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Chapter 1
Why Succession Planning?

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Agriculture is often thought of as an intergenerational venture, and one that is handed down through the generations. A principal operator or a core group of family members often serve as the key decision makers, therefore risk bearers, and likely run or own the business, depending on the structure. As these key family members age, day-to-day responsibilities may shift, but ownership often remains a much stickier situation.

Although the intent may be to hand the family farm venture down from generation to generation, the devil is in the details. The situation becomes even more challenging if realizing your dream of ensuring your farm's legacy is complicated by the lack of interested family members or those whose vision does not align with yours. In addition, many family farms are a relatively complex mix of relationships, business structures and revenue streams that make planning and succession challenging, as well as precipitating a need for professional guidance.

Use this manual to plan for the future of your family farm. It is designed to assist you and your farm family as you go through the planning process necessary to position yourselves for a successful transition of your business.

You Are Not Alone

If you have just started thinking about the long-term future of your family farm, you are not alone. A recent study (Caring.com, 2020 survey) suggested that while a majority of adults think it is important to have a will, 68 percent of adults in the United States do not have one. In agriculture, the situation may be far worse. *Farm Journal (Finck, 2009)*, a popular farm magazine, did a survey of its readers in 2009 to find out more about their succession and estate plans. Almost 70 percent of the respondents plan to transfer control of their operation to the next generation, but fewer than 20 percent are fully confident of their succession plan. These survey results are cheerier than a recent study quoted by the FarmLASTS Project (2009), which found that 88 percent of farmers and farmland owners neither had an exit plan nor knew how to develop one. In addition, of the farmers planning to retire, only about 30 percent had an identified successor. American Farmland Trust (2020) estimated that the ownership of 40 percent of agricultural land in the nation will be in transition within the next 15 years. Given all of these statistics, it is easy to understand why the Small Business Administration has found that family businesses have less than a 33 percent chance of survival between the transition from the first to second generation ownership, and only half of those businesses survive the second to third generation transition. This leaves roughly 16.5 percent of family farms surviving to a third generation of ownership. Inadequate succession planning is one of the biggest threats facing most small businesses, including farms.

Farmers are Older and Farming Longer

We constantly hear about the aging or "graying" of the farm population, and the numbers support this statement (see charts on next page). However, this aging is mostly due to older farmers exiting at a slower rate alongside a declining rate of new farmers entering the agricultural sector. In fact, between 2012 and 2017, the number of all operators (farmers) above the age of 55 grew 6.6 percent, and those above the age of 65 grew 26.1 percent. In contrast, the number of all operators under the age of 45 fell 16.9 percent (Figure 1.1). The result is that the average age of farmers continues to increase, and the majority of U.S. farmland remains under the control of farmers over the age of 55. This means two things for farmland transfers: there are less of them in a given year than in the past, and these older farmers may be more resistant to developing a succession plan, perhaps given the weighty financial considerations and emotional stress. Ultimately, these demographic shifts emphasize the need for succession planning as farms remain under the control of an increasingly older generation. Without proper succession planning, land use, agricultural production and rural economic development issues will likely arise.

