Getting Started In Farming

Via The Home Farm

North Central Regional
Extension Publication 84

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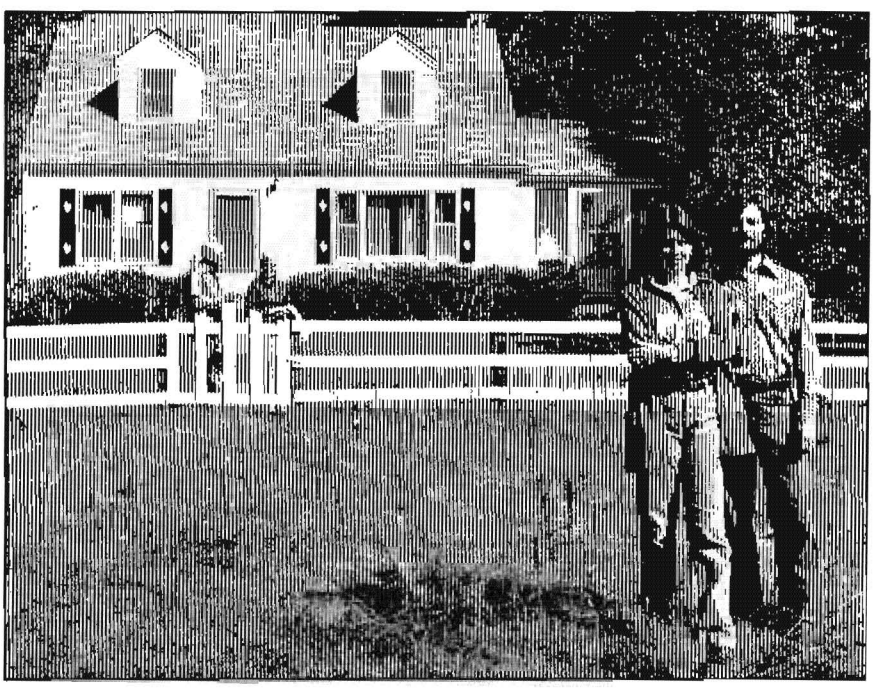

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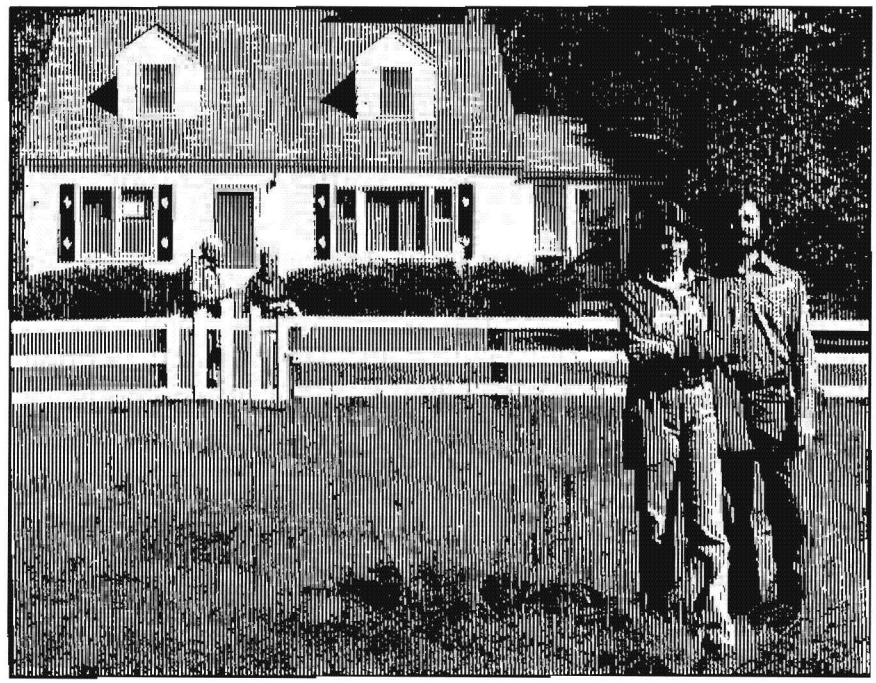
Introduction



To operate the home farm with Dad, and take it over when he retires has long been a beautiful part of the American dream for many a farm youth. Similarly, many parents look forward to their farm business being continued in the hands of the children in generations to come.* But, dreams and desires can be shattered if the realities of personal and farm business relationships are not understood by all parties. Not only must all parties face these realities prior to any family farming agreements, but concrete steps must be taken to give the arrangement the best possible chance for success.

The decision to make one's living from farming demands much thought. Today's commercial farm businesses involve large quantities of land and capital. Gaining control of these is a major problem to persons considering farming as an occupation. It is also essential to have the managerial ability to combine these resources into an efficient and profitable farm business. "So You Think You Want to Farm," NCR No. 8, discusses many of the considerations that surround the decision whether or not to attempt to start in the farming profession. This publication will address the question of how to get started and established in farming for those who have (1) made the decision to farm for a living and (2) have the opportunity for a beginning on the home farm.

While the materials presented herein seem to be directed to the son considering whether to enter into a farming arrangement with the parents, the materials should also be considered by the parents. The information is also relevant to situations involving how best to get the son-in-law, nephew, or even the neighbor's son started and established in the farming operation.

**The authors wish to acknowledge that today more than ever before there are daughters returning to the farm in operator and managerial roles. For the ease of writing only will the "father-son" terminology be used throughout the remainder of this publication.*

The Home Farm Situation

The home farm provides some potentially favorable opportunities. The first, obviously, is access to land. The fact that there is little land available to a beginning farmer is the chief factor restraining many who would like to farm. Also provided by the family farm is access to capital and the opportunity to accumulate additional capital that might otherwise be unavailable. The third appealing aspect offered by the home farm is that farming with Dad provides the opportunity for gaining managerial experience under his guidance and encouragement. This managerial assistance removes some of the uncertainty and hesitation in borrowing money and in entering new enterprises on an efficient scale, according to many beginning farmers who participated in a study by F. J. Reiss (4).

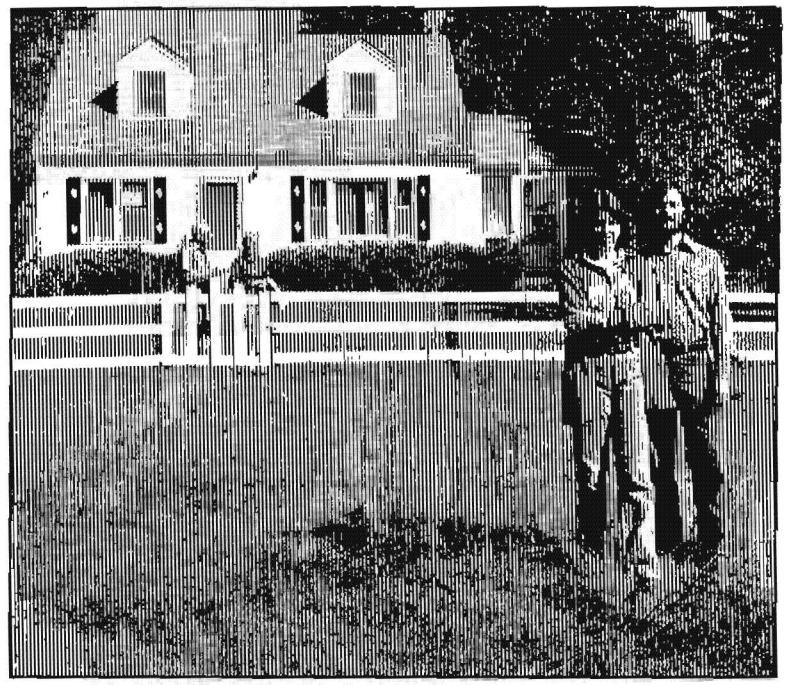
Even though the home farm provides a viable opportunity to begin farming, several matters need serious attention. Family arrangements are not automatically successful. Serious thought, open discussion, and careful planning must precede the agreement. Moreover, after the arrangement is started lots of hard work and considerable "give-and-take" on the part of all participating parties will be necessary to keep the arrangement going.

