

# Valuing Sweat Equity and Adding a Person to the Farm

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# Outline

- Ag Economy Barometer
- Important Concepts
  - Succession Planning
  - Compensation and Sweat Equity
- Sweat Equity Example

# Ag Economy Barometer

# Ag Economy Barometer

Index

200

175

150

125

100

75

01/16

01/17

01/18

01/19

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01/21

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01/23

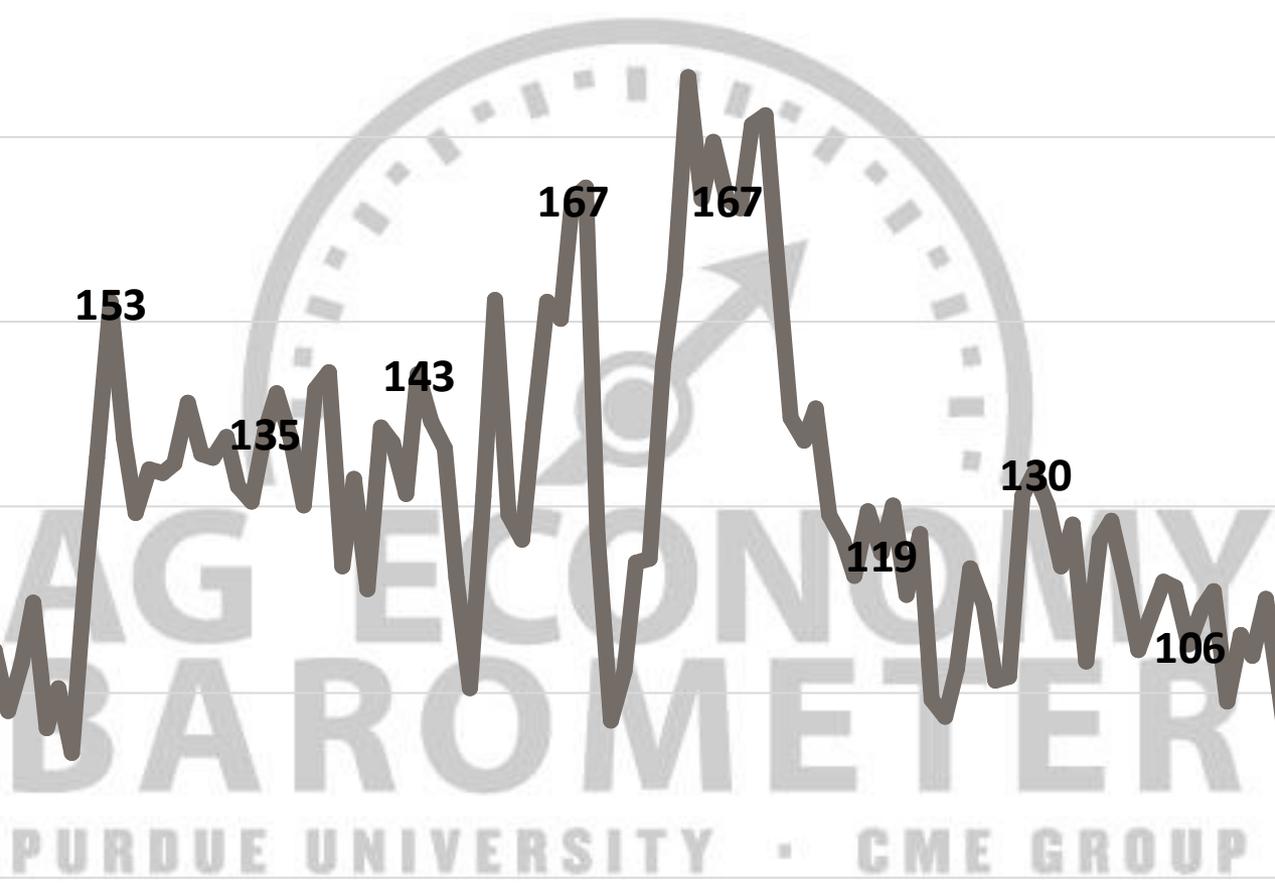
01/24

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Month & Year

Source: Purdue University Center for Commercial Agriculture, Producer Survey, October 2015 - January 2026