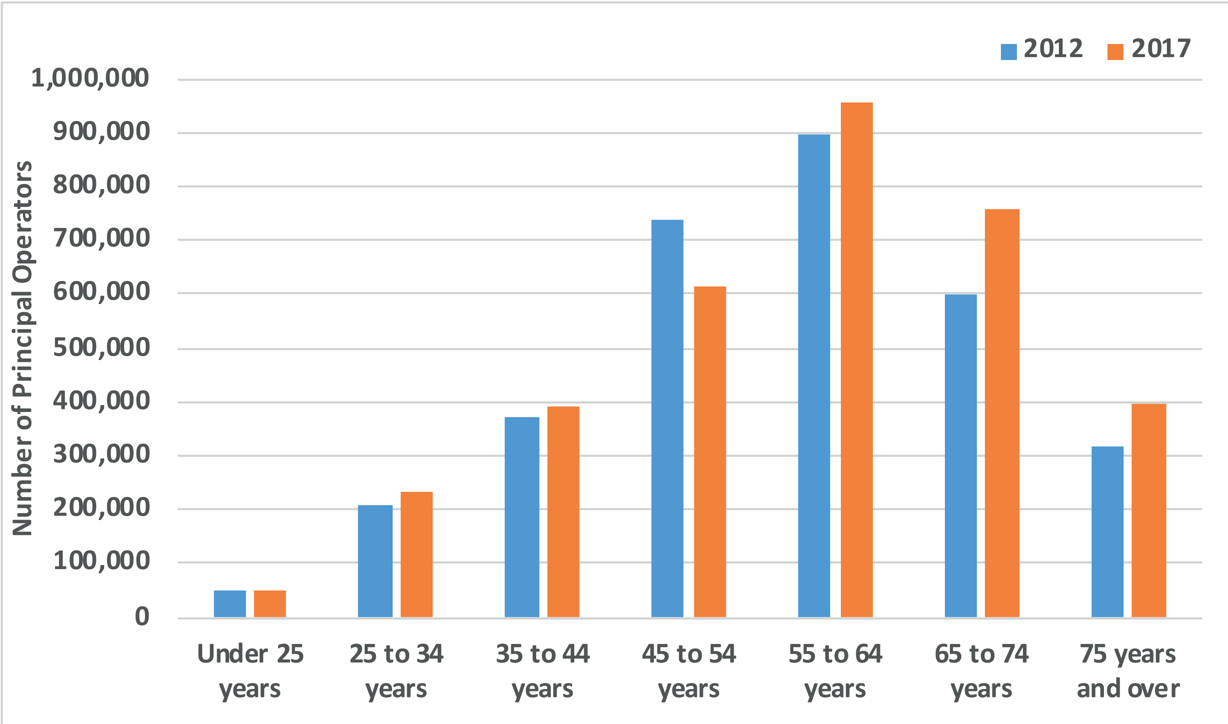
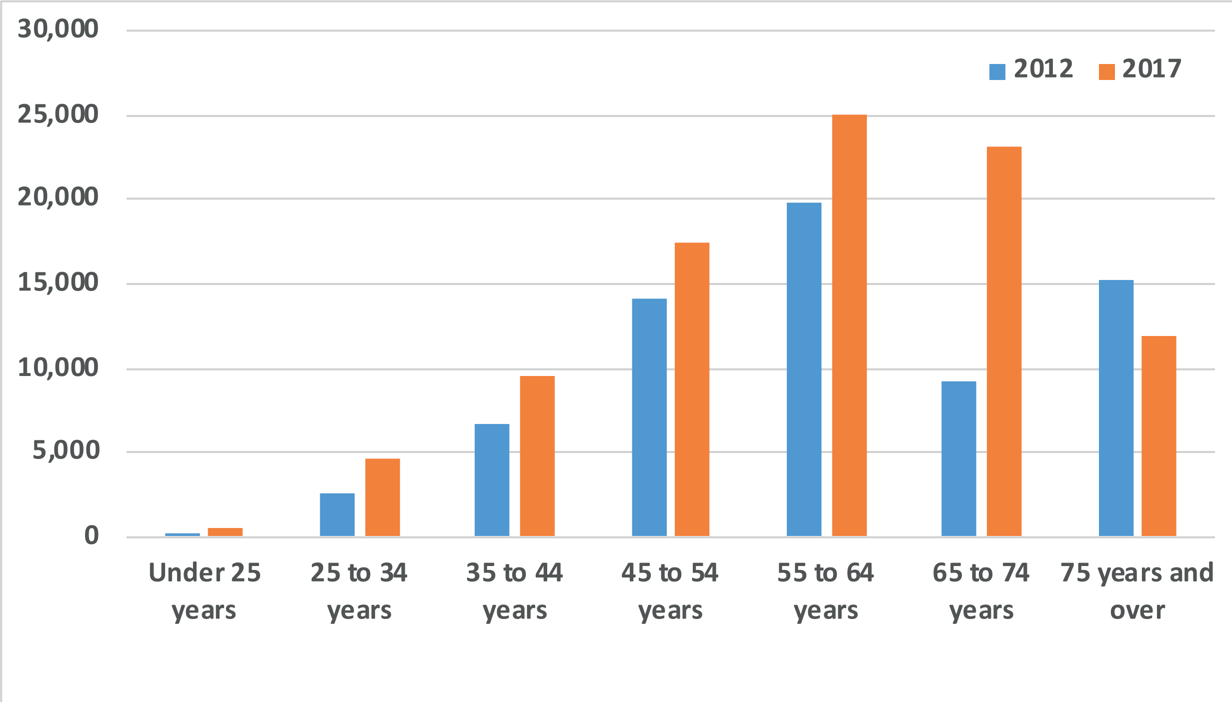


