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Suggestions for Making Family Farm And Ranch Operating Agreements Work

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Both parents and young people are interested in ways to help the younger generation get started in farming. The kinds of arrangements being used are many. No two are exactly alike. Families have different objectives; different resources are involved; and the relative contributions which involved parties make are unique to each family situation.

There are certain principles, however, that need to be recognized in every family farm or ranch operating agreement. The principles involved are economic and psychological. Failure to recognize and abide by these principles can, and often does, result in short lived, disappointing experiences which sometimes leave bitter memories.

The Principles? Here they are:
(No particular order of priority is intended.)

1. Mutual regard for other person's opinion.

Both families need to recognize that involvement of two or more individuals in a business on some basis other than an employer-employee relationship almost necessarily limits the business independence of the various individuals involved. In multi-family operations, important business decisions usually need to be made jointly. Compromises may have to be made and "I told you so" attitudes must be suppressed. Differences of opinion need to be discussed freely and thoroughly, but each person must try to understand and respect the point of view held by others.

2. Decision-making should be shared.

One of the hardest things for a father to do when he enters into a father-son operating agreement may be to give up his right to make independent management decisions. The son needs to learn the processes of decision-making and he needs the opportunity to practice these skills with Dad's help. The father's years of experience and the ideas the son may bring from 4-H, FFA, Extension meetings or college need to be blended. This can be done by thinking through problems and ideas together. Talk about the problems and things that might be done to improve the operation. Take advantage of the ideas and thoughts that all the parties involved can contribute. You may want to check tentative decisions against the thinking and experience of others who may already have tried the idea.

If agreement can't be reached on major decisions, compromises may have to be made. Son or Dad may have to say, "Okay, we'll do it your way." And if the idea doesn't work out, you may have to run another "play." A different "ball carrier" may or may not be called for. Remember, it's a team effort. In those instances where complete agreement can't be reached and one or the other has to "give in," the "giving in" shouldn't always be done by the same person.

If the skills and interests of father and son are different, there may be an opportunity to capitalize on these differences. People usually do best at the things they like to do. Consequently, the entire business may benefit by assigning major

responsibilities for management decisions and work on this basis.

3. Potential for sufficient income.

The business must be large enough to produce enough income to satisfy the needs of all the families involved. No working agreement, regardless of how carefully it may have been designed, will make up for lack of adequate income. If the business isn't large enough to support two (or more) families, what are the possibilities for increasing the size of business? Is it practical to consider buying more land? If not, can more land be rented? What are the possibilities for adding some kind of livestock enterprise or enlarging one that is already on the place?

Some "pencil pushing" to see how much income would be available to each family on a continuing basis should be done *before* the decision is made to set up a multi-family operation. Projected cash flows should help size up the income potential for the farm as a whole and for each of the partners involved.

4. Equitable sharing of income.

Income should be divided on a business-like basis. There are several ways this can be done. One widely accepted principle of sharing the income from joint business endeavors is to share all the income in the same proportion as each party contributes to the business or enterprise. If this method of dividing the income is to be used, it is necessary for father and son to list the contributions that each will make and to place values on those contributions that are mutually acceptable. This will enable them to determine what proportion of the total contributions will be made by each of the participating parties, and at the same time, give them a basis for dividing the income that may be realized. Since the parents frequently own the land, they may prefer to rent the land on regular leasing terms to the joint tenant made up of father and son. In this case, the father would be "wearing two hats"—one as the landlord, and one as one of the tenants. The advantage of this procedure is that it establishes a return to land and eliminates the need for setting a value on the land contribution—something that is sometimes difficult to do in view of present day land values, high interest rates, and increasing property taxes. The tenant income would be divided between father and son in proportion to the contributions that each makes to the tenant's portion of the business.

Still another way that income could be divided is to agree on an acceptable return which will be paid to land, breeding livestock, machinery, and labor, with the understanding that any income not allocated accordingly would then be split equally between father and the participating son.

5. Son's share of net income must be satisfactory.

If the income is to be shared in proportion to contributions made by father and son, it is important that the son's share of the contributions be large enough to entitle him to enough of the income to meet his needs—enough to enable him to grow financially as well as to take care of his family living expenses.

