PIFF Newsletter

Fall Edition

PIFF | Purdue Initiative for Family Firms

October 2017

Included in this Issue:

Welcome to PIFF!

The Purdue Initiative for Family Firms (PIFF) is an initiative in Purdue's College of Agriculture. PIFF is an integrated research, outreach, and teaching program. It offers educational programs that address the major competencies needed for effective family business ownership and management. The goal of the initiative is to prepare family business stakeholders—strategically, financially, and emotionally—for the significant and sometimes unpredictable transitions and decisions that must be made, which determine the success and continuity of the family business.

PIFF provides multi-generational family businesses with research-based business management resources aimed at improving personal leadership performance and driving operational growth. Our ambition is to prepare family business owners, managers, and stakeholders (including non-owner spouses and future owners) to be effective stewards of their family enterprises.

PIFF publishes a quarterly newsletter that will house an article from each part of the pie, found on our website – purdue.ag/piff. The four quarters of the pie include topics of: estate and personal financial planning, strategic business planning, maintaining family bonds, and leadership and succession planning. Each section houses articles, guides, and assessments of related topics which can be viewed online or downloaded. Also found on the website is a *Question of the Month*, PIFF Research, an option to subscribe to our quarterly newsletter, and upcoming events.

Workshop helps answer the question, "Who gets the family farm?"

Maintaining Family Bonds

"It's easier to talk to your children about sex than farmland transition." -An Iowa Farmer

WEST LAFAYETTE, Ind. — One of the toughest challenges facing Hoosier farmers has nothing to do with unpredictable weather, price fluctuations and damaging infestations. It has to do with the question inevitably facing every owner of a family farm: "Who should I designate to inherit the farm?"

That's the question that will be addressed during events hosted by the Purdue Initiative for Family Firms — the "Map of My Kingdom" play and Legacy Letter Workshop. Those invested in farms and family businesses are invited to attend the play/workshop, which will be held 4 p.m.-9 p.m. on Nov. 16., at Purdue's Krannert Auditorium, 403 W. State St.

Farmers and business owners participating in the workshop will learn strategies for developing a legacy plan that's based on the pros and cons of their options. The play, "Map of My Kingdom," offers a depiction of the rich legacy of land transition. It is commissioned by the Practical Farmers of Iowa and written by Iowa's Poet Laureate Mary Swander.

As part of the workshop, attendees will learn:

- How to start difficult conversations with family members and tenants about legacy plans.
- How to write down the rich history of the farm and future goals.
- How to develop a farm legacy document.
- How to outline details on how to manage the farm in the future.

For more information or to register, visit http://bit.ly/2fogFf4. The cost of the workshop is $50 per person for the Legacy Legacy Letter Workshop, "Map of My Kingdom" play, a reception, and a discussion session. The cost is $20 per person for the play and discussion session only.

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Writer: Shari Finnell, 765-494-2722, sfinnell@purdue.edu
Source: Renee D. Wiatt, 765-496-9051, reneewiatt@purdue.edu

INTENDED AUDIENCE
Farm & Family Businesses

SCHEDULE (NOV. 16)
4pm-6pm: Legacy Letter Workshop

6pm-7pm: Heavy hors d'oeuvres

7pm-9pm: Map of My Kingdom Play

COST PER PERSON
Register & your Purdue student can attend for free!

$50: Legacy Letter Workshop, Reception, Map of My Kingdom Play & Talk Back

$20: Map of My Kingdom Play & Talk Back

QUESTIONS?
Contact Marsha Pritchard at mpritcha@purdue.edu or at 765-494-0889

Should I Form a Business Entity? To the Young, Beginning, Small Farmer

Ryan Conklin

Leadership & Succession Planning

Since joining Wright & Moore in August 2015, one of my priorities has been working with young, beginning, and small (YBS) farmers. Many of the folks I encounter in professional and social circles fit this mold, and are using their 20s and 30s to begin farming or join existing family operations. For these YBS farmers, getting off the ground can be a steep climb, and it's a climb that often presents unique legal challenges.