Figure 1.1. Number of All Operators (Producers) in the United States, by Age Range, in 2012 and 2017.

Data source: NASS, 2012a7, 2017a

A Look at Tennessee

The situation in Tennessee is very similar to the rest of the United States. Farm succession continues to weigh on all operators who, as a whole, continue to retain farm ownership as they get older (Figure 1.2). As the older generation retains ownership, the number of farms in Tennessee has increased by 2.8 percent and land in farms has also increased 0.1 percent since 2012 (Table 1.1). The aging of Tennessee's farmers implies considerable changes in farm management and ownership over the next decade. These changes pose risks to the continued operation of family farms and to the ability of new and beginning farmers to acquire farmland. In fact, 65.2 percent of all Tennessee farmland is controlled by operators who are more than 55 years old. In contrast, only 34.8 percent of Tennessee farmland is controlled by an operator less than 55 years old.



Data source: NASS, 2012b, 2017b.

Figure 1.2. Number of All Operators (Producers) in Tennessee, by Age Range, in 2012 and 2017.

Table 1.1. Number, Average Age, Gender and Primary Occupation of Principal Operators (Producers) in Tennessee, 2012 and 2017

Item	Principal Operators (2012)	Primary Producers (2017)	Percent Change
Operators/Producers (number)	68,050	69,983	2.8%
Average age of operator (years)	59.2	60.1	1.5%
Gender of operator/male	60,280	54,015	-10.4%
Gender of operator/female	7,770	15,968	105.5%
Primary occupation/farming	28,454	29,282	2.9%
Primary occupation/other	39,596	40,701	2.8%
Farms with internet access	44,001	49,699	12.9%

Data source: NASS, 2012b, 2017b

In the 2017 Census of Agriculture, based on the recommendations of a National Agricultural Statistics Service panel, the questionnaire allowed farmers and ranchers to designate multiple people per farm as principal producers instead of asking for one principal operator. This change is reflected in the titles in Table 1.1. In addition to age, the primary occupation of the principal owner is of interest. Nearly two-thirds (63.6 percent) of principal operators in Tennessee work off-farm as their primary occupation (Table 1.1). This is especially true among principal operators who are less than 65 years old. However, it is interesting to note that principal operators who work primarily on-farm and are over the age of 55 own the majority of farmland. This has implications on land availability and farm transition. For new agricultural ventures, if land remains tied to the older generation, land availability will be an issue. And, though the farm may contribute to the livelihood of the family in many important ways, primary off-farm employment signals an important nonfarm source of income. Potential access to additional retirement planning tools that are accessible as a result of off-farm employment (e.g., 401[k] or 403[b] plans) and other considerations that may significantly affect farm succession planning on either end of the generational spectrum.

Farm Succession and the Future of Agriculture

According to the 2017 Census of Agriculture, the market value of Tennessee's agricultural products was $3.8 billion, which placed Tennessee 31st in the country. However, this does not take into account the entire agricultural value chain. Hughes et. al. (2018) and Menard et. al. (2019) note that in 2017 the entire agri-forestry sector contributed $81 billion to

The evolving role of women in agriculture:

Implications for farm succession planning

A closer look at the current demographic trends for principal operators in Tennessee underscores the importance of farm succession planning. Between 2012 and 2017, the number of principal farm operators increased, as well as the number of farms. This result was driven by a proportionally larger gain of female than male principal operators (Table 1.1). In 2017, women represented 22.8 percent of principal operators in Tennessee, more than doubled from 11.4 percent of all operators in 2012. In fact, women more than 55 years old represent the fastest growing demographic for operators in Tennessee! Female operators are of interest because women play a significant role in the financial management and decision-making aspects of their family farming operations.