Many sons have little to contribute to the business except their own labor and some management ability. These alone would probably not make up more than 10 to 15 percent of the total contributions required and, therefore, would entitle him to only a small portion of the net income. Consequently, some way needs to be worked out for the son to increase his contributions. One possibility would be for the son to take over all or part of the machinery contribution. He might buy part or all of the machinery from Dad on an installment contract basis or he might rent it from Dad. The latter might be the better alternative during the first few years until it becomes certain that the operating arrangement is going to survive. Dad will probably have to help the son get needed operating capital also, by co-signing notes.

6. People involved must be able to "get along."

If a two-generation family operating agreement is really going to work, the persons involved must be able to get along with each other. Not only must father and son be able to work with each other, but the wives must be compatible also. When you're thinking about forming a father-son operation of some kind, it should be recognized by both generations that such a relationship is quite different than the one which existed when son was growing up and Dad was making all of the decisions. Son is likely to have some ideas he'd like to try that Dad isn't going to approve of. Can you work out the differences and still be on speaking terms? If you can't, then possibly you shouldn't even consider working together.

If there is any question in your minds relative

to this point, it might be well to consider the possibility of making the first few years a sort of "trial run" period. During this time, irreversible commitments on the part of either the father or the son should be avoided if at all possible. If more machinery is needed, you might want to consider renting instead of buying. You might even want to think of operating on an employer-employee basis during this time—but with one important stipulation! During this time, Dad should make it a point to involve the son in decision making. Find out how well you can talk problems over and resolve differences.

7. Good communications important.

Good communications between all parties involved is important. Father and son need to discuss their thoughts and concerns about the business openly and completely. If you have complaints about the way things are being done, get your feelings out in the open. If dissatisfactions are bottled up, there's a real danger that they might explode some day and blow the whole business apart! It's a good idea to have the overall plan of operation in writing. The written agreement shouldn't be thought of as a legal club to be held over the other person's head, but as a reminder to father and son and as a guide to heirs should death take either the father or son, or both.

And it isn't sufficient to have good communications between just the father and son; the wives should be kept informed of what is being done and what is planned. In fact, it would be a good idea to involve them in the decision-making process itself. Not only do they have good ideas but it will help to coordinate the financial needs of the farm business with those of the households.

Brothers and sisters (other children of the parents) also need to be kept informed of what is being done and the reasons for doing so. Misunderstandings easily lead to jealousies and hard feelings between family members.

8. Living arrangements a potential problem.

If the son is not married when he first enters into the joint operation of the farm or ranch, he may want to continue to live at home. If he does, he probably should pay the folks for his board, room, and laundry. Not all families will see it this way, but remember, Mom isn't as young as she used to be and other children who may be working in town and paying their own way may feel they are being discriminated against.

If the son is married, separate housing is a "must." It may even be desirable to have the houses more than just a few hundred feet apart. The young couple should be careful not to let their children outwear their welcome at Grandma's house. Grandchildren are nice to have, but grandparents shouldn't be made full time babysitters. Too intimate and constant association between grandparents and grandchildren increases the likelihood that grandparents will become critical of the way the grandchildren are being raised or that grandparents will become too bossy.

Generally it's best if the personal living of both families can be kept out of the business as much as possible. Critical thoughts about what the other family does or doesn't do probably should be left unsaid in most instances.

9. Long range planning needed.

Before the father-son operating agreement has gone on too long, some consideration needs to be given to estate planning on the part of the older generation. Once the parents have worked out their estate planning objectives, they should find a good attorney to help them develop a good plan for carrying out these objectives. Particularly important is the ultimate disposition of the farm. The son who is working with the father needs to have some basis for making plans for his future. Will part of the farm go to other brothers and sisters? Will he have a chance to buy their share of the land? Parents may want to consider selling part or all of the farm to the son who is farming with Dad. Such a sale would probably have to be on a long term installment contract basis. Lifetime gifting of part or all of the land to children should also be considered. This could be done in one of several ways over a period of years.

If the son wants to put any kind of permanent improvements on the father's land, there should be an agreement in writing which would give the son the right to recover the undepreciated value of such improvements in case the farm is sold or goes into an estate. Otherwise, the improvements might be considered part of the parents' real estate and the son who put them up could lose part or all of his investment.

10. Good records always help.

This is a good way for the younger couple to get a better understanding of the business, so it might be desirable for one of them to be the bookkeeper.

This is not a complete list of factors contributing to success—simply some of the more important ones.

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