Because of the large quantities of resources involved, and the total dollar value of these resources, all parties must recognize that a father-son arrangement has long-term consequences. It is not something to be entered haphazardly, or with less than full confidence by all parties that a successful working relationship is possible. It is unlike many non-farm jobs, where two weeks notice will terminate employment. Traumatic personal and financial consequences and strained family relationships can result from the failure of a father-son farming arrangement.

To gain the long term commitment and confidence needed for success, plans must be developed *before* the arrangement is initiated concerning more than just the son's entry into the business. Prior to any agreement, plans must be developed, understood, and agreed upon concerning: (1) the arrangements under which the son enters the business; (2) how the son develops a greater role in the management and financial structure of the business; (3) when and under what conditions does the son gradually assume the managerial reins of the business; and (4) how will eventual ownership of the farm be transferred to the son (and other children) upon retirement or death of the parents.

Before starting a father-son farming arrangement, it is also essential that serious consideration be given to such matters as (1) is there the opportunity for both son's and the parents' goals and objectives to be met; (2) is the business large enough, or can it be made large enough to financially support two families; (3) will the arrangement supply the economic security required by the parents, and (4) will overall family harmony be maintained?

Thoroughly Appraise Your Situation



Several aspects of entering a father-son arrangement merit serious consideration. Some of these aspects are strictly personal, some are strictly business, and some are a combination of both. Making a complete appraisal of all aspects prior to initiating a father-son farming arrangement is not only the most convenient time, but is also the least costly in terms of dollars, personal heartache, and strained family relations.

Appraising Personal Situations and Goals

The first step in assessing the potential for a successful beginning on the home farm is to evaluate the situation on the home farm as it now exists. This includes an evaluation of the present situation of the established parents, the entering son, and other brothers and sisters (potential heirs).

Parents should carefully consider the following:

1. Do we still have minor children at home to be cared for and educated?
2. What is the likelihood that one or more of these children will want to farm in the future?
3. How much income do we currently spend for family purposes, and how will this likely change in the years ahead?
4. How many more years does Dad plan to actively participate in the farm business before retirement?
5. How hard does Dad want to work in the farm business operations in the years ahead? In the next 5 years? In the next 10 years?
6. What goals do we have for the future?
   - Personal goals—retirement, travel, family living, etc.?
   - Farm business goals—what do we hope the farm business will be like in the years ahead?
   - Financial goals—income expectations, future security, providing for children?
7. Are we willing to openly "share" these goals with our son?
8. Is the present farm business still growing, stabilized in size, or reduced from previous years?
9. Is the present farm business large enough to support two families?
10. If it is necessary or desirable to expand the farm business, are we willing to incur more debt and, thus, perhaps, greater risk?
11. Are we willing to totally disclose and to discuss frankly all financial aspects of the business with our son as we would with a lender or other non-related business partner?
12. How do we visualize our son's participation in making farm decisions in the years ahead—Making organizational decisions including land and borrowing more money; making operational decisions?

The son must also evaluate his situation and goals, considering such questions as:

1. Why do I want to farm with Dad?
2. What can I bring into the home farm business, in terms of
   - interests, experience, and education, and
   - financial and other resources?
3. How well do I get along with my parents in personal matters?
4. Can I talk openly and frankly with my parents?
5. If married, does my wife like and get along with my parents? How does she feel about the possibility of farming with Dad?

6. What are my (our) goals in life? What do I want to accomplish professionally, personally, and financially?
7. Are my intentions to eventually take over the home farm, or is it just a way for me to get experience, land, and financial stability until I can become established on my own?
8. Am I willing to openly share these goals with my parents?
9. How do I view my role in the father-son farm agreement in the years ahead? In 5 years? In 10 years?
   - Am I willing to gradually mature into acquiring more managerial responsibilities, or do I want to become "boss" immediately?
   - How do I visualize that we can share responsibilities?
   - From past personal dealings, do I believe Dad will be reluctant to share and/or relinquish managerial responsibilities?
10. Am I willing to invest some of my farm earnings into the farm for growth and expansion?
11. How much income do I believe I will need for family purposes next year, 5 years from now, and 10 years from now? How much, if any of this will come from nonfarm sources?
12. Is the present farm business large enough to support two families?
13. If the farm business needs to be changed or expanded, in what way do I believe this should be accomplished?
14. Am I (we) willing to make the sacrifices, compromises, and extra effort to make the father-son arrangement work?

Because of the importance and complexity of the decision to form a father-son partnership it would be advisable to write down in an organized manner the responses to these questions. Writing down something forces you to pinpoint your thinking. Moreover, as the responses are written they can easily be reviewed as the father (son) "rehashes" his thoughts, and they can be used later when both parties meet to discuss the decision. Using a form such as the example in the Appendix, "Appraising Your Situation, Goals and Potential for Joint Farm Operation," should facilitate making this important appraisal.

Brothers and Sisters

To know the goals and future aspirations of nonfarming brothers and sisters concerning the continuation of the home farm business is essential. The fact that most parents want to treat all the children equally with respect to inheritance provisions can sometimes be devastating to the farming son unless provisions are made well ahead of the death of one or both parents.

Equally as important as ascertaining each party's present situation and goals is the determination of whether or not the goals of the parents and the children are in conflict. Many times personal goals and the goals of the business are not compatible. Prior to the formal agreement is the best (and least costly) time to determine compatibility of goals, and of thoughts about the future business organization and operation.

Is the Business Large Enough for Two Families?

Not all farms are suitable for the development of successful father-son operations. Some are too small; some are not productive enough; some are organized such that they cannot support two families; and some are so located that they cannot be made into the kind of unit upon which a son wants to spend his life and rear a family. Many young men entering business with their fathers

are disillusioned by thinking that since the home farm provided a sufficient income and a good standard of living when they were growing up that it will now provide the same for two families. While the farm itself may still be as productive or more productive than it was during the son's childhood, it may fall short of providing the volume of business necessary to provide sufficient living income and expansion capital for the families of both father and son.

It is extremely difficult to say what amount of income will be needed to provide the standard of living desired by both families. Chances are that Mom and Dad will require less than will the son to maintain their respective families. Mom and Dad who have only themselves to support (having reared their family) have little or no housing expense, and possibly have generated some savings over the years. The son on the other hand may have a wife and a young family, which probably means paying on a house and car, paying off some debts that were incurred while in school, and educating his children. Usually, the son enters the business as the junior partner, receiving a smaller share of the business earnings, but requiring more to live. It is extremely important to estimate how many dollars it will take for family living and compare this with the expected share of the business income.