For more information see NASS, 2017b.

Farms with internet access

The number of farms with internet access in Tennessee has increased 12.9 percent from 2012 to 2017. With increase in farm connectivity, farmers are increasingly dependent on smart phones or tablets to conduct farm business, purchase agricultural inputs and readily access information on weather, marketing and prices. Newer precision agricultural technologies will further improve productivity and profitability in agriculture.

Tennessee's economy and employed more than 342,000 individuals. Therefore, who controls these businesses and how they transition in ownership over time could have a significant impact on Tennessee, not just on the farm family seeking to prepare for the future.

The future of agriculture in the U.S. and in Tennessee relies on the ability of older operators to exit without losing their farm to development, taxes, poor planning and/or family disputes, in conjunction with the ability of new farmers to overcome the challenge of gaining access to affordable and productive farmland. In other words, the future of agriculture depends, in part, on successful farm succession planning between current and future generations of farmers. This can be in the form of farmland transfers between two generations of family members or between two unrelated farmers working together to aid in the exit of one and the entry of the other. Lastly, approximately 70 percent of U.S. farmland will change hands in the next decade (FarmLASTS, 2009), further underscoring the need for succession planning if we are to plan today for tomorrow's farms in Tennessee.

Farm Succession Planning Overview

A successful family farm business is a composite of many different elements (Figure 1.3). First, a family farm is a combination of individual human resources (skills, health, abilities) and family social resources (the bonding and trust between farm family members and the bridging across families). In addition to individuals and their families, the family farm has business inputs: natural (land/climate), financial and built (buildings, capital, infrastructure) resources that can be transformed into marketable outputs (products and services). Ultimately, the goals of the family farm are based on these resources and serve as the values that guide their use. In other words, the "mission" of the farm is a result of individuals, their families and available resources. Successful ventures develop a robust mission statement around these elements and seek to run efficient operations that effectively adapt to external influences affecting product demand, supply, costs and other important factors.

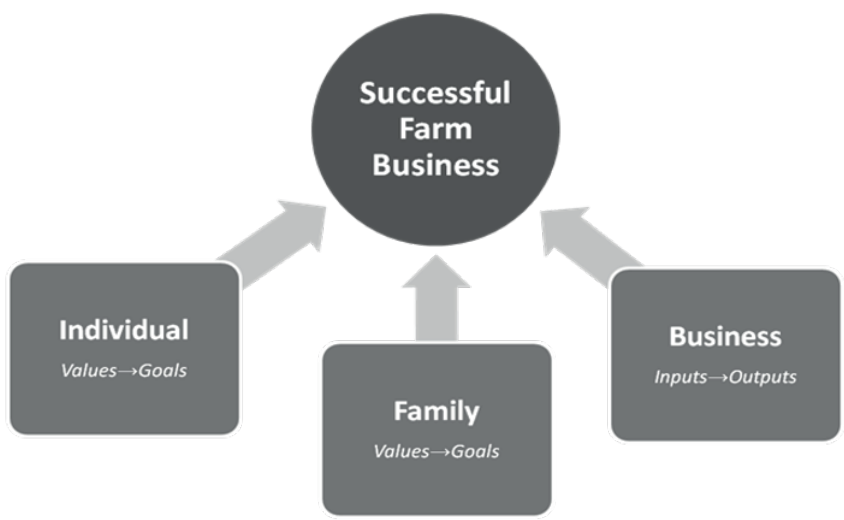


Figure 1.3. Elements of a Successful Family Farm Business.

Succession is defined as the act or process of one person taking the place of another. Farm succession planning is essentially planning for change in farm business ownership from one person to another.

Farm succession planning is a continuous process that involves transferring knowledge, skills, labor, management, control and ownership between generations. This workbook guides users through the development of five major succession plan elements (Figure 1.4):

- **Retirement Plan:** Defining retirement needs and planning how to meet those needs;
- **Estate Plan:** Determining how farm assets will be distributed upon the death of the farm owner(s);
- **Transition Plan:** Creating a strategy to transfer ownership, management and control of the business;
- **Business Plan:** Defining business goals and crafting a strategy to reach them; and
- **Land-use Plan:** Determining the desired current and future uses of the farmland.