98

153

135

143

167

167

119

130

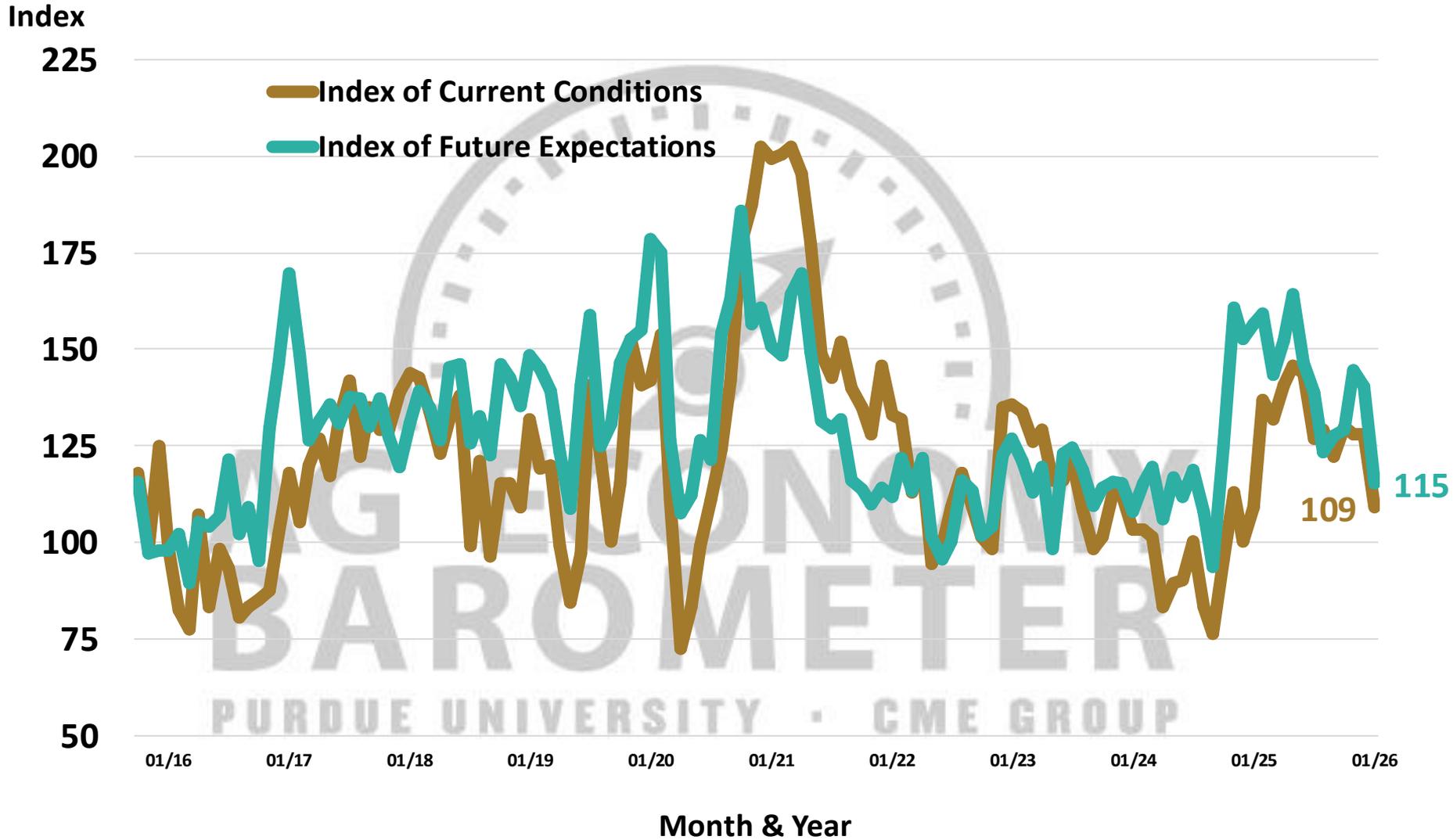
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