Table 1 shows data concerning living expenses of farm families based on studies in three midwest states. While a family has to be cautious when using someone else's living costs to estimate their own, the data in Table 1 will provide some general guidelines. It should be noted that the data in Table 1 do not include money for savings, repayment of debt, or new investments. In addition to the incomes for living expenses, it must be remembered that growth capital for farm business expansion and debt principal repayment must be generated.

Frequently budgets are generated to evaluate whether or not a certain investment should be made, such as enterprise expansion or farm land purchases, without recognition of the fact that principal repayment must be taken from the same funds as living expenses. Thus, investments may be made and debts incurred that cannot be repaid after family living expenses have been met.

The cash requirements for family living and for farming operations have been escalating at a rapid pace. We may call it inflation, or call it something else, but the fact remains that the volume of farm business sufficient to supply the cash needed for two families, for farm operating expenses, and business expansion (including loan principal repayment) is increasing dramatically. Let us take a simple example of the magnitudes involved, using some general guides.

Assuming that family living expenses amount to $15,000 for each family, and all income comes from the farm business, the amount of cash income for this purpose that must come from the farm is $30,000. The amount of income needed for debt repayment and business expansion depends chiefly on financial position (equity position) of the two parties, the debt load already assumed (and terms thereof), and business expansion plans. Thus, the cash required can vary greatly. For our example we'll assume two levels of cash needed for debt repayment and business expansion: (1) $10,000 (which is only a moderate amount considering today's farm capital requirements), and (2) $20,000 (which would permit appreciable business expansion). Adding these amounts to the assumed living expenses means that $40,000 to $50,000 net income would have to be generated by the farm business to maintain this prospective father-son (and families) operation. It should be remembered, however, that part of this income could come from

off-farm employment or other sources.

The next question is how much gross income will need to be produced to have a net farm income of $40-50,000? Farm records across the country indicate that it takes from $2-5 gross income to result in $1 net farm income. Assuming again for simplicity, that it takes $3 gross to generate $1 net, for this potential father-son arrangement to be viable, $120,000 to $150,000 gross income will have to be generated annually.

Table 1. Family Living Expense Data for 1977 from Iowa, Kansas and Illinois.[1]

	Iowa	Kansas	Illinois			My Family
			High 1/3	Ave.	Low 1/3	
Family Size	4.2	3.4		3-5		
Food	2,456	2,527	*	*	*	
Clothing/Personal Items	1,577	—	*	*	*	
Household Operations	1,352	2,138	*	*	*	
Health	1,274	—	*	*	*	
Personal/Recreation	593	1,237	*	*	*	
Clothing	—	946	*	*	*	
Education	413	471	*	*	*	
Transportation	820	698	*	*	*	
Medical	—	1,526	1,958	1,662	1,351	
Contributions	718	1,167	1,677	1,013	374	
Expendables*	—	—	17,565	12,915	8,208	
Total Cash Living Expense	9,203	10,710	21,200	15,590	9,933	
Insurance	886	936	3,050	1,869	1,246	
Total Non Capital Living Expense	10,089	11,646	24,250	17,459	11,179	
Capital Living Expense	1,084	NA	3,424	4,078	3,168	
TOTAL LIVING EXPENSE	11,173	11,646	27,674	21,537	14,347	

*Expendables include food, operating expenses, clothing, personal items, recreation, entertainment, education and transportation.
[1]Data in Iowa is based on a survey of 152 farm families. Kansas data is based on Farm Management Association Records. Illinois data is based on a sample of 118 farm families in Illinois Farm Business Farm Management Associations who participate in total farm and nonfarm cash flow. Expenses do not include payment of income or self employment taxes.

Based on estimated gross returns per unit, Table 2 shows how many units of the various enterprises would have to be produced to generate that $150,000 gross farm income. Figures presented in this table are 1978 estimates taken from "The Farm Planning Manual," developed by the Department of Agricultural Economics, University of Kentucky. Obviously, on most farms a combination of enterprises would be employed.

While the numbers presented in Table 2 are not guaranteed amounts, they will provide approximations in the absence of actual farm data. Budgeting expected returns based on *actual farm records* is by far the best method of evaluating the farm business potential. If a possible father-son agreement is anticipated 2-3 years in the future, and comprehensive farm business records are not now being kept by the father, the son should strongly encourage that this be initiated immediately. It is far better to determine prior to entering a father-son arrangement that there is going to be insufficient income generated than to find out a year into the venture. If it is determined that there will not be sufficient income generated from the home farm as it now exists, expansion of the business or alternative supplemental sources of income must be considered.

Table 2. Units of Various Crop and Livestock Enterprises Necessary to Generate $150,000 Gross Farm Income

Enterprise	Gross/Unit	No. of Units
Burley Tobacco	$3,250/Acre	46 Acres
Corn	288	521 Acres
Soybeans	240	625 Acres
Wheat	140	1,071 Acres
Wheat/Soybeans DC	290	517 Acres
Grade A Dairy	1,575/Cow	95 Cows
Beef Cow, 400# calf	228/Cow	658 Cows
Beef Cow, 750# calf	271/Cow	554 Cows
Beef Cow, 1000# fed calf	418/Cow	359 Cows
Ewe/Fed Lamb	66/Ewe	2,273 Ewes
Feeder Lambs (purchased)	18/Lamb*	8,333 Lambs fed
Sows/feeder pigs	412/Sow	364 Sows (2 litters ea.)
Sows/pigs fed	1,280/Sow	117 Sows (2 litters ea.)
Feeder pigs (purchased)	62/Pig*	2,419 Pigs fed

*Gross above the purchase price of feeder animal.

In some situations merely increasing the efficiency of the business (better yields, improved timeliness, and better management) may be sufficient to provide the necessary increased income. However, generally bringing another person into an existing business necessitates expansion of the business. This expansion can take many forms. On some farms, expansion of the land base may be feasible, but for others it may not. The opportunity to expand various livestock enterprises or intensify cropping programs is available on many farms. In the short run the best alternative may be for one or both members (or members of their family) to seek nonfarm employment. Each farm situation is different, therefore, each situation must be analyzed to determine the means that provide the most potential for successful expansion. While future conditions, opportunities and problems can never be fully anticipated, it is important that prior to initiating an arrangement the father and son agree on the basic format of needed business expansion.

Can You Live and Work Together and Share Management Resonsibility?

It is absolutely essential that not only must the father and son be able to relate well to each other in personal as well as business matters, but other members of the families must be able to do so. All parties (father, son, spouses, and other family members) must be kept aware of the business matters and be understanding and tolerant of each other's idiosyncrasies. More business arrangements are dissolved because of disagreements over trivial matters than over matters of real consequence.

When starting a father-son arrangement, the father must be sufficiently wise and open-minded to recognize the son's maturity and increasing ability. A father, whose views are typically more conservative, needs to recognize the son's drive and desire to get ahead. On the other hand, the son must recognize that his father has had years of experience in making managerial decisions and, thus, should have confidence in and show respect for his ideas.