To start, the most common line of questions YBS farmers will ask me is about whether to form a business entity. Makes sense, right? Between starting a family, working an off-farm job, and spending your free time in the fields or barn, many YBS farmers start to wonder "is it time for me to make my business legitimate?" Well, in a classic attorney's answer, I will tell you "it depends," and that is the truth. I must stress that the needs of each client need to be considered when answering this question. However, here are a few examples that could provide some guidance.

My wife and I are starting to market our own products at local markets and directly to customers, should we have a business? Most likely, yes. Selling products directly to markets and consumers is considered a high-risk activity. If you make someone sick with your products, your liable no matter how careful you are. Take advantage of all the liability protection you can get (and buy plenty of liability insurance). Other high risk activities include property rentals, trucking, and raising large amounts of livestock.

My best friend and I have this great idea and want to start using it to make money, should we put something formal in place? Again, most likely the answer is "yes." Business ventures among family members or friends are also high risk endeavors. If the business effort fails, what happens to the profits or losses? If one party wants to leave, can the other buy back his/her share? These issues, and others, can be addressed through forming a business, and can save lots of headaches down the road.

Business for my farm recently picked up, and I had to hire a few employees to help with the workload. Should we have a business? Forming a business entity would be a great idea in this scenario. If you are not incorporated, and one of your employees causes an accident, you could be directly liable for the accident. Even if you are the only business owner, operating under a formal entity is a key form of liability protection (in addition to your liability insurance!).

I am going to get married next month and have some farm assets I want to protect from a potential divorce. Would a business entity help? Possibly. This question is more difficult to answer. If you form a business and put your farm assets into that business, it could provide some short-term protection from divorce. However, the longer you are married, the more that the line between marital asset and non-marital asset begins to blur. If this is a concern for you, the best route to protecting farm assets is a prenuptial agreement.

I currently farm with my dad and my sister. We each contribute some land, equipment, and inputs and do our best to split up profits and losses. Is there a better way to do it? *(continued on page 4)*

("Should I Form a Business Entity? To the Young, Beginning, Small Farmer" continued from page 3)

Multiple family member farming operations are also tricky, but a business entity could help. Forming a business could ensure that profits and losses are shared equally among all parties based on their ownership interest. It would also allow purchases such as inputs and equipment to be made under the same umbrella, rather than by individual people. Additionally, brother and sister can use their money to buy shares from dad, rather than buying expensive equipment or land.

There are two things to keep in mind. First, probably 99% of the business entities we create are limited liability companies (LLCs). LLCs are a great business entity for any farmer because they provide tremendous flexibility, pass-through taxation, and adequate (but not absolute) liability protection. So, if you are going to do some research on businesses, concentrate your efforts on LLCs.

Second, these are not meant to be "one size fits all" answers. As I mentioned earlier, the needs of each individual client are different. So even though you fit into some of these scenarios, please complete some due diligence before making this type of decision.

Ryan Conklin grew up on a dairy farm in central Ohio and is currently Ohio attorney with the agriculture law firm Wright & Moore Law Co., LPA. Ryan drafted this article based on his knowledge of Ohio law. Though the information may apply to similar situations in other states, you should consult a licensed attorney in your state of residence with any questions.

Top 5 Things to Consider Before Pricing Your Products *Ariana Torres*

Pricing strategy is one of the key strategies influencing your earnings. This article provides you the top 5 issues you should consider before setting prices for your products.

Strategic Business Planning

1. Define your price floor.
The price floor is the minimum price you can afford to receive from customers and *still* cover the total costs involved in bringing your products to life. Costs can be further categorized as **variable costs** if they vary with the level of production (seed, water, fertilizer) or **fixed costs** if they do not vary with production (rents, administrative labor). Good record keeping facilitates price floor calculations. Calculating your costs per unit of product, or price floor, will help you determine the minimum price for your product.

2. Define your price ceiling.
The price ceiling depends on the maximum price consumers are willing to pay for your product. Figure 1 (on page 4) is an illustration of how costs, profit margin, and prices are related.