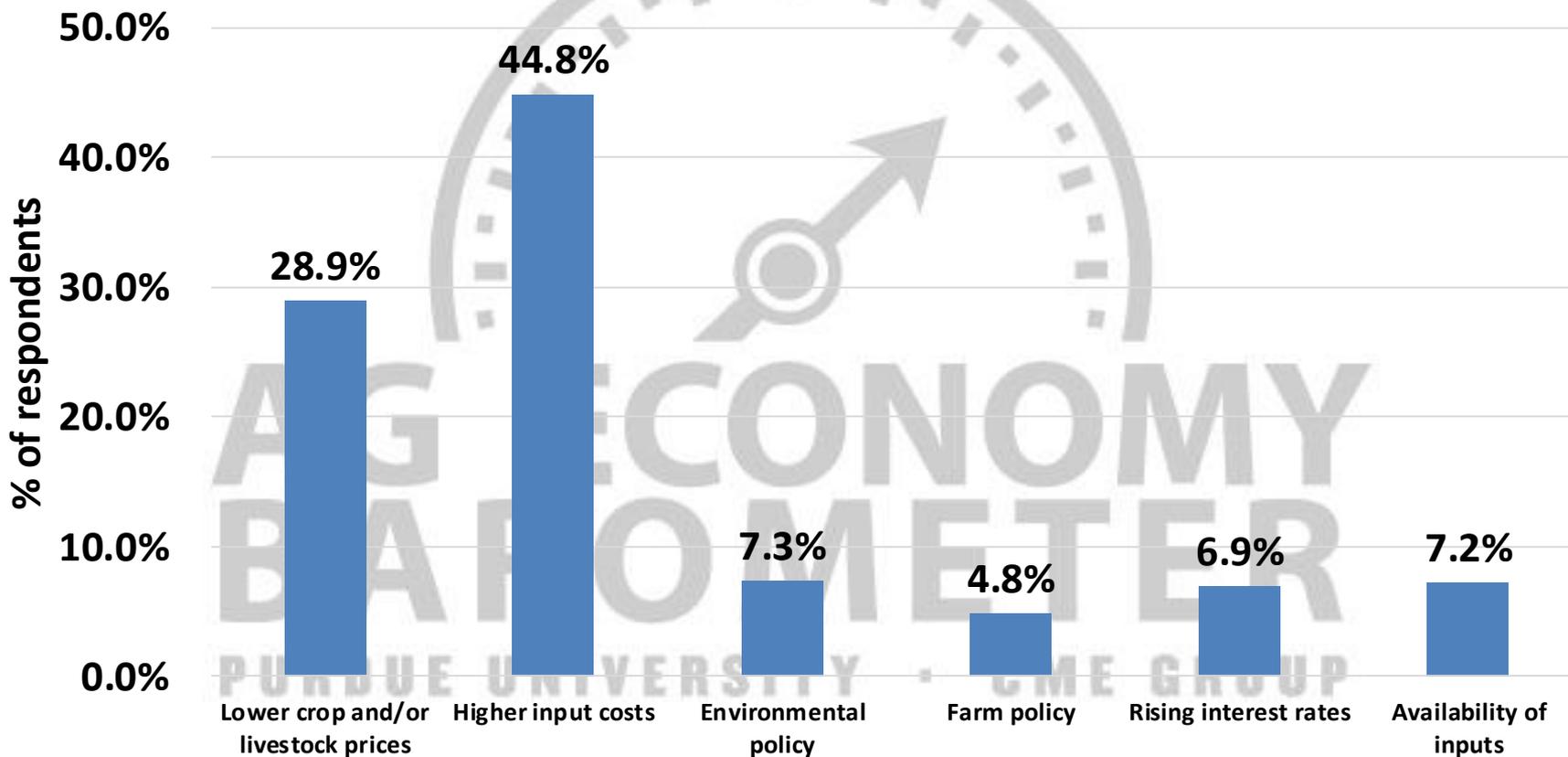
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# Indices of Current Conditions and Future Expectations