In some situations the father and son may arrive at slightly different solutions to a problem. The successful father and son will discuss the differences, each listening to the other's point of view, and without implying negative feelings toward the other, arrive jointly at the best solution. Sometimes this may result from one party convincing the other that his course of action is the better, and sometimes, by discussion, the best decision is really a compromise. Good family business arrangements should never imply that one party or the other is right or wrong, and the words "I told you so" should never be used if a decision proves to be wrong. The key to the matter is a willingness by both parties to discuss openly and honestly all aspects of the decision to be made. Open and honest communication includes both talking and listening. In most instances, both parties cannot do both simultaneously.

Interviews conducted by farm management extension specialists at the University of Missouri (Columbia, Missouri) of participants in father-son partnerships (some successful, others not successful) provide some insight into successful family business arrangements. Communication was listed by all parties as probably the key to success or the reason for failure. In addition to frequent and open communication, one of the essential elements for successful arrangements suggested (also recognized by the parties of the unsuccessful arrangements) was a discussion and division of the labor and decision-making responsibilities. Successful father-son agreements divided the various jobs to be done between

individuals. Each party had certain tasks to perform, and each had final decision-making power in certain areas. Of course, there were also many jobs and decisions that required the involvement of both father and son. These were agreed upon at the outset. In successful arrangements, father and son "agreed to disagree," agreed to be honest with each other, and exhibited a genuine willingness to work out any differences.

To have a successful arrangement, there has to be a genuine desire by both father and son and their families to make it work. All parties should be dedicated and willing to work toward similar business objectives to make the business successful. When values and goals appear to differ, care needs to be taken to arrive at a reasonable compromise. The ability to compromise is essential.

There may be times when it seems that an acceptable compromise is impossible. For these instances it is extremely valuable to have a predetermined procedure for arriving at a decision. It may mean calling on a third party such as the county extension agent, extension specialist, vocational agricultural teacher, lender or other mutually respected individual for advice. A plan for binding arbitration may even be necessary. Most of the time the mere fact that such a plan for arbitration exists is sufficient to alleviate the occurrence of the problem. If not, you have already agreed upon a mutually acceptable plan for settlement.

Joint participation in major managerial decisions is a must. Typically, parents understand the importance of transferring property ownership to the farming heir, but may fail to realize the importance of transferring management. To ensure a successful father-son arrangement, gradual transfer of managerial control is just as vital.

In addition to working together and sharing management, appraisal should be made of the "living together" aspect of the father-son arrangement. From the outset of the joint venture there must be an understanding that two distinct families are involved. While the father-son relationship holds, the son is no longer "Daddy's little boy." Clutching to that idea will surely bring disaster.

There *must* be separate living facilities. This is desirable even if the son is not married. If the son is married, it is an absolute necessity. There is a tendency for the son's wife to feel additional pressure (whether real or imagined) to meet mother's expectations when living in the same house. The personal needs, interests, and desires of the two families are likely be much different. This is especially true as two generations are involved. For example, Grandma loves her grandchildren, but having them around all the time may get on her nerves.

There also needs to be a general understanding of working hours, weekend responsibilities, and time off. Parents must recognize that at the end of the work day, the joint venture stops. Parents must not attempt to run the lives of the farming son and his family. A general understanding of when the supper hour is, when the free weekends are expected, and when vacations can be anticipated fosters smoother family living conditions. When members of a man's family are happy and satisfied, he is more productive in his job and is easier to work with.

Will the Arrangement Facilitate Change?

Unless the father-son arrangement is designed specifically as a temporary or short-term venture, prior consideration must be given to a number of very fundamental but long-term decisions. The first step in making these decisions is to recognize that there will be *changes*—in the people involved, in goals, in financial needs, in financial positions, and in the farm business. The father-son agreement has to be considered beyond the first year or two of operation. It should be designed so that smooth adjustments can be made when changes occur.

When a father-son agreement is initiated the father is often still in the prime of his working life, capable of long hours of hard work. As time passes he will be less able and probably won't want to work as hard, and finally he will wish to retire. Current cash income needs of the parents typically decline, and their interests and goals change. Security in their retirement years becomes much more important. On the other hand, as the son marries and children arrive, his cash income demands increase. His management experience and competency also increase, along with the desire to assume more responsibility and become "master of his own destiny." If the business is profitable, his equity in the farm business will also be growing.

Adjusting to these changes cannot be left to chance. Before starting a father-son arrangement, it is vital that definite written plans be agreed upon that will provide: (1) security for parents after retirement, (2) transfer of managerial control of business to the son, and (3) transfer of farm ownership to the son, with appropriate compensation to other brothers and sisters. Let's briefly examine each of these.

Security for parents After working hard for years, through good times and bad, to build up the farm business and buy the home farm parents are entitled to enjoy the rewards of their long efforts and have security in their retirement years. Security and the wish not to be a burden on the children during retirement are strong desires of parents. Some parents are afraid to turn loose of managerial control and ownership of their business to their son. They love and trust their children, but also know of cases where ungrateful children have turned their backs on parents in the parents' twilight years.

Provisions must be included in the father-son agreement to provide security for the parents after managerial control has passed to the son. While this basically involves arriving at an agreement that is equitable to both parties, there is one thing that must be clearly recognized. Security must be built up over the years. Thus, the farm business must be efficiently managed, and big enough, to provide adequate income for two families so the security can be obtained.

Management control for son One of the most important matters to be resolved in a father-son agreement involves managerial responsibilities. While specific responsibilities should be agreed upon at the start of the arrangement, the responsibilities must change over time in a definite manner. Typically, the father, who controls most of the land and capital resources at the start of the arrangement has the primary managerial role. But, as the son's contribution to the business increases, he assumes more managerial responsibilities until the time when he takes over complete managerial control (perhaps at the time of Dad's retirement). The share of business income received by the son should change in a similar manner.

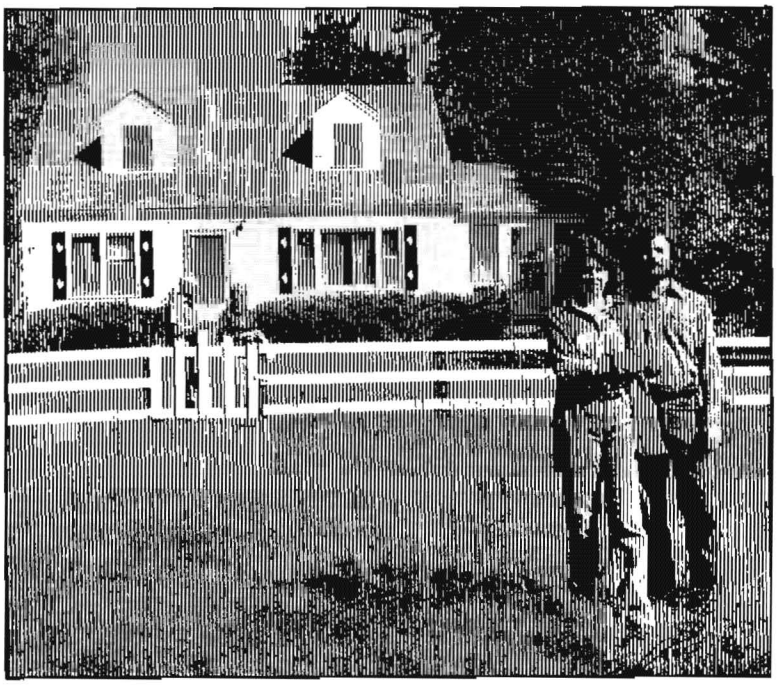
It is very important that the son know prior to entering the arrangement when or under what conditions his managerial responsibilities will change—particularly when he will assume managerial control. This cannot be left to the whim of the parents, as too often Dad is hesitant to give up controls and keeps putting it off. This uncertainty is unfair to the son, and is likely to lead to personal and business problems that could destroy the arrangement. Dad may not know exactly when he will retire, and has no way of knowing if or when illness will curtail his participation in the business. This entire matter must be openly discussed, agreement reached, and the agreement put into writing prior to a long-term arrangement. If specific dates cannot be cited, at least conditions under which managerial changes are to be made should be specified.

