David M. Kohl

Professor, Virginia Tech
Agricultural Finance and Small Business Management

This is one of a series of articles written by Dr. David Kohl for the Minnesota State Farm Business Management Education Program.
Vol. #95

I Want to Own a Farm Business

By: Dr. David M. Kohl

Since the beginning of the lockdowns in March 2020, I have presented over 140 webcasts to participants throughout the United States, Canada, and globally. I miss the face-to-face encounters with producers, lenders, and agribusiness professionals. However, avoiding traffic jams on the way to the airport in the Twin Cities, canceled flights, snow, thunderstorms, and other travel adventures are clearly an advantage of broadcasting from "cyberville." One of the top questions I receive, whether it is a producer, lender, or agribusiness group, is concerning ownership and management of a farm business. Let's explore this topic from three vantage points: entry via family, a startup, and inheriting a farm. The following advice can be used as a checklist for any individual entering a farm business to bring objectivity to a very emotional decision. This checklist can create critical questions for crucial conversations and identify potential consequences before making a commitment.

The first step is to analyze whether the business has been profitable using a three to five-year trend analysis. Using income tax returns to make this determination is one of this century's worst management practices. Revenue, cost, and depreciation manipulations to reduce income taxes skew profitability. A good accrual adjusted income statement with adjustments for inventories, receivables, payables, prepaid expenses, and accrued expenses is necessary for transparency. Farm management instructors, consultants, lenders, and accountants can be excellent, objective third-party resources.

In family businesses, one common flaw is too many people in the business as it relates to size or the ability to generate net income. The entering generation must consider producing an extra $40,000 to $70,000 of accrual adjusted net income. If not, the senior generation must curtail their withdrawals. In some situations, supplemental or non-business revenue such as wages or outside "gig" income can be utilized to circumvent this standard. Conflict, and sometimes even family breakups, can result when too many people are living out of the business operation.

Whether it is a family business or a startup, conduct a resource assessment. Even the best managers can have difficulty overcoming rusted out, worn-out, and faded out resources. An objective evaluation of equipment, facilities, land, livestock, and overall infrastructure is priority number one. Capital expenditures for improvements and repairs can be very detrimental during a transition or in the startup phase. A recent visit with a young dairyman proves this point. Three years into a very profitable grazing and value-added milk sales business now finds the need for a new milking parlor to allow for efficiency and growth. He now wishes that his desire to get started would have been balanced with an objective assessment of future needs, which would have created a higher priority to negotiate the investment of the business three years prior.

The people equation is the next hurdle in the overall assessment. This is often more of an issue when entering or inheriting a family business versus a startup. What will be the role and responsibilities of siblings? More importantly, who will they be accountable to? People management is a big flaw in many family businesses. What is the skill set of the players and will they evolve as the business changes? Is the entering generation complementary to existing players or a chip off the old block? How, when, and will management and ownership take place? How will the new generation phase in as the older generation phases out? In the planning process, it is important to balance the passion and energy of the younger generation with the purpose and legacy of the seniors.

Does the senior generation meet the 50 percent rule of retirement income needs? At least 50 percent of retirement income should be generated either through Social Security or investments outside the sale or lease of the farm business. This diversification provides security for the senior generation and flexibility for the younger generation.

Additional considerations must be taken by the younger generation and startup businesses. Seek assistance through many of the young and beginning farmer and rancher programs offered through the Farm Service Agency (FSA), your lender, or agribusiness firms. These programs can range from educational programs with reduced rates and more flexible terms to government guarantees and grants.

Next, come to the plate with a business plan that includes a well-thought-out cash flow with financial sensitivity tests. Articulating your goals and vision is a valuable part of the business planning process. A family living budget separate from the farm budget also needs to be a part of the plan. Decades of engaging with successful small farmers and ranchers has led me to believe that modest living costs are a key to success, particularly in a growing business.

Success in a startup may require outside or “gig” income. For example, a young man and his wife have started a successful farm. He is a welder, and she is a nurse. Through their outside income and shared goals, they are embarking on the purchase of their second farm that they had previously been renting. Starting from scratch to acquire a business with no family descendants can be successful in today's world of entrepreneurship and niche markets.

If you inherit a farm, what do you do? You have won the lottery from an assets and equity standpoint. However, the same process outlined for entering a family business or a startup needs to be conducted. If you have previously worked on the farm, consider how your role may change from production to business management. Do you have the skill set or should you seek complementary management to make up for deficiencies? A good mentor, such as a lender, farm management instructor, consultant, or another producer could be a valuable addition to your team. You also need to protect your newfound equity with buy-sell agreements and pre-or postnuptial agreements. Remember the old saying, “Easy come, easy go!”

Each of the ways to enter a farm and ranch business has its challenges and opportunities. Time spent planning, following the process, and engaging resources to assist you along the way can place the odds of success on your side!