

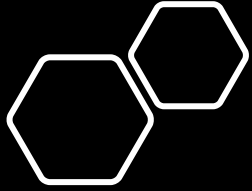
Management and Ownership Transfer in Small and Medium Family Farms

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Institute for Family Business



Motivation

- Less than 30% of family businesses last into the 2nd generation.
 - Only 10% last into the 3rd.
- Over 90% of U.S. family business owner desire to pass the business to the next generation.
- Family business succession is complicated!
- Most family businesses are ill-prepared.
- Incorrect planning for succession can end up costing family businesses a lot in the form of taxes and family disharmony.

The Succession Process

Three main components

1. **Management**
2. **Ownership**
3. Estate (transfer taxes)

Management and ownership can occur concurrently or asynchronously.

Estate transfer occurs upon death.



Management & Ownership Transfer

...are different but have similar qualities!

Management:

- Day-to-day operation
- Leadership
- Owners groom their candidates
- May take years
- Owner and successor need to be prepared and willing participants
- Allows skill and knowledge transfer

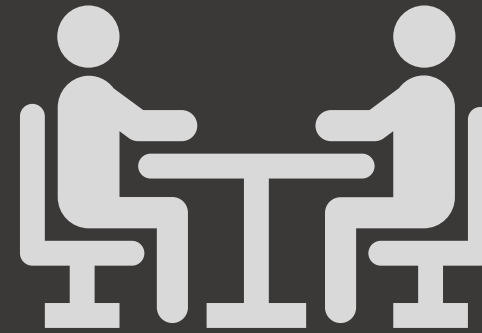
Ownership:

- Financial possessions and property
- Transfer can be costly (roughly 160 hours and over \$33,000 to plan)
- Tax and wealth considerations
- Retirement considerations
- Timing can be determined by who pays
 - Owner losing income or successor paying inheritance costs

Considerations for...

Management succession

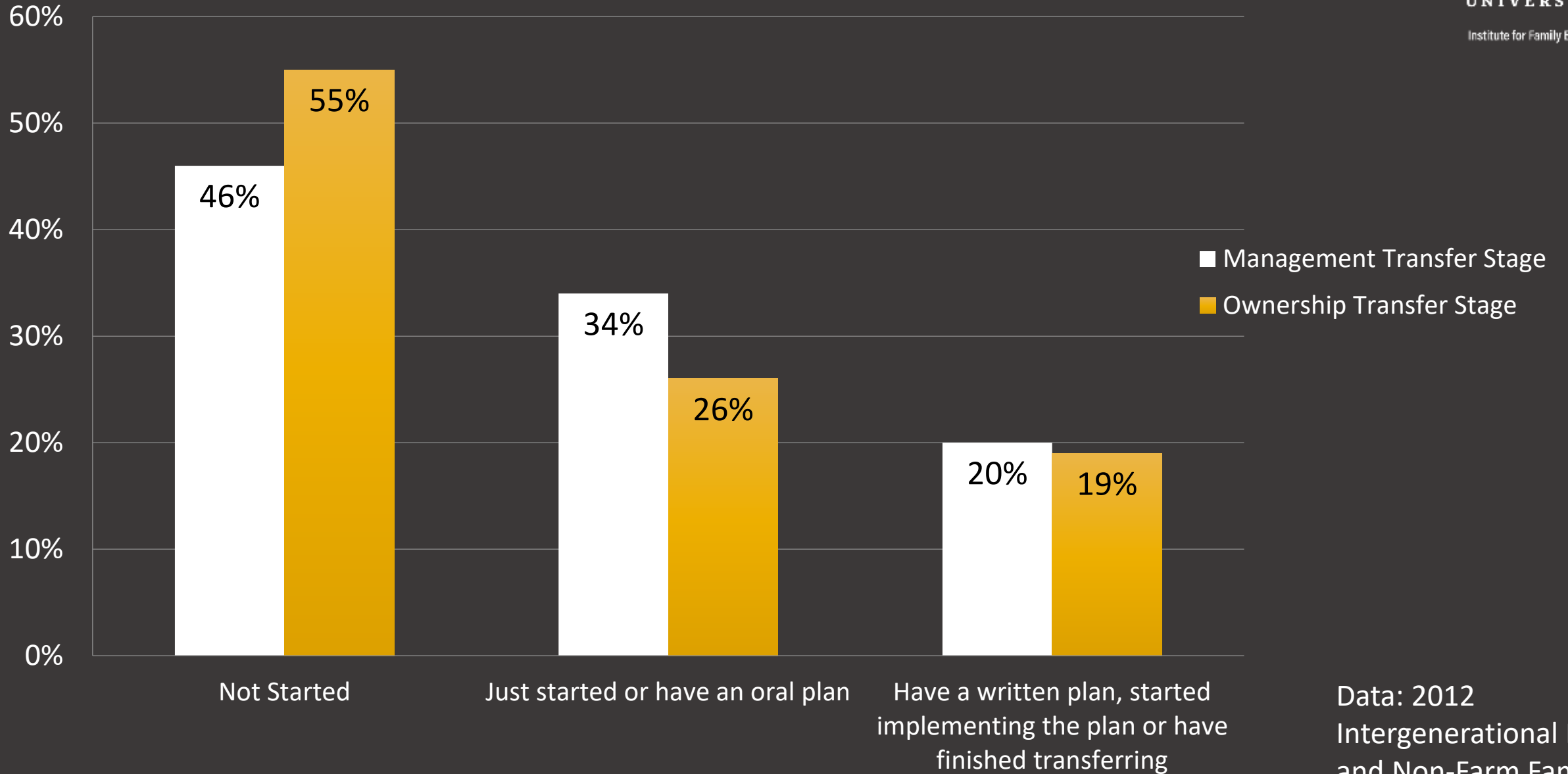
Clarifying goals and responsibilities
Family dynamics
Handing over day-to-day operations