Transfer of farm ownership to son Most sons entering a father-son arrangement want to eventually own the home farm. If the son is the only child (heir), agreement as to when ownership will be transferred can usually be worked out without much difficulty. Security and living provisions for parents during retirement and tax considerations are primary factors to be considered in the decision.

In many families there are other children involved, and the matter of transferring farm ownership can become complex. A primary family objective should be maintenance of overall family goodwill, and equitable treatment of all heirs. Accomplishing this, while maintaining parent security during retirement, transferring the farm to the son in the most expeditious manner, and protecting the rights of the farming son (in the partnership) takes careful thought and planning. Estate planning is beyond the scope of this publication. Publications on estate planning are available from most land grant institutions. Copies can be obtained through your local county extension office. Several points should be emphasized here:

1. Good estate planning is not done at the time of parents' death. If planning is not completed before then, all that can be accomplished is to pick up the pieces.
2. Strange things sometimes happen to heirs when an estate is settled. Brothers and sisters, even those who may have been close in early life, can become jealous and greedy. Thus, it is very important if one son is to acquire ownership of most or the entire farm, that the estate plan clearly specify provisions for *equitable* treatment for all heirs.
3. Communications are extremely important in this matter. All sons and daughters should be informed of the nature and intent of the father-son agreement at the time it is initiated. This should include intentions for changes in managerial control, farm ownership transfer, and inheritance. Bringing these things into the open then, can prevent major personal family problems later.
4. The son will be building up his own share of the total farm equity over time. Accurate records of the son's investments should be maintained to facilitate an equitable settlement when farm ownership is transferred. This also protects the son's rights if the parents' estate must be settled prior to ownership transfer.

While the preceding discussion is not exhaustive of items that need be considered prior to entering the farming business by way of the family farm, it offers a guideline. The home farm does provide a unique opportunity for getting started in farming; however, for the attempt to be successful, much thought, open discussion, and thorough consideration of the items mentioned above (and others) must precede actual initiation of any father-son arrangement.



Initiation of the Father-Son Business

The appraisal of all aspects of the situation has been completed. No attention focuses on how the son actually enters the home farm business. The initial arrangement will vary with each specific situation.

One situation may have the following characteristics: the son has been away from the farm for several years (college, military, or non-farm employment); he has little capital accumulated with which to buy into the home farm business; he has limited managerial experience in farming; and Dad has operated the farm as a sole proprietorship for years and has grown accustomed to making all management decisions without having to discuss them with a partner.

In this situation it may be desirable to start the son in the business on an employer-employee basis. This arrangement should not be continued for any great length of time. It would, however, permit a testing or trial period enabling the son to either mature into the business leading to a more long-lasting arrangement, or permit sufficient time to discover that working with Dad is not possible. If this is the case, the son's decision not to continue with the arrangement would cause a minimum of disruption in the business.

Another situation may be: the son has been working with Dad while finishing high school; he has some capital already accumulated; and Dad has already been sharing some minor management decisions, permitting the son to gain some managerial experience. In this situation, the initial business arrangement may be a more sophisticated and a longer lasting one than an employer-employee arrangement. A joint operating arrangement or even a partnership type arrangement may be desirable. The individual situation will dictate what the initial business arrangement will be.

Employer-Employee Arrangements

In the employer-employee arrangement the son usually has little more to contribute to the business than his labor. The son will be able to share some of the management responsibilities and possibly some capital, depending upon individual circumstances.

The son starts as an employee in the current business for a specific wage. While being the least complicated means of starting the son, it provides little or no direct involvement in the business matters. Thus, if this arrangement continues for long without steps being taken to get the son more involved and to reward him for his business contributions, dissatisfaction is likely to occur.

One approach is to pay the son well in excess of what a hired man would earn. This accomplishes several different objectives. It displays faith in the son and his potential contribution to the business; it serves to keep the son motivated and more genuinely interested in the business; and it provides an indication as to whether the business will be able to generate enough income to ultimately satisfy the needs of both parents and son; and it will also help to ensure that this type of wage agreement (rather than some joint sharing of costs and income) will not last too long.

Several modifications of this basic wage agreement may serve as the initial form of business, or as a means of maturing into a more complex, joint arrangement. One such arrangement is the combining of a wage incentive plan with the basic wage. This serves to stimulate more direct interest in the business as well as permitting the son to realize that the amount and quality of his efforts will directly affect his earnings.

It is not the intent to discuss incentive plans in depth here, but a few fundamentals need to be presented. An incentive must be payment in excess

of the basic wage and not mere substitution for a living wage, adequate housing, or working conditions. The incentive should be large enough and achievable to encourage the extra effort desired. A token incentive, or one that is either a poor substitute for a living wage, or one that is totally out of reach will surely guarantee disaster.

A sound incentive plan is likely to result in increased income for both father and son. The incentive payment should be based on performance over which the son has direct control or influence. Once an acceptable incentive plan has been developed, as with any business agreement, it should be written. It should describe the purpose, the responsibilities of both father and son, the method of calculation and time of payment, and provide a method of settling disputes.

Another modification of the basic wage agreement is the wage and income sharing arrangement. Under this kind of agreement the son is paid a wage (approximately equal to a hired man's wage) plus a share of net farm income. This share of net income could be in the form of livestock, equipment, or cash. Thus, it provides a means of building the son's capital involvement in the business. With this type arrangement, the son has reason to take added interest in the business, and it encourages him to take the point of view of the manager rather than the hired hand.

Because of his interest in keeping the *net* income as high as possible, he will likely become aware of and have more interest in the cost side of production. As a result, income for both father and son will be increased. It is very important, however, that as net income can be calculated different ways (and have quite different results), that a specific definition of what net income is be agreed upon.

Under the wage and income sharing agreement both father and son must be aware that as long as the arrangement is *income sharing* and not *loss sharing,* an employer-employee relationship exists. This implies that the son, as an employee, is not responsible for the liabilities and losses of the business. It also implies that the son has authority to do only the things that the father authorizes him to do. If it becomes obvious that losses are also being shared, then legally a partnership exists and the problem of unlimited liability and other partnership responsibilities must be faced.

Joint Operating Arrangements

It may be obvious, because of the son's personal situation (farming experience, capital accumulation, and desire to invest in the business, or managerial experience and ability) that a more sophisticated joint venture type arrangement is desirable. If this arrangement is viewed as "the next step" in the father-son business relationship, an enterprise working agreement may be suitable.

