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## Successful Farm Business Transitions

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# Cornhusker Economics

Cooperative Extension

Institute of Agriculture & Natural Resources  
Department of Agricultural Economics  
University of Nebraska – Lincoln

## Successful Farm Business Transitions

Market Report	Yr Ago	4 Wks Ago	9/7/01
<b><u>Livestock and Products,</u></b>			
<b><u>Average Prices for Week Ending</u></b>			
Slaughter Steers, Ch. 204, 1100-1300 lb Omaha, cwt	\$63.89	\$69.46	\$69.37
Feeder Steers, Med. Frame, 600-650 lb Dodge City, KS, cwt	91.61	94.25	98.72
Feeder Steers, Med. Frame 600-650 lb, Nebraska Auction Wght. Avg	92.12	106.19	101.35
Carcass Price, Ch. 1-3, 550-700 lb Cent. US, Equiv. Index Value, cwt	98.02	108.24	107.50
Hogs, US 1-2, 220-230 lb Sioux Falls, SD, cwt	41.50	52.50	46.00
Feeder Pigs, US 1-2, 40-45 lb Sioux Falls, SD, hd	*	*	36.37
Vacuum Packed Pork Loins, Wholesale, 13-19 lb, 1/4" Trim, Cent. US, cwt	119.69	120.00	114.25
Slaughter Lambs, Ch. & Pr., 115-125 lb Sioux Falls, SD, cwt	*	43.00	49.05
Carcass Lambs, Ch. & Pr., 1-4, 55-65 lb FOB Midwest, cwt	163.00	143.38	125.15
<b><u>Crops,</u></b>			
<b><u>Cash Truck Prices for Date Shown</u></b>			
Wheat, No. 1, H.W. Omaha, bu	2.93	3.04	2.97
Corn, No. 2, Yellow Omaha, bu	1.54	1.92	1.88
Soybeans, No. 1, Yellow Omaha, bu	4.71	5.14	4.50
Grain Sorghum, No. 2, Yellow Kansas City, cwt	2.71	3.74	3.61
Oats, No. 2, Heavy Minneapolis, MN, bu	1.20	1.52	1.45
<b><u>Hay,</u></b>			
<b><u>First Day of Week Pile Prices</u></b>			
Alfalfa, Sm. Square, RFV 150 or better Platte Valley, ton	105.00	102.50	102.50
Alfalfa, Lg. Round, Good Northeast Nebraska, ton	67.50	75.00	70.00
Prairie, Sm. Square, Good Northeast Nebraska, ton	82.50	105.00	105.00
* No market.			

Nebraska farmers and ranchers are growing older. The trend continues. Who will farm the land and operate the farm/ranch business in generations to come? The answer to these questions in part will depend on how successful we are at transferring farm and ranch businesses to the next generation.

Successful farm business transitions do not occur without planning and effort. Sure, the assets will be owned by someone upon the death of the farmer/rancher, but the farm business will not continue unless planning and decision making have occurred.

The steps that have produced successful transitions in the past have typically not been formally outlined and many times have not been well documented. There are however, many factors that successful farm/ranch transitions have in common.

### Financial Viability

The farm must be financially viable if it is to be passed to the next generation as a functioning business. Farm financial viability is composed of the interaction of four key factors: farm efficiency, family living cost contribution, farm debt structure and farm size.

**1. Farm Efficiency**, sometimes called profit margin, can be increased by controlling expenses, producing and marketing at optimum levels and evaluating all farm investments to make sure they are “earning their keep.” Farm efficiency may be measured using the operating expense ratio, or expressing cash operating expenses as a percent of gross sales.

**2. Family Living Costs** greatly influence the financial viability of the farm. How much the farm is expected to contribute toward the family living expenses helps to determine how much farm profit will be available for principal payments and capital growth.



**3. Farm Debt Structure** is another key contributor toward financial viability. How many dollars will be used each year for principal payments? After tax profit is used to pay for family living, and to build equity through principal payments or capital purchases. If the debt structure requires large principal payments each year, this reduces the amount available for family living and capital growth.

**4. Farm Size** is an important factor in farm viability. Is the pie big enough to take out another slice, or do we need to increase the size to accommodate the additional family living and principal demands? If the margins are low and the family living draw or principal payments are high, the size of the operation needs to increase to account for those demands. If the family living is earned by a non-farm job or is reduced during the transition phase because of non-farm investments or social security benefits, this reduces the need for size and reduces the pressure on farm efficiency to free up cash for principal payments and growth.

#### **Goals**

Both generations need to determine their goals and attitudes toward such things as business growth, debt, lifestyle, likes and dislikes; as well as use of time, family time vs. work time. Goals that are written and shared have a much better chance of attainment than those only thought of.

#### **Communication**

Good communication needs to occur on a regular and continual basis throughout the transition period. Communication between the generations should occur early on as individual goals are molded into mutual family and farming goals. As the process continues, non-farm family members need to be aware of plans and decisions that are being made. Regular business meetings should occur throughout the transition period and beyond. An agenda will help keep the meeting on track.

#### **Retirement Plan**

The retirement plan should be done by the retiring generation. Consideration should be given to: Where will the retiring generation live? What will they do with their time? How long will they be involved with the farm, and in what ways? How much draw on the operation will be needed for their family living? Where will the funds come from? How are we going to account for the non-farming heirs? Is a non-farm investment a good way to partially compensate non-farm heirs? Is fair necessarily equal? Finally, the retirement plan should include a time line. When will activities occur?

#### **Income/Labor Transition Plan**

Planning the division of labor and income is an essential part of successful transitions. Many will incorporate some type of “testing phase” to insure the practicality of the transition. Division often occurs by enterprise, by percentages or shares. Some will pay a wage as partial compensa-

tion for labor in the beginning stages. Most likely, some sort of combination is the method of choice for most business transitions. A time line indicating the division of labor and income is again highly recommend.

#### **Management Transition Plan**

One of the most difficult elements of farm transition involves the transfer of management. It is particularly difficult if the transition involves family members. The previous parent/child relationship can be difficult to overcome when a business relationship is now needed. For many parents it is difficult to allow the younger generation to make mistakes, and to discontinue “giving the orders.” Likewise, there are times when the younger generation needs to step up and “take a hold” of the decision making process. When will the junior member of the transition team be allowed to make the management decisions? How will that transfer be orchestrated? Some will allow management control to be transferred by enterprise or by business activity, such as marketing or record keeping. Others have used a learning or “testing phase” to insure a smooth transition. A time line indicating management responsibilities and the length of testing phases and completion dates is helpful.

#### **Ownership Transition Plan**

Elements of the ownership transfer plan include: tax considerations, business structure, use of insurance products, transfer method (sale, gift, inheritance) and again, a time line for the business and the assets to transfer. A professional needs to be involved with the transfer of ownership phase. This phase is usually best left until last to implement, although planning for it should be completed early in the planning phase.

Obviously farm and ranch businesses have been transferring for generations without detailed written plans. But, there are many transfer efforts that have failed. A well thought out plan will increase the odds of success and reduce the potential for misunderstanding and hard feelings.

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