(continued on page 5)

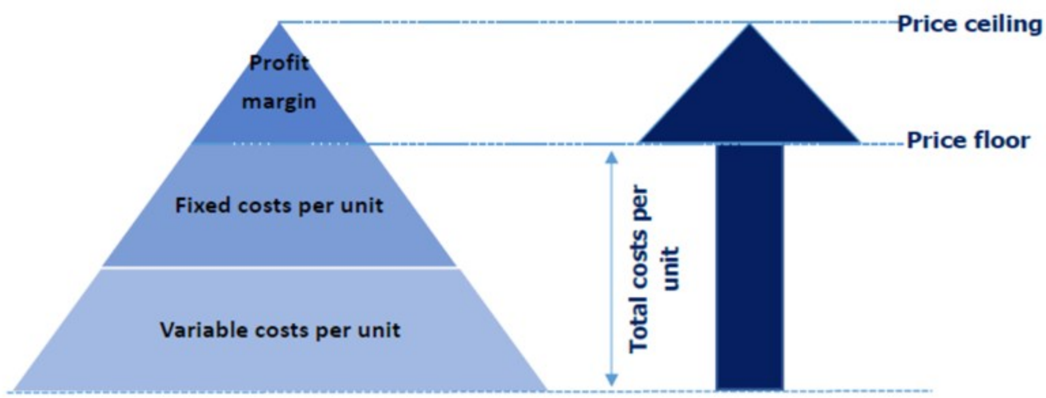

Figure 1. The relationship between costs, prices, and profit margin.

("Top 5 Things to Consider Before Pricing Your Products", continued from page 4)

The set of prices between the price floor and the price ceiling is the range of potential prices that you can set for your product. To estimate your price ceiling, you need to assess the value that customers perceive from your product. Keep in mind that while you sell product or services, customers perceive benefits and values. One way to estimate the value of your product is by asking customers what they like about your product: does it have a better taste; does it save them time; is it convenient?

3. Your selling price has a lot to say about the image of your company.
The price that you set for your products reflects their quality. I mentioned above how important it is to understand your customers. Talk to them and find out why they buy from you and what they buy. The point is to assess the image of your company from your customers' point of view and how can you use that image (or correct it) to set your selling prices. Pricing your products too cheap may get customers wondering what if there is something wrong with your product. On the other hand, if the price is too high they may perceive a better quality or wonder if you are taking advantage.

4. Identify your competitor's strategies.
This is a key aspect impacting your pricing strategy. You need to know who your direct competitors are and the range of products they offer. Investigate how your competitors' products compare to yours, their prices, and their market strategies. Your goal is to offer products and services that provide more benefits to your customers than the competition. However, you want to avoid getting into a price war as much as possible. Price wars are created when you and your competitors cut down prices to gain market share. This strategy can be dangerous for small businesses as it can undermine your sense of worth and the value of your business. A better alternative is to win the non-price competition battle by differentiating your product.

5. Provide value-based pricing strategy
Price is the monetary value of a product or service. Value-based pricing uses a customer- centric approach to pricing. The higher the value perceived by customers, the higher the price that customers will be willing to pay for it. Thus, it is important to understand the attributes that your customers value, and offer them exactly that. A high value product offers several benefits to customers such as convenience, taste, and freshness. The goal is to build long-term relationships with customers by offering more value than your competitors. Adopting a differentiation strategy can help small businesses gain customer loyalty. Differentiation means offering products and services that are important to *customers*.

Notification for Farm Lease Termination Should Be Made in Writing!

Gerald Harrison

Indiana landowners and tenant farmers who want to renegotiate or terminate farmland leases should deliver clear, timely, written notification of their intentions. The customary Indiana notification deadline is three months before the end of the current crop year unless the landowner and tenant have agreed on a different date. By custom, crop years end the end of the last day of February - in this case, Feb. 28, 2018 - meaning the deadline for delivering notification is before Dec. 1, 2017. If no changes are made to the lease, the existing terms may remain in place for the next crop year.