An enterprise agreement usually implies that the son will be given primary responsibility for a specific enterprise within the business. Generally, in addition to his labor, the son will furnish some of the livestock and/or machinery, as well as some management. He will have major decision making authority in decisions affecting the total farm. As the son gains more experience and displays ability to handle more responsibility, he can be given a larger share of the responsibility for the total business.

The enterprise agreement should be viewed as only a temporary form of arrangement. If this arrangement lasts too long without shifting more total business responsibility to the son, he may become so preoccupied with "his" source of income (his enterprise) that he neglects some of his total farm obligations. This form of an agreement should be written, and include such points as job

responsibilities, contributions by father and by son, sharing of income, methods of settling disputes and ultimate graduation into more of a total farm joint operating arrangement.

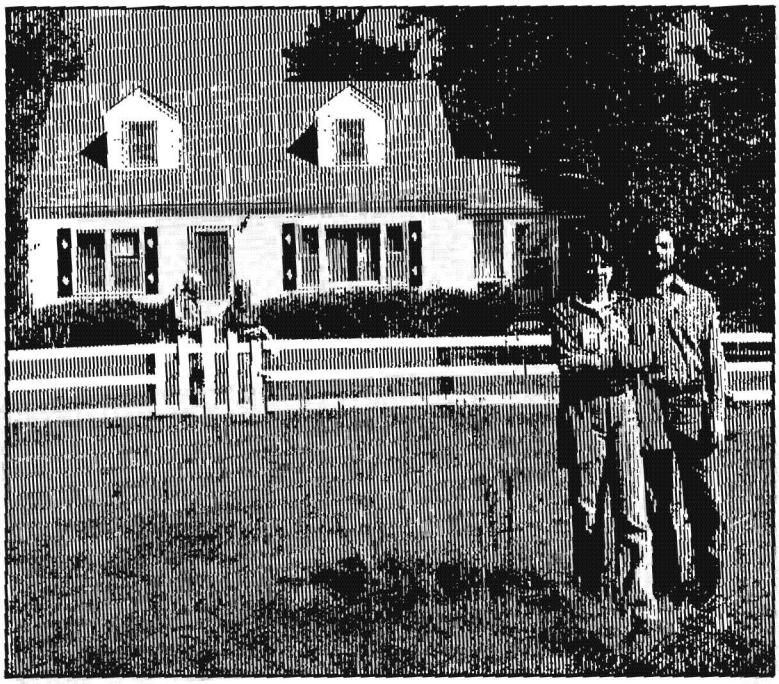
If the joint operating agreement is *not* to be considered a next step in the father-son relationship, but rather is to serve as the initial form of business partnership (for example where the son has the necessary ability, experience, and desire), a total farm operating agreement may be desirable. A total farm operating agreement is a complex form of organization for a beginning farmer. If the situation is right, a total farm operating arrangement can be developed where initially the son's investment in the business can be minimal for the first few years. Thus, some of the advantages of a testing or trial period can be realized. Before entering this type of an arrangement, the family should have made some long-range decisions and thus, may well be beyond the "testing" phase. If this is the case this should be considered a more permanent type arrangement.

Reappraise the Situation

Once initial entry into the farming business has been accomplished, either as employee or as a junior member of a joint operating agreement (and some time has been spent in a testing or trial period), an evaluation of the question "where to go from here," must be made. This evaluation could lead to three basically different conclusions. One might be that a permanent father-son partnership won't work, and the son decides to move into some nonfarming occupation. A second conclusion might be that the son's goal of "getting started in farming" has been accomplished, and now is the time for the son to leave the family farm situation and start farming on his own.

Possibly the father is at or near retirement age, and may want to let the son assume total control of the home farm by either buying or renting the farm. The third conclusion could be that the father-son arrangement has proven successful and all parties want to continue farming together. This third conclusion means that consideration should be given to a more formally organized, long-term, joint farming arrangement.
This could be a partnership or a family corporation.

More Permanent Forms of Father-Son Business Arrangement



When more formally organized joint operating arrangements are contemplated, more emphasis needs to be placed on consideration of both the parents' and son's long range goals. Since these types of arrangements imply a more complex sharing of management as well as capital investments, attention needs to be given to the detrimental effects that would result if it became necessary to discontinue the joint operation. Also, as these arrangements are considered, some definite plans for ultimate transfer of managerial control and eventual transfer of property ownership from father to son become extremely important.

The two common business arrangements that fall under this heading are the partnership, and the corporation. While the advantages and disadvantages of these business arrangements merit comprehensive discussions, only a brief overview of their relation to father-son situations will be presented. (A few regional publications which address various aspects of these forms of business structure are listed on the bibliography. Other publications, which include state legal provisions, are available in individual states. These may be obtained from your County Agricultural Extension Office.)

Partnership as an Alternative

A partnership permits the combining of father's and son's assets, sharing of the management responsibilities, and the sharing of both profits and losses of the business. Partnerships tend to facilitate the gradual transfer of both management control and ownership from father to son. As the son builds equity, his contribution to the business increases both in total dollars and percentage compared to Dad. As Dad reaches the stage in his farming career that he wishes to start phasing out of the business, more management and ownership can be conveniently transferred to the son.

Ownership of property prior to the formation of a partnership sometimes causes concern. Not all assets owned by both father and son have to be contributed to the business. However, once property is contributed, it is no longer yours and mine, it becomes ours (i.e. the partnership's).

When establishing a partnership, corporation, or even a landlord-tenant arrangement, the problem of inventory and the estimation of fair value of individual contributions becomes of utmost importance. Each partner should list and value the capital, labor, and management he contributes to the partnership. Even though the partnership may pay a salary to each for labor contributed, business profits should be ultimately shared on the basis of contribution.

The formation of a partnership, while providing a means of transferring management and ownership, places great importance on record keeping and written agreements. This is true, not only for income sharing and income tax reasons (while a partnership pays no income tax an informational tax return must be filed), but also for reasons associated with possible dissolution and/or death of one of the partners. A severe financial burden can be placed on the remaining partner if, at the death of either the father or son, no records are available to determine ownership of property or no plans have been agreed upon as to the disposition of the business. The partnership can be set up to provide for continuation after Dad's retirement or after the death of a partner. These arrangements should be set forth in the written partnership agreement.

Another item that merits consideration when contemplating formation of a father-son partnership is the unlimited liability feature. Each partner is an agent for the partnership. Therefore,

the acts of either partner while carrying out partnership business can bind the partnership. Both partners are liable for acts committed and obligations incurred by either partner in the course of conducting partnership business. The possible consequences of this feature, as well as others, emphasize the extreme importance of careful and thorough consideration prior to establishing a partnership.

If father and son decide to form a partnership, the written document should address issues such as, but not limited to: (1) respective contributions made by each party; (2) how profits and losses are to be shared; (3) duties, powers, and limitations of the partners; (4) provisions for the continuation of the business at death of a partner, if so desired (including purchase options, buy-sell agreements, and the agreed-upon funding of same); and (5) statements showing that the wives involved agree to the proposed settlement procedures. To ensure that both the parents' and the son's estate planning goals will be fulfilled and the partnership intentions honored, property titles, will, and other documents may need to be altered. While it is not a requirement that an attorney draft the partnership agreement, it is strongly encouraged.