COMMUNICATION IS KEY

It is important to note that communication is at the heart of every well-designed and successful succession plan. Communicating the wants, needs, values and goals of all individuals involved is a pivotal first step. However, it is imperative that communication be an ongoing element of any succession plan. Succession plans do not happen overnight. Over time, the opinions, needs and desires of those involved in the planning may change. Maintaining constant and transparent lines of communication will increase the probability of successful succession planning. When communication is front and center during each step of the plan design, needs and wants will be openly addressed and the pathway to a successful conclusion will be more completely understood by all.

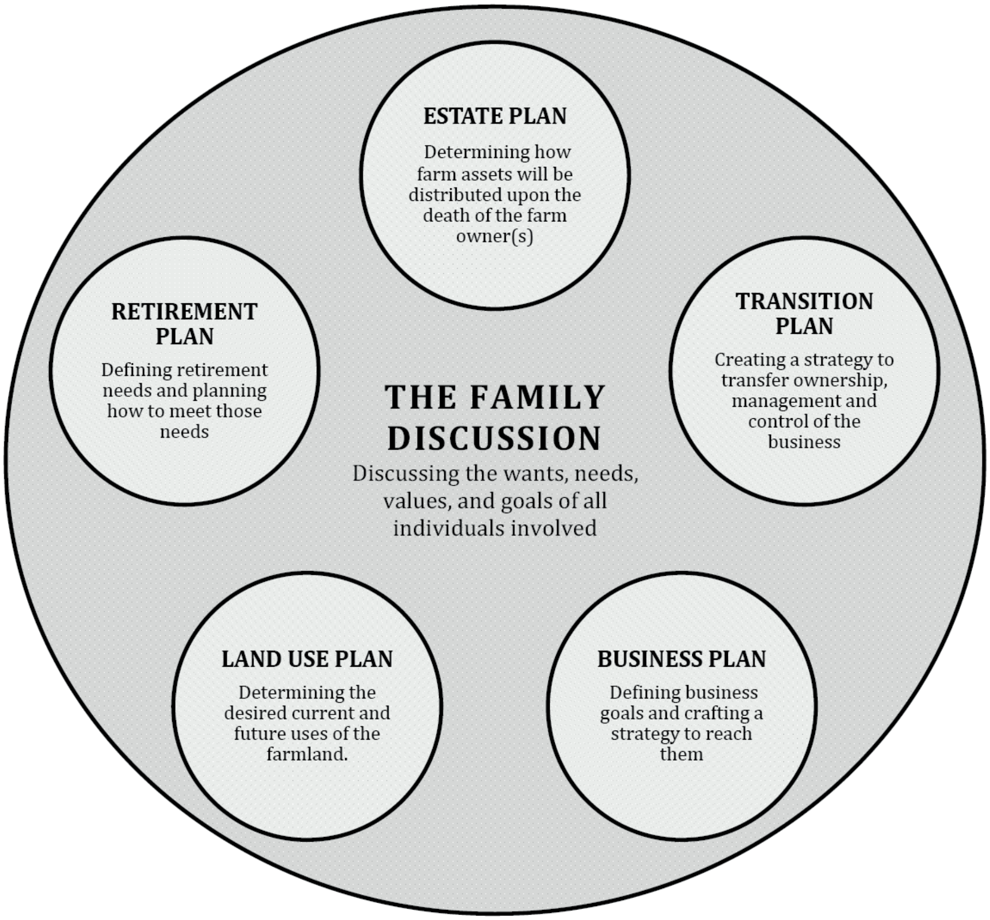


Figure 1.4. The Farm Succession Plan.

A Word of WARNING!

All elements of a complete succession plan are important. Often the most overlooked part of a farm succession plan is the transition plan. Part of the transition plan is the transfer of management, which is a process, not an event, and may take years to complete. Ideally, the transition plan should involve mentoring and shifts in responsibility from one owner to the next over an agreed-upon period of time, the length of which depends on the complexity of the operation. Most commonly, the only part of a succession plan that is completed or focused on is the estate plan, which only transfers the ownership of assets. This is dangerous. If you simply give ownership of a car to a 16-year old without driving lessons, it could lead to a disaster. The same holds for businesses. If you only transfer the tractor, livestock, barns and land to the next generation without teaching them how to manage the operation, your farm legacy could be short-lived. Just as the 16-year old will know more about how to drive safely after lessons and some experience on the road, a young farmer who has time to learn how to manage the farm will more likely know how to operate a successful farm business.