A 2012 ruling by the Indiana Court of Appeals indicated that a legal notification to terminate a lease agreement must be: in writing, and properly identify the leased property and a timely, effective delivery. Landowners and tenants might also want to agree on an earlier date for the required notification to terminate an existing lease rather than three months before March 1 of the next crop year. You may find more information about Indiana farmland leases online at: https://www.extension.purdue.edu/extmedia/EC/EC-713.pdf

How Do We Divide Farm Business Income? *Michael Langemeier*

If everyone in the farm business owned a similar amount of business assets, worked the same number of hours, and provided management expertise, the answer to the question in the title would be very straightforward. In this unlikely scenario, business income could be split equally. Unfortunately, asset ownership, hours worked, and management responsibilities vary across managers, operators, and owners of the business. This increases the importance of coming up with a conceptual framework to divide farm business income. Some key points pertaining to dividing farm business income are described below.

If there is enough income to pay both resource owners and family employees, a contributions model can be used to divide farm business income. With this model, an annual contribution is computed and allocated to each party before splitting net income. Annual contributions are computed using the relative value of each party's contribution of resources to the farm business. Resources that need to be included in the contributions model include land, buildings, machinery and equipment, breeding livestock, working capital, and labor and management. Here, we are focusing on resources that are owned by each party. Owned resources are typically valued at their opportunity cost. For example, if we have two generations, and the older generation owns 500 acres and the younger generation does not own any acres, the older generation should receive compensation for their owned acres.

The easiest way to compensate the older generation for the owned acres would be to use a current rental rate for the area. The annual value of buildings, and machinery and equipment can be estimated using a rental rate or the cost of ownership. Breeding livestock could be valued at its current sale value. Working capital; which includes cash, accounts receivable, purchased inputs, grain inventories, and market livestock inventories; contributed by each party to cover the cash flow needs of the business can be valued using the rate of return that would have been received from alternative investments. Labor and management can be valued using typical wages for performing comparable work or the opportunity cost associated with other employment opportunities. For example, if one of the parties could work for a local agribusiness for a salary with benefits of $50,000, this figure could be used to estimate their labor and management contribution. The annual value of the contributions for each party are computed by adding up their opportunity costs for land, buildings, machinery and equipment, breeding livestock, working capital, and labor and management. The annual value of each party's contribution is paid before net income is split between the parties. Net income can be split using a corporate, a partnership, or some other type of agreement.

The above conceptual framework works well when there is sufficient income to pay all of the resources. Net farm income is expected to be relatively low again in 2017. How should income be divided in years when income is very low? This is not an easy question to answer, which means that it is important to plan for this event. In years with low income, it would make sense to have a hierarchy with regard to which resources are going to be covered first, second, third, etc. This hierarchy would likely vary among farms. However, it would make sense for labor and management to be the first resource covered. Any resources that are not fully compensated could receive extra compensation in later years. This is similar to how sweat equity is often treated.

This article described a model that can be used to divide farm business income. Additional information can be obtained in a longer version of this article (here).

Meet the Authors & PIFF

Ryan Conklin
Guest Author
Email: rconklin@ohiofarmlaw.com
Attorney
Wright & Moore Law Co., LPA

Gerald Harrison
Email: gah104@comcast.net
Professor Emeritus
Purdue University
Department of Agricultural Economics

Michael Langemeier
Email: mlangeme@purdue.edu
Professor & Associate Director, Center for Commercial Agriculture
Purdue University
Department of Agricultural Economics

Maria I. Marshall
Email: mimarsha@purdue.edu
PIFF Director & Professor
Purdue University
Department of Agricultural Economics

Ariana Torres
Email: torres2@purdue.edu
Assistant Professor of Horticulture & Landscape Architecture and Agricultural Economics
Purdue University
Departments of Horticulture and Landscape Architecture & Agricultural Economics

Renee Wiatt
Email: reneewiatt@purdue.edu
Editor, Family Business Management Specialist
Purdue University
Department of Agricultural Economics

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