Ownership succession

Valuing the firm
Financing the transfer
Legal and tax strategy and implications

Management and Ownership Transfer Stages



Data: 2012
Intergenerational Farm
and Non-Farm Family
Business Survey

Method: Seemingly unrelated
bivariate ordered probit regression

Dependent Variables

Variable Name	Scale and Definition
stage of management transfer	=1 if not started; =2 if have just started or if have an oral plan; =3 if have a written plan, have started implementing the plan, or have finished transferring management
stage of ownership transfer	=1 if not started; =2 if have just started or if have an oral plan; =3 if have a written plan, have started implementing the plan, or have finished transferring ownership

Business Characteristics

Variable Name	Scale and Definition
successor identified	=1 if business has identified a successor; =0 otherwise
discuss business goals frequently	=1 if future business goals are discussed on a quarterly basis or more frequently
profit over \$50k	=1 if profit is over \$50,000
business age	=age of business in 2010
founding generation	=1 if founding generation
farm	=1 if business specialization is agriculture, forestry, and natural resources
LLC_corp_trust	=1 if the business is structured as an LLC, a corporation, or a trust
lack of common goals hindering transfer	=1 if the lack of common goals is hindering the transfer of the business
business is successful	=1 if the owner believes that the business is successful
enough capital present to transfer the business	=1 if there is sufficient capital present to implement the transfer of the business

Family Characteristics

Variable Name	Scale and Definition
family members in daily management	=number of family members in daily management
family owners	=number of family members who own part of the business
owner will give business to family	=1 if the intention of the business owner is to give the business to family members when he or she exits the business
owner will sell business to an outsider	=1 if the intention of the business owner to sell the business to outsiders when he or she exits the business
business functionality scale	16-point Likert scale of how functional a family and business interact and work with one another (0=most dysfunctional; 16=most functional)

Owner Characteristics

Variable Name	Scale and Definition
owner invests in business before personal finances	=1 if the business owner invests in the business before personal finances
owner wants heirs in business	=1 if the owner has a want to bring heirs into the business
owner will transfer business even if it risks personal wealth	=1 if the owner plans to transfer the business to a family successor even if it puts their own personal wealth and livelihood at increased risk
owner knows how to start transfer process	=1 if the owner is knowledgeable about how or where to start the transfer process
female owner	=1 if owner is female
years of owner's education	=number of years of education of owner
owner's age	=owner's age as of 2011
owner is married	=1 if married
copreneur	=1 if owner and spouse are copreneurs

Descriptive Statistics

- Only 29% of family businesses had identified a successor
- Goal discussion happened quarterly or more frequently in 62%
- Roughly 72% of owners in this study were founders
- Mean owner age: 55 years old
- Only 38% were structured in an LLC, corporation or trust
 - 62% were sole proprietorships or partnerships
- Farms accounted for 68% of family businesses in this study
- Copreneurs: 68% of businesses; 90% of owners were married

Methodology:
Seemingly
unrelated bivariate
ordered probit
regression

$$(1) \text{Prob}(y = 1|\mathbf{x}) = \Phi(\mu_1 - \mathbf{x}'\boldsymbol{\beta}) - \Phi(-\mathbf{x}'\boldsymbol{\beta})$$

$$\text{Prob}(y = 2|\mathbf{x}) = \Phi(\mu_2 - \mathbf{x}'\boldsymbol{\beta}) - \Phi(\mu_1 - \mathbf{x}'\boldsymbol{\beta})$$

$$\text{Prob}(y = 3|\mathbf{x}) = 1 - \Phi(\mu_3 - \mathbf{x}'\boldsymbol{\beta})$$

$$(2) \text{Management}_i = \mathbf{x}'_{1i}\boldsymbol{\beta}_1 + \varepsilon_{1i}$$

$$\text{Ownership}_i = \mathbf{x}'_{1i}\boldsymbol{\beta}_2 + \varepsilon_{2i},$$

where \mathbf{x} is a vector of characteristics of family businesses.

