Who’s Next? Succession Planning
For Your Business
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What Is Succession Planning?
Succession planning is the ongoing process of ensuring the continuation of the business.
• Prefer a process to an event.
• Acts as risk management for business owners and successors.
• Need to address both succession of management and succession of ownership.

Farm Business Arrangement For Succession Planning
• Intra-family farm transfers
• Two or more farmers establishing a joint operation

The Scary Statistics
• Only about 30-35 percent of family businesses make it to the second generation.
• Only about 10 percent make it to the third generation.
• While 78 percent of families intend to pass their business to their children, only 34 percent have created a succession plan.

Challenges to Planning
• Increased assets and larger debt
• Tighter cash flow; lending covenants
• More than one successor
• Change
  • Independence to Interdependence
  • Sole decision making to shared decision making
• Differing objectives
• Transfer tax issues
• Treatment of non-farm family members
• Farms have become complex entities

The roadblocks to business relationships are most often self-imposed and result in poor group dynamics.
• Resistance to change, procrastination and lack of priorities
• Poor communication (style, aggressive or passive)
• Owner, sibling or spouse rivalries, unrealistic expectations
• Personality differences, conflicts in management styles and personal agendas and perceived need for control
• Disputes about authority, duties and responsibilities
• Inadequate performance by an owner and refusal to accept constructive criticism
• Differing commitments of time and effort
• Disputes about compensation and benefits
The Delicate Nature of Human Relationships

- Successful organizations have a culture that began with trust among the owners and then maintains trust between the owners and throughout the organizations
- Anticipating relationship problems
  - Parents may not be objective in assessing the next generation’s strengths and weaknesses
  - Small relationship problems often become big relationship problems
  - Relationship issues are somewhat subjective and get lost in the planning process

Principal #1: The relationships must be based on the owners’ quality, compatible shared values and goals for the farm and as individuals.

- The concept of “We”
- Do the owners have values that are quality, compatible and shared?
- Do the owners think, “we” rather than “I”?
- Do the owners have mutual respect and concern for each other?
- Do the owners want to be in business together and to share management long term?
- Are each owner’s actions consistent with his words?

Principal #2: Differences in the owners’ styles of management and personalities may be the key to the farm’s success or a primary cause of conflict.

- Individually and collectively:
  - Do the owners’ skills and interests fill the farm’s needs? What voids are left? What training or outside assistance will be needed?
  - What conflicts can be anticipated because of incompatible differences in management styles or personalities?
  - What are the owners’ expectations about each other’s commitment of time and effort, performance and potential constructive criticism?

Principal #3: Potential rivalries must be recognized, evaluated and brought under control.

- Sibling rivalries
  - How have the siblings gotten along in the past?
  - How do they share decision making?
  - How do they react when they disagree?
- Owner rivalries
  - What are the areas of potential conflict?
  - How will conflicts be resolved?
- Spousal rivalries
  - Should spouses be included in decision making?
  - Who does a bookkeeping spouse report to?

Principal #4: Planning for the farm must also recognize the convergence, and often conflict, of family values vs. business values.

- Family values
  - The farm is the family’s way of life – its business and a tradition to be preserved for future generations.
  - The family stresses its core values – unconditional love, support, loyalty, acceptance and inclusion within the family.
  - Family relationships are most important.
  - Mistakes, underperformance are often overlooked and tolerated.
  - You don’t get fired from the family.

Principal #4: Planning for the farm must also recognize the convergence, and often conflict, of family values vs. business values.

- Business values
  - Based on results – rational and objective business decisions.
  - Actions are carefully assessed and often challenged.
  - Business values stress profitability, effective effort, pro-activity, self-actualization and team effort.
  - Job performance is recorded and evaluated.
  - Poor performance is not overlooked and has negative consequences.
  - The success of the business is the benchmark.
Principal #5: Planning must recognize the need for consistent and adequate communication between owners and within the organization.

- Poor communication skills erode trust and adversely impact relationships.
- When actions or decisions are not adequately explained, others may misunderstand the underlying rationale and purpose, whether valid or not.
- Poor communications isolate decision making and breed insecurity and mistrust.
- Good communications.
- Better decisions, fewer errors and greater trust.
- The underlying decision is understood.

Principal #6: The owners and successors must be committed to the full planning process. It is primary and necessary.

- Planning takes time, effort, introspection and financial investment.
- Planning is the mental creation of the business and relationships as they “ought to be” and creating the steps to get there.
- Good planning results in the right organization, implementation, staffing, motivation and feedback systems.
- Planning is navigational by nature. It is an ongoing process, not an event. Plans must be updated.

Individual Goals: Each owner must understand his or her goals for being part of the farm business. Equally important, each owner must understand the personal and business goals of the others involved.