Incorporation as an Alternative

The corporate form of business organization is by far the most sophisticated. A coporation is a legal entity, distinct and separate from the individuals who own, manage or work for it. The corporation is owned by the shareholders who may or may not be actively involved in the day to day operation of the business. The major characteristic of the corporate form of business is this distinction between the business and the owners.

As the corporate business is a separate legal being, it can own property, sue and be sued, enter into contracts, and must pay income tax. Because of the legal and definite manner in which corporations must be formed and dissolved, it is of extreme importance that father, son, and their respective wives and families give thorough consideration to the advantages, disadvantages, and possible consequences of this form of conducting the farm business.

Advantages of Corporation

A corporation provides the opportunity for both father and son to contribute some or all of their assets to the business in return for which each is provided with shares of stock commensurate with their contribution. Thus, the actual property owned by each after incorporation is stock and not the specific piece of property contributed. This makes possible the convenient transferring of business ownership from father to son by merely transferring shares of stock. The son can acquire more of the business as he accumulates dollars to invest, or when Dad decides to phase out and transfer stock to the son.

Another advantage of the corporate structure, and having assets represented by shares of stock, is that the business can continue virtually uninterrupted after the death of a shareholder. The corporation exists as long as the shareholders desire it. It is able to withstand ownership changes caused by one generation replacing another, because shares of stock rather than physical property pass to the next generation.

Farm land owned by either father or son may or may not be transferred to the corporation in return for shares of stock. There are advantages and disadvantages to both alternatives. If the land is in fact left out of the corporation, the family corporation can rent the land from the father and/or son. Thus, as discussed in relation to partnerships, the father may in effect assume the

role of a landlord, and the corporation the role of the tenant.

Father and son can be full-time, salaried employees of the corporation as well as owners. Because of this, Dad, as he reaches retirement age, can conveniently withdraw from the actual labor and management of the business, but still remain as an owner. Thus, the corporation provides a lot of flexibility in terms of turning the management over to the son.

One of the major advantages of the corporate structure is the limited liability feature. A shareholder is liable for the debts of a corporation only to the extent of the shares of stock he owns *unless* he has signed personally, as well as agent of the corporation, as surety for a corporate debt. If, on the other hand, a corporation becomes insolvent, shares in it are worthless. Thus, if a farmer's assets are all in shares of stock, he has lost all of his property.

The income tax advantage of a corporation may be of major interest, if the business income is sufficiently large. Tax advantage to the business and shareholders should be identified before a corporation is decided upon. Because a corporation is a legal entity, unlike the partnership, it is also a taxpayer. However, the corporate tax rate schedule is such that there may be sizable tax savings available with sufficient planning.

There may be other advantages of the corporation as a form of father-son business arrangement. Some of these include possible increased efficiency over time, possible increased credit status, added flexibility in estate and retirement planning, and possible fringe benefits which are available only to corporations.

Disadvantages of Corporation

Disadvantages must also be considered. The first may well be the initial costs of incorporation. These initial costs may include filing fees, preparation of the articles of incorporation (this document describes the compact with state and defines the scope and organization of the corporation), and attorneys' fees. In addition, annual fees and taxes are required for the privilege of conducting business within the state. These fees are not required of other types of businesses.

Some consider the strict requirements of formal organization and accurate record keeping a disadvantage. A corporation is required to keep complete and accurate records of accounts, minutes of its shareholder and board of directors meetings, and a record of its shareholders with the number and class of shares held by each. Reports must be filed when certain changes take place in the capitalization or issuance of shares. Annual reports of the business must also be made to the state. While this is considered a disadvantage by some, it may well be one of the major improvements over other forms of business.

While there are obvious income tax advantages discussed above, there can also be tax disadvantages. As the father and son are employees of a corporate business, social security taxes will be higher than they would be if self-employed. Also, the corporation does not receive the favorable tax treatment on capital gains items or first year depreciation which is available under other forms of business arrangements. There is also the possibility of double taxation of some of the income. This occurs when the corporation pays corporate income tax on income which is retained in the business and later distributed to shareholders as dividends. The dollars are taxed as income to the corporation and the dividends are taxed as income to the shareholders. In addition, there is an intangible personal property tax associated with owning shares of stock in some states.

Another feature that may be overlooked is, that other than member shareholders, there may be few individuals who want to buy shares of stock from a minor shareholder. If members do not want to buy minority shares at the fair value, the minority share holder will either be "locked in" or forced to sell at less than fair value.

It should be obvious that while there are many advantages to the corporate form of business for father and son, there also are disadvantages that must be considered. In most cases a corporate form of business structure should be "matured into" rather than be the initial form of father-son business. It is essential that fathers and sons consult legal council for detailed discussion of all facets of corporations and advice before deciding on the corporate form of business. A more complete discussion of corporations can be found in the North Central Publication No. 11, "The Farm Corporation" (1).

Final Consideration - Put It in Writing

Regardless of which form of arrangement the father and son initially choose, or which more permanent form eventually results, the agreements should be written. As a part of the initial agreement there should be a discussion of how the arrangement will be dissolved or discontinued. Even in the most ideal situation, parties change, objectives change, and personal conflicts may arise resulting in a decision to discontinue the joint farming arrangement.

The ability to dissolve or dismantle the business without additional injury to personal and family relationships is very important in such situations. A complete record of capital contributions and income sharing from the outset can minimize difficulty at this point. Plans for arrangement of property titles, the division of specific business assets, and determining final interests in the partnership or corporation should be documented. Equally as important as providing for the continuation of the business is providing for final settlement if the need should arise.

Essentials to Make the Arrangement Work

A successful father-son arrangement has to be measured in terms of whether or not the goals of both the son and the parents are accomplished. As these are long-run considerations, success cannot be measured at the end of one or two years. Even though careful consideration regarding all major aspects of the arrangement is given prior to establishing an agreement, total success is not guaranteed. As noted earlier, changes will occur that necessitate adjustments. In all arrangements, there will be some tough spots that will have to be worked out. To have a successful arrangement, all parties must be dedicated to the arrangement and continually strive to make it work.

The following items are very important in keeping problems from arising, and in minimizing the effects of those that do. Most of these have been mentioned earlier:

1. Keep the farm business and family matters separated. Have separate living facilities for the two families.
2. Have an understanding regarding working hours, weekend responsibilities and time off.
3. Outline specific areas of individual and joint responsibility, and adjust these as the situation warrants.
4. Communicate! Discuss openly, honestly, and *regularly,* decisions to be made, and things that are bothering you. Remember that communication involves both talking and listening by both parties.
5. When decision making involves two parties, some give-and-take is necessary. Compromises are often the best solutions.
6. Recognize that, as future events cannot be seen with certainty, wrong decisions will be made by even the best manager. The words, "I told you so" should never be used by either party in a father-son agreement when decisions turn out to be wrong.
7. Set up a regular schedule for discussing problems, reviewing business progress, and making decisions. This does not mean that Dad and son shouldn't discuss things at other times, but it does force them to regularly stop long enough to communicate. This should be done even during the busiest times of the year.
8. All major agreements should be put down in writing. This is not an indication of lack of trust, it merely protects both parties in case something happens to one of them. It also prevents disagreements that result from relying on memory to determine what was agreed upon some time in the past.
9. Follow through on all agreements made unless both parties agree that adjustments of past agreements are advisable. This is particularly true in matters of managerial responsibilities and farm ownership transfer.
10. Keep complete, comprehensive records on the farm business. This is vital for accurate business analysis (which is the basis for sound decision making), and the distribution of business income. Accurate records must also be kept of the capital investments made in the business by each party.
11. There may be times when it seems that a compromise between father and son is impossible. Set up a predetermined procedure for arriving at a decision. A third party to give advice, or plan for binding arbitration could prevent a small problem from becoming insurmountable.
12. Set up an insurance program that will protect the business and both parties from financial disaster. The program should contain appropriate amounts of health, liability, property, mortgage, and life insurance. Life insurance can be used to fund buy-sell agreements which should be an integral part of the partnership agreement.