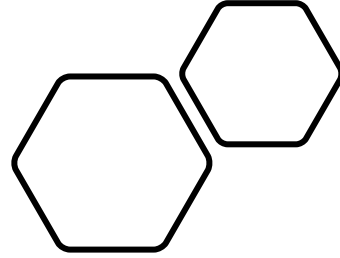
Results: Management Transfer

- Successor identified (+)
- Discuss business goals frequently (+)
- Farm (-)
- Lack of common goals hindering transfer (-)
- Owner invests in business before personal finances (-)
- Owner wants heirs in business (+)
- Owner knows how to start transfer process (+)

Results: Ownership Transfer

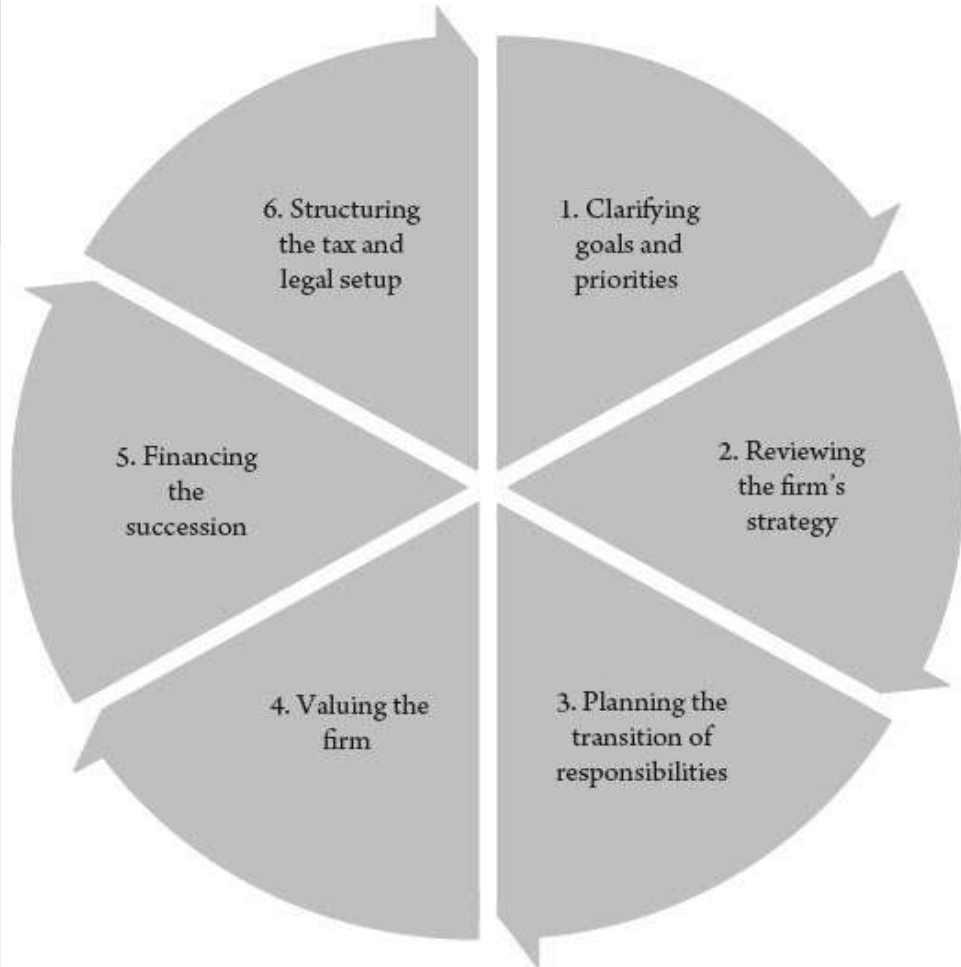
- Successor identified (+)
- Discuss business goals frequently (+)
- Business age (+)
- Farm (-)
- LLC/Corporation/Trust (+)
- Family owners (+)
- Owner will give business to family (+)
- Business functionality scale (+)
- Owner knows how to start transfer process (+)
- Owner's age (+)
- Copreneur (-)

Conclusions



- Ownership and management transfer SHOULD be modeled separately but concurrently
 - Interrelated processes
 - Bivariate ordered probit regression
- Family, business and ownership characteristics
- Farms progressed slower than non-farm businesses

Conclusions



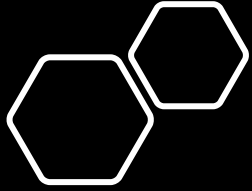
- Strong foundation:
 - Discussing goals
 - Identifying a successor
 - Educating the owner on how to start the transfer process
- Family businesses need to focus on communication
 - Survey: only 44% of succession transfers that had been completed were deemed as successful



<https://ellulschranz.com/family-business-act-chapter-565/>

Conclusions

- For practitioners advising family businesses:
 - Build a strong foundation
 - Family governance
 - Clarify goals and priorities



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