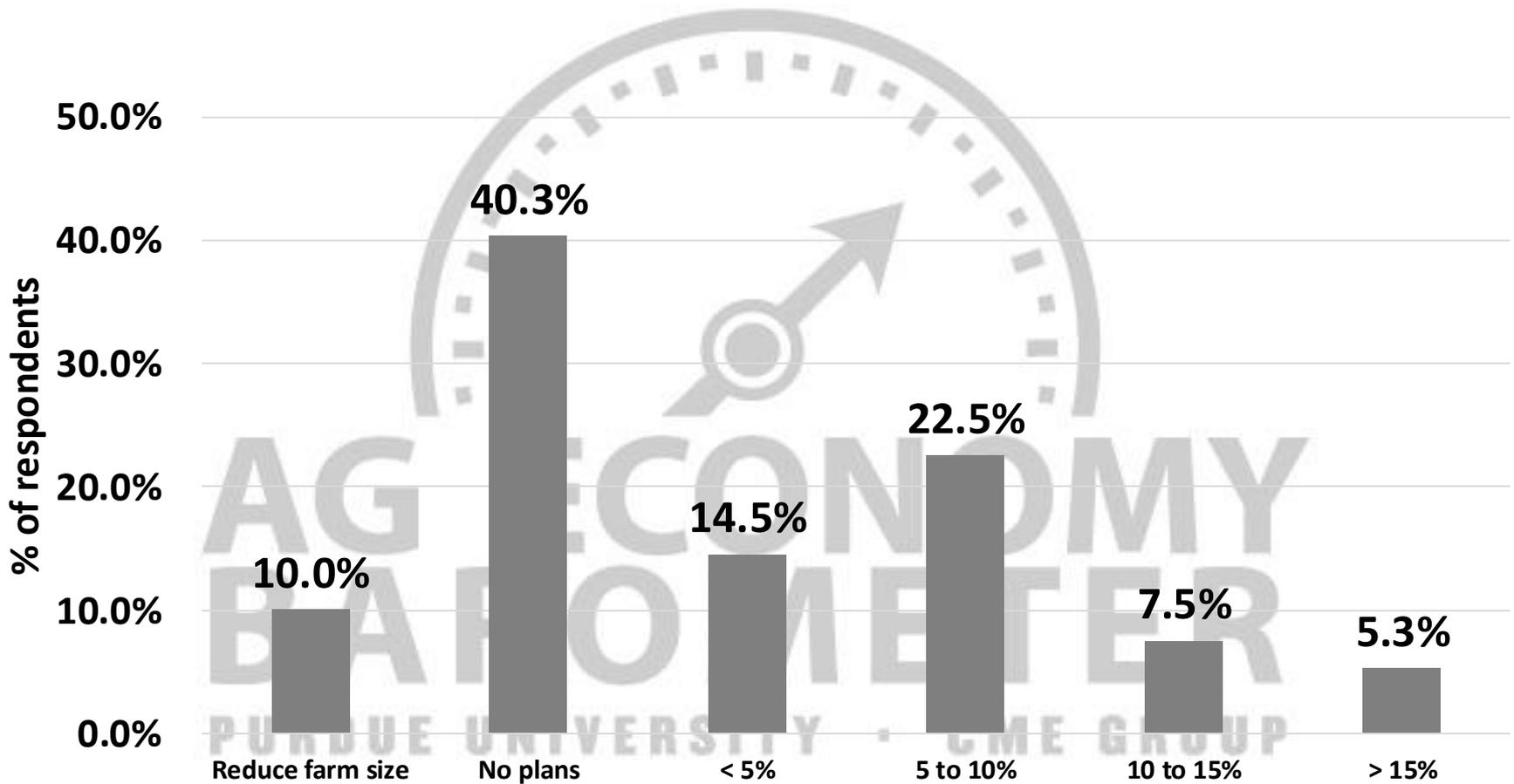
Source: Purdue University Center for Commercial Agriculture, Producer Survey, October 2015 - January 2026