- Why are you in the business? What do you want to achieve? What role do you want to take now and five years from now? How could your abilities be better utilized? What skills do you want to develop? How much do you want to earn? What time and effort are you willing to commit? What are your goals for creating a balanced life? What are your management and communication strengths and weaknesses? What are your biggest frustrations?

Personal and Partner Assessment: Each owner has a unique perspective about his or her management strengths and weaknesses and those of the other involved family members or third parties.

- Are you concerned about the time and effort the other owners are willing to commit? What are the other owners’ management and communication strengths and weaknesses? What potential conflicts are you concerned about?

Vision for the Farm: The owners should develop a common vision for the future of the farm as a financial and family business. A common vision clarifies the owners’ general direction and collective sense of the future. It should help motivate and coordinate their future actions. The owners need to consider their business options, their goal for the future size of the farm and how management and ownership will transition.

- What should the farm look like in the future? How does that vision compare to the current situation? What do we need to do to make the necessary changes?

Core Values: The owners should develop a clear understanding under which the owners will work within the business and, in a family farm, within the family.

- What are the values that you will never knowingly violate?
- Honesty, respect, teamwork, responsibility, commitment, good communications.
- Treatment of cows.
- Good stewards of the land.
- Appreciation of heritage.
- Etc., etc., etc.
The Standard Operational Issues

- Ownership?
- Responsibility?
- Contributions?
- Management?
- Compensation and Distributions?
- Classes of ownership?

What’s In An Agreement?
Management and Decision-making:

- Flexibility vs. Rigidity.
- Define powers and authority (e.g., How much can a manager spend without the prior consent of the other owners?).
- “Corporate” formalities.
  - Provide for meetings so that the owners can have a forum to discuss issues and concerns regarding the farm (address professional and personal issues).

Management and Decision-making (continued):

- “Corporate” formalities (continued).
  - Maintain a business relationship within the family and owner context (this can be difficult).
  - Adhere to the voting requirements so that decisions are thoughtful and informed.
  - Include deadlock provisions in the transfer or management agreement just in case an issue cannot be resolved.

Distributions and Compensation.

- Money is a common cause of conflict and disagreement

Distributions and Compensation (continued).

- Compensation.
  - Compensation is NOT usually addressed in the transfer agreement.
  - However, it is too big of an issue to not address.
  - Separate agreements can be drafted to handle the compensation structure.
  - Incentive based?
  - Hourly?

Transferring Ownership.

- “Permitted Transferee”
  - Carefully define this term in the operating agreement.
  - Spouses.
    - Is maintaining the bloodline important?
    - Does the spouse believe he or she should be an owner?
    - Providing limited ownership rights?
Transferring Ownership (continued).

- Methods of Restricting Transferability.
  - No restrictions.
  - Company option to purchase.
  - Owner option to purchase.
  - Mandatory purchase by company.
  - Retention by owner (force a transfer to third party).

Transferring Ownership (continued).

- Transfers to a Third Party.
  - Departing owner must obtain an offer to purchase.
  - First right of first refusal to the owners.
  - Second right of first refusal to the company.
  - Final right of first refusal to the owners.
  - Transfer is permitted.

Transferring Ownership (continued).

- Dealing with Disability.
  - First option to purchase to the company.
  - Second option to purchase to the owners.
  - Retention by the owner.

  » Annual renewal of options.
  » If options are not exercised, the disabled owner can transfer to a third party.

Transferring Ownership (continued).

- Dealing with Divorce.
  - Provide for the orderly transition of the economic benefit.
  - If spouse is an owner, transfers will follow the applicable processes (e.g., death, transfer to third party, etc.).

Transferring Ownership (continued).

- Dealing with Death.
  - Members can vote to admit recipient as owner, or
  - First option to purchase to the company
  - Second option to purchase to the owners
  - Mandatory purchase by the company

Transferring Ownership (continued).

- Purchase Price and Payment terms.
  - Price: Agreement or Appraisal.
  - Terms: Longer term with small payments? Outside financing? Attached promissory note!
Transferring To Family Members

- Gifts
  - Good time, values are low
  - Voting or Nonvoting Interest
  - Discounted gifts
- Sale
  - Interest rates are low
- Gifts/Sale
- Death
  - Through effective estate planning

Combination of Farms

- To get efficiencies of size
- Share Expenses of expansion
- Big enough to be attractive to third party buyers

Conclusion

- Farms are highly specialized businesses.
- The highly charged emotional atmosphere that can surround farms need to be considered.
- Identify interest, establish expectations, and create a shared vision.
- Use the agreements, and other related documents, as a means to reduce friction.
- Minimize disagreements by minimizing surprises

How do we combine these two farms?

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