Why Should You Plan for the Succession of Your Farm?

Like many rural businesses, family members typically run farm businesses. These businesses, reminiscent of the family members who own the farm, typically go through a predictable life cycle (Figure 1.5) with four basic phases: start-up, growth, maturity and decline.

1. **Start-up:** The goal of the business in this phase is survival. Survival depends primarily on the ability of the owner to maintain cash flow, overcome new challenges through innovation and sustain confidence and enthusiasm about the future of the business.
2. **Growth:** Survival of the business generally leads to growth. During this phase, the owner focuses on expanding production and sales. As the owner continues to develop his or her managerial skill set, he or she begins to delegate responsibilities in an effort to develop and implement new products/services or management strategies to sustain growth. Cash flow and available investment capital may still constrain efforts.
3. **Maturity:** This phase is the point where ownership and leadership begin to intermingle. As a leader, the owner uses managerial skill to steer the business toward greater efficiency during this phase of profits and relative stability. At this point, the business has reached a sustained level of sales and a full complement of employees. Now that the pieces are in place, the owner may begin to struggle with complacency and the business may struggle with lack of innovation.
4. **Decline/Renewal:** In this phase, successfully meeting the demands of starting and sustaining the business often means business owners may rely on the infrastructure already in place. Getting to this point takes time, and many owners find themselves thinking about the future of the business. Inaction may result in the eventual decline and, ultimately, termination of the business. Proactive planning may serve to revitalize the business, as employees and the eventual successor begin to lay the groundwork for a new era.