# Looking ahead to next year what are your biggest concerns for your farming operation?



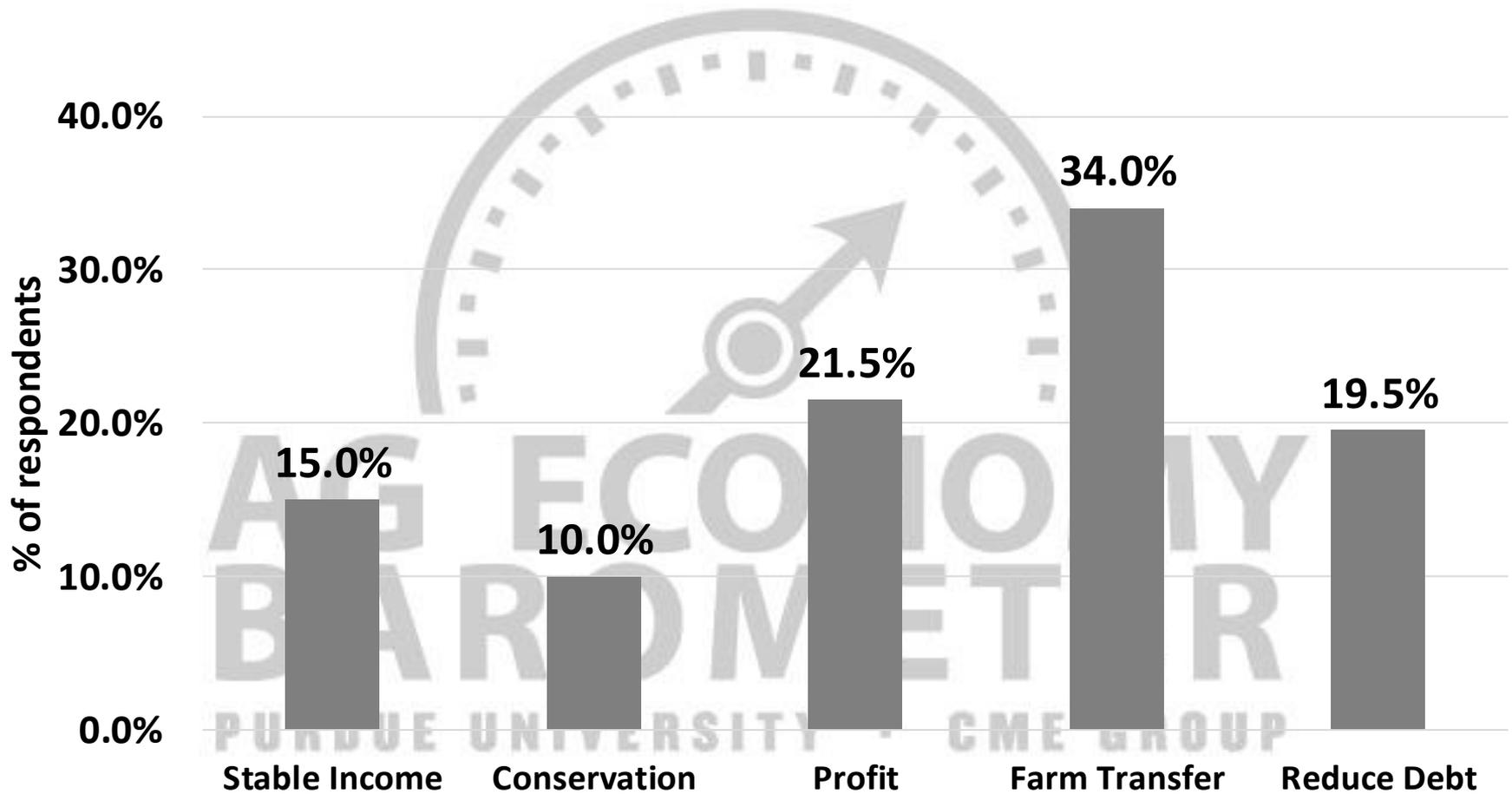
Source: Purdue Center for Commercial Agriculture, Producer Survey, January 2026