Farming today is running a business—a much bigger business than most people realize. The size of farm businesses in the midwest has increased greatly in the past decade. What both father and son must recognize is that this increase will likely continue in the years to come. This means that they will have to develop into a progressive, efficient management team. To be successful they must not only keep current with and utilize improved crop and livestock technology, they must stress the business aspects of their arrangement. They must keep and analyze their farm business records, and in their decision making they must use the best planning techniques available. Their management "tool kits" must contain the latest budgeting techniques, including cash flow analysis and other financial management tools. Descriptions of these tools can be obtained at your County Extension Office. A father-son farm business must be efficiently managed and sufficiently large to provide a living income for both families.

A father-son farm business can be one of the most rewarding types of farm business organizations possible. However, it can be a sad situation, too, because both business and family issues are involved. Thorough prior planning, continued open communication and a genuine concern for each other will certainly go a long way to ensure success.

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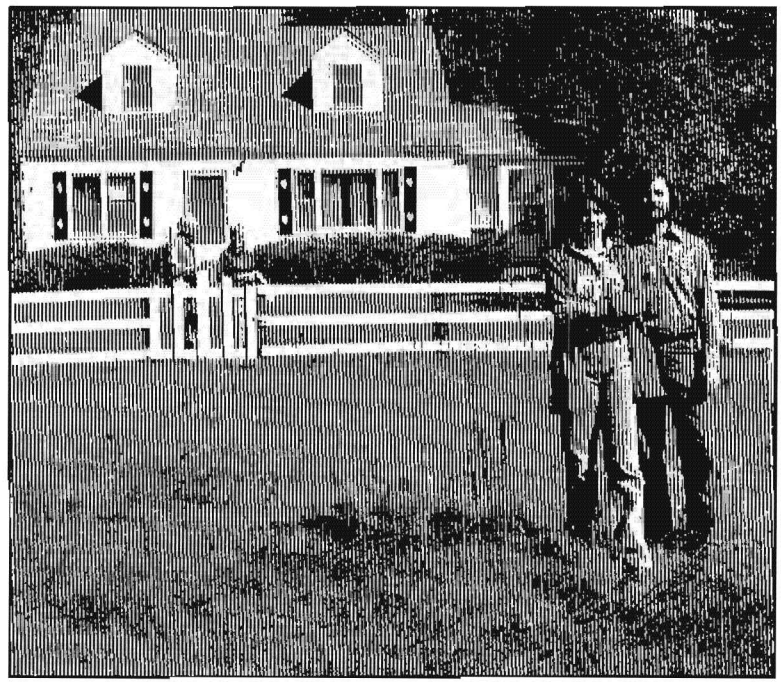

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Appendix

Appraising your situation, goals and potential for joint farm operation*

Use this form to first describe your present farm and family situation and to clarify family goals. This information will be helpful to you and to your advisors as you plan changes in the organization of your business.

I. Present Situation and Changes Being Considered

- Have you been operating together in the past? If so, describe arrangement.

_____

- Describe plans for future and types of business arrangements being considered.

_____

_____

_____

II. Overall Family Situation

A. Family Members

	Name	Age	Education	Marital Status	Present Employment	Comments (special considerations, etc.)
1.						
2.						
3.						
4.						
5.						

B. Interests and Future Plans of Minor Children and Non-Farm Heirs

- If there are *minor children*, do you think any of them might want to farm? If so, who? When might they start? Would they be brought into the present business?

_____

- *Non-farm heirs:* Do any of them have an interest in coming back to the home farm? If so, who and when?

_____

If it were necessary, would they be willing to leave their inheritance in the business for a period of years, in order to keep the farm business intact?

_____

III. Farm Business Situation

A. Size of Business and Efficiency

	Acres Operated Owned	Acres Operated Rented
Total		
Crop		
Availability of more land		
Yields on major crops		

Livestock Kind	Livestock No.	Livestock Efficiency

Facilities available _____

With machinery available we could farm _____ crop acres

Labor Supply

Number of full family _____

Number of full-time hired _____

Months of seasonal labor _____

Housing Situation

_____

_____

_____

B. Profitability and Financial Soundness

- Under normal conditions, would income be sufficient for number of families involved? _____ If not, what are your plans for increasing or shifting income? _____

_____

- Debt position of father _____

son(s) _____

*From Farm Management Series 221, Kenneth H. Thomas and Mervin L. Freeman, Univ. of Minnesota.

IV. Parents' Situation and Objeetives

A. Situation

- What stage are you at in your farming career: expansion phase? slowing down? ready to retire?

_____

- What would you like to see happen to your farm business and what would you be willing to do to make it happen?

_____

_____

B. Objeetives

Rank each of the following objectives according to their importance to you:

	Extremely Important	Moderately Important	Not Important
To provide sufficient income for me and wife during our lifetime.			
To make provisions for special family needs			
To keep farm in family			
To help one or more children get started in farming			
To treat all children fairly			
To reduce my labor contribution			
To maintain control of management of business			

V. Farming Son's Situation and Objectives

A. Situation

- What stage are you at in your farming career? What contributions have you been making to date?

_____

_____

- What would you like to see happen to the farm business and what would you be willing to do to make it happen?

_____

_____

_____

B. Objectives

Rank each of the following objectives according to their importance to you

	Extremely Important	Moderately Important	Not Important
To make farming my career			
To acquire a larger share of business			
To assume more management responsibility			
To eventually gain control of the home farm			

VI. Appraising Potential for Joint Operation

Every business needs certain characteristics for success. This is particularly true of joint arrangements because personal as well as business relationships are so important. So before pursuing your proposed change further, appraise your situation in terms of the following five essentials for success.

A. Ability to live and work together and share management responsibility. A good way of checking this is to take the test contained in "Test Yourself—Would You Be a Good Partner?"

B. Business profitable enough to provide security for parents and opportunity for son. Before entering into a detailed arrangement test the financial feasibility of your proposed plan using a form such as FM 220W "Farm Partnership Worksheet".

C. Provide opportunity for junior partners to gain control of business over time and to be in a position to effectively manage it.

D. Preserve, protect and foster family good will through careful planning and good communications. Due consideration must be given to other heirs.

E. Seek out and use competent legal and business management help in planning and carrying out changes in farm business arrangements and related estate plans.

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