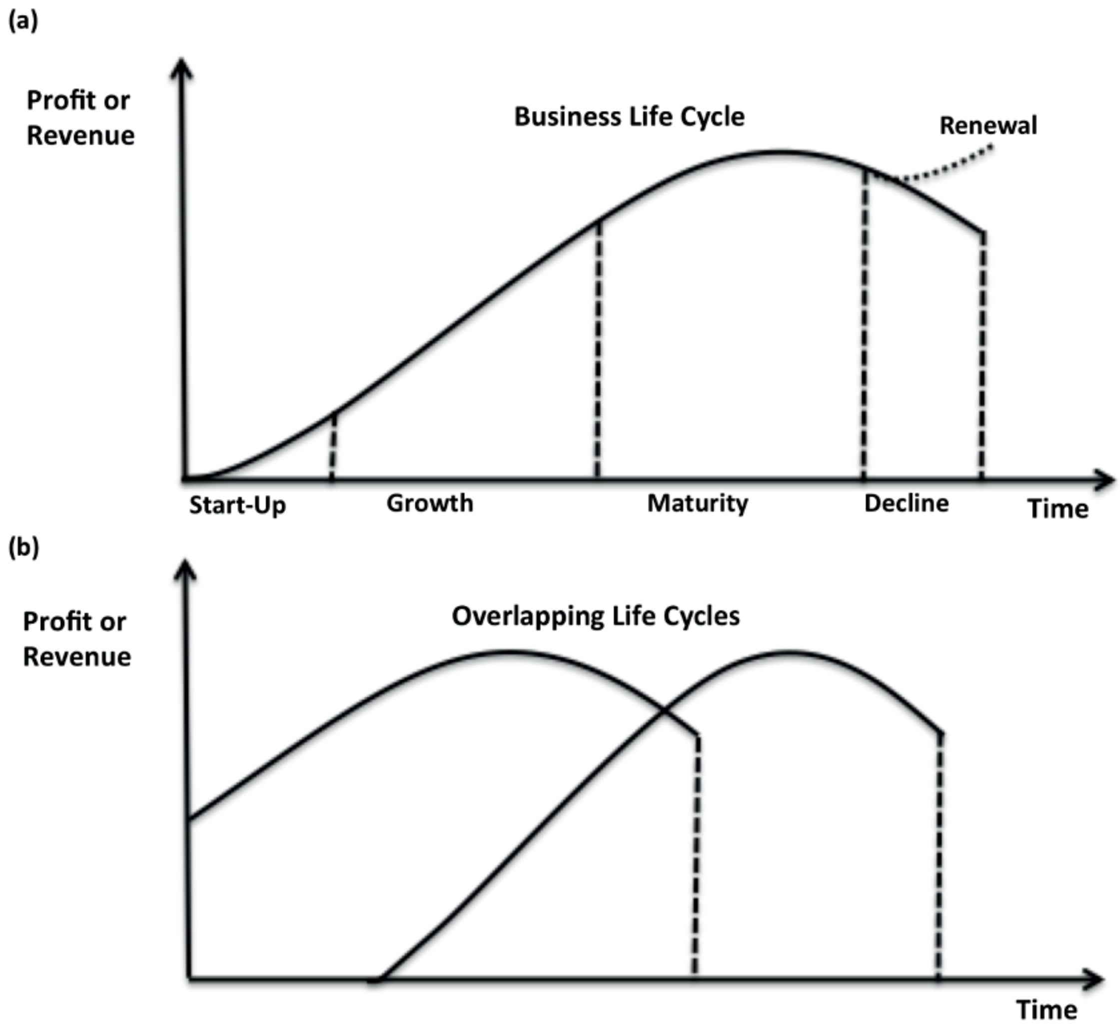


Figure 1.5. (a) Typical Business Life Cycle, (b) Business Life Cycle With Overlapping Generations (Adapted from Hofstrand, 1998).

For farming businesses, these stages are closely tied to changes in human, built and financial capital. The skills and experiences of the successor, especially if he or she is a family member with close ties to the farm, have been built on years of experience helping out and possibly working as a paid employee on the farm. Oftentimes, the successor has also received applicable training at a school, college or university. This human capital provides a foundation for succession. However, nothing surpasses actually being mentored by the current owner. As many have found out the hard way, agriculture is as much art as it is science. Overlapping life cycles allows the successor to learn the intricacies of the farm. Not only will this relationship be beneficial for knowledge transfer, but this will also be an opportunity for the owner and the successor to support one another. For example, the owner will be able to offer the financial and management support that is often lacking during the successor's start-up and growth phase. The successor may serve as an important source of labor and innovation that is in short supply in the owner's maturity and decline phase. These complementary phases are the source of the "Renewal" in Figure 1.5. Another goal of farm succession planning is to ensure that farm assets — primarily land and improvements (natural/built capital) and financial capital — are efficiently used over successive generations of farmers. With proper planning, the benefits (income and other) provided by these assets can be maximized. Maximizing these benefits will increase the chances that the farm can help support the retirement of one generation, while ensuring that their successors are able to continue to operate the farm. This is complicated somewhat by the fact that farming differs from most businesses in that the residence of the principal owner is often located on the farm itself. In fact, a greater percentage of farmers live on-farm in Tennessee (81.3 percent) than the national average (76.8 percent) (Gale, 2002).

The most common causes of the failures in transitioning family-owned businesses are (1) not having a plan, (2) taxes and/or (3) family discord, all issues that a good family business succession plan can help iron out. Certainly, to do this efficiently, smoothly and in fairness to all parties requires comprehensive planning rather than just a will.

Typical Goals of Farm Succession Planning

Successful farm succession planning is ultimately defined by the achievement of goals that were set forth in the planning process. This manual is designed to assist in defining goals and identifying ways to achieve them. Once the goals are identified, they can be included in each component of your farm succession plan: business, retirement, estate, land and/or transition — each of which is discussed in detail in the chapters that follow.

Common farm succession planning goals include:

- Maximizing net worth of the estate.
- Distributing assets in accordance with wishes, including treating all children fairly.
- Eliminating, or at least minimizing, cost, delay and public disclosure associated with probate.
- Providing for care of minor children and/or other dependents.
- Planning for owner's illness or incapacity.
- Determining future land use for the long term.
- Maintaining quality of life for current owner(s) after succession.
- Sustaining profitability during and after the succession period.
- Developing a stepwise managerial transition process.

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