# What is the planned annual growth rate you have for your farm over the next 5 years?



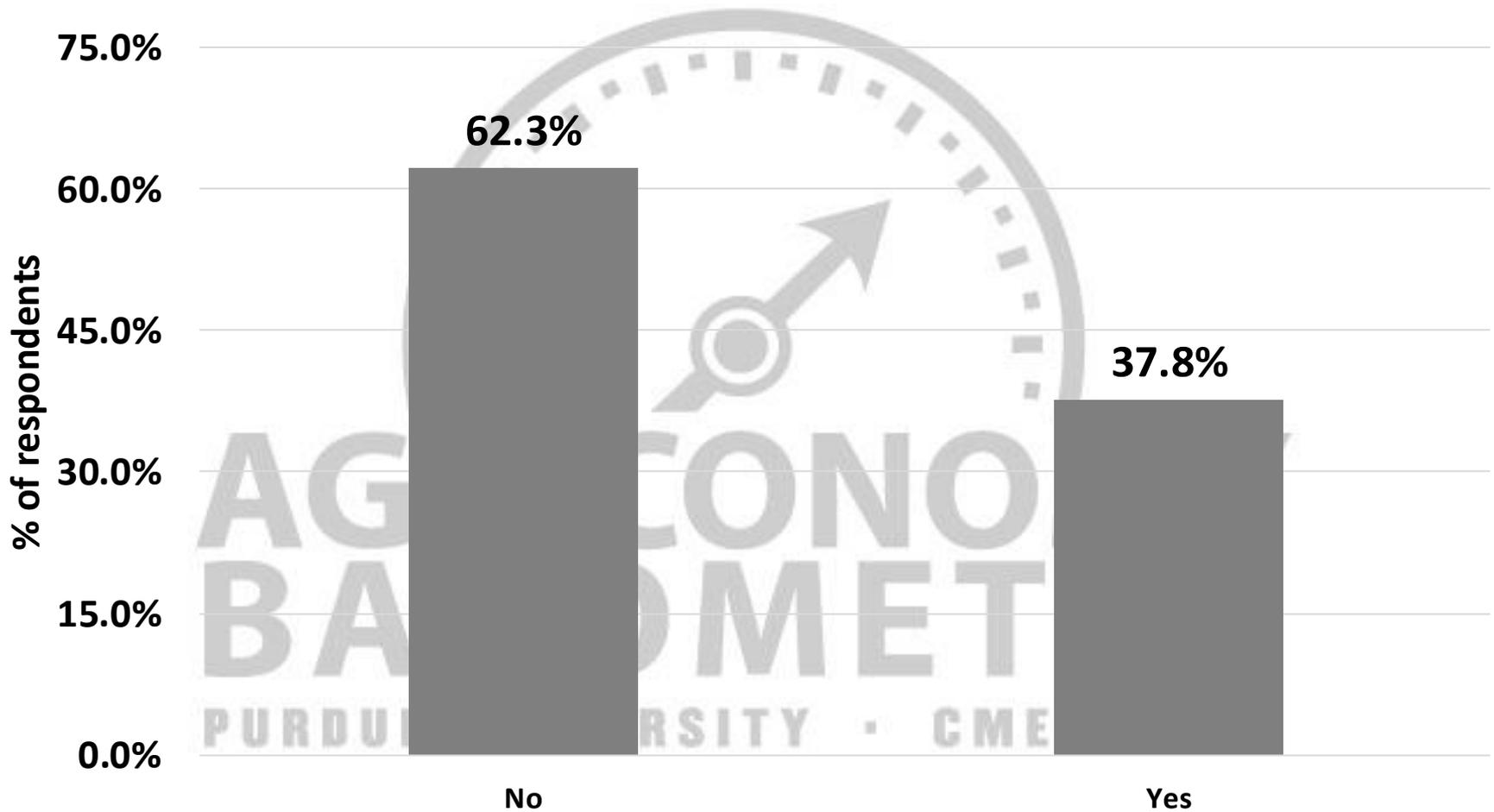
Source: Purdue Center for Commercial Agriculture, Farm Goals Survey, February 2025

# What is the most important goal for your operation?



Source: Purdue Center for Commercial Agriculture, Farm Goals Survey, February 2025

# Do you plan to bring another family member into the business (full-time) in the next 5 years?



Source: Purdue Center for Commercial Agriculture, Farm Goals Survey, February 2025

# Important Concepts

# How is “family farm” defined?

- Maintaining family ownership of farmland is not the same as maintