and goals already developed?

Without analyzing the numbers within the business, how does anyone know there is room for other family members to join in the operation? Basic financial statements include beginning and ending balance sheets, an income statement, a statement of cash flow and a statement of owner equity. This step may be the most important of this process. It establishes the feasibility of transition plans and the financial requirements for success.

Full disclosure is important for the successor to understand the financial realities of the business. A complete evaluation of the current financial position of the business should include a determination of the vulnerability of the business to common financial hazards, such as the often-cited "Three D's" — death, disability and divorce.

Step 7:

Do we have what we need?

This step involves developing an inventory of the resources available. These resources include land, machinery, buildings, financial resources, community support and services, and people. Focus on the productive capacity, the usefulness of the resources, and think about how the resources help achieve the vision, mission, objectives and goals.

Is there a combination of underused resources that could create a new business opportunity? How large does the business need to be? Can the business supply the sales volume required to provide the income for living expenses and debt repayment? Simple calculations can shed light on the feasibility of transition success.

Unless the retiring generation turns over the business to the successor and formally retires, there may not be room for a successor unless the business grows or the successor works part-time away from the business. If additional resources are needed, investments in machinery, land and livestock all need to add adequate income to an operation to cover the additional debt. Additional investments need to be considered carefully to determine if they are feasible.

Step 8:

SWOT analysis of internal/external factors

Planning by identifying the strengths, weaknesses, opportunities and threats (SWOT) identified with an operation allows families to determine management strategies. The SWOT analysis helps identify strengths and weaknesses internal to the business, and opportunities and threats from outside the business.

In the strengths section, identify the strengths that make you competitive, what you do better than anyone else, and what your customers see as your strengths.

In the weakness section, identify what you can improve, what you should avoid, and what your competitors do better than you.

In the opportunities section, consider the trends facing your business, opportunities that are available, and things in the community that can be an advantage for you.

In the threats section, identify obstacles from outside your business, including your competitors, changes in technology or other outside factors that threaten your business.

In building the farm game plan, it is important to analyze your opponent. Farming is challenging as producers work with the weather, markets and other issues. Identification of these issues is part of the risk management planning.

Step 9:

Evaluating financial feasibility

This step involves developing a financial evaluation of your future operational plan. It may involve crop or livestock enterprise budgets, cash-flow budgets and partial budgets that show the results of changes in your operation.

Completing a detailed financial projection using a program called Finpack[1] helps to place the goals into a financial roadmap the business can follow. Finpack is a comprehensive financial planning and analysis system designed to help producers understand their financial situation and make informed decisions. It is not a recordkeeping system. Instead, Finpack provides tools to effectively use farm records to make business analysis, long-range planning and cash-flow planning as complete and meaningful as possible. It teaches financial concepts through their individual application on each farm.

The questions about your operation that must be answered are:

- Where am I?
- Where do I want to be?
- How can I get there?

Providing a formal financial plan to follow allows focus on the plan and enables producers to know they are on track. Evaluating the results each year against the projections allows for better planning in the future.

Step 10:

Developing a business plan

After defining values, developing

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vision and mission statements, setting objectives and goals, and running the numbers to make sure the plans are feasible, it is time to incorporate everything into a comprehensive plan for the farm. A business plan is particularly important for expanding businesses and for farms that are transitioning from one generation to the next. The business plan effectively communicates plans to lenders, investors and partners, as well as internally to family members and employees. The business plan documents the financial viability of the business and shows that you have taken the time to think through the details required to succeed. Excellent sources of help for developing a business plan, such as AgPlan[2], provide a framework to use and examples to see what should be included in each section of the plan.

Step 11:

Estate planning, retirement planning and business entity buffet

No transition plan can be effective and sustainable without addressing the issue of estate planning. This does not just mean for the retiring generation. It is important for the succeeding generation to apply estate planning to their assets and liabilities, as well.

There is a great deal of interdependence between the organizational structure (how decisions are made and who is responsible for what), business structure (legal form of the business) and financial structure (who or what owns the assets, and where does the income go?). This interdependence is further complicated because it has implications for estate taxes, income taxes, how the assets can be passed on to the next generation, and who gets the income.

There are a number of choices to consider in choosing the legal form of the business, and they have many implications for the business. These issues need to be carefully considered, and it is likely that professional legal help will be needed. Much of the planning up to this point can provide the background needed to make these decisions.

Security is important for all parties, and communication of plans is valuable for all involved. The succeeding generation needs to know what they have worked for will be put into writing and made legal, allowing successors the comfort of knowing estate settlements will not end up in conflict between heirs on and off the farm.

Step 12:

Putting the plan into action

It is important at this point to develop a timeline spelling out when the various succession planning details will be addressed, and who will take the lead on the various components. Over this timeline, promises made must be kept. There must be respect for the needs of the retiring generation while allowing management to be passed on to the next generation.

Transitions will happen, one way or another. If accomplished with effective communication and formal business planning, the result can be an operation that is highly competitive and will enable another generation to come aboard.

[1] For more information about Finpack, see *www.cffm.umn.edu*

[2] For more information about AgPlan, see *www.agplan.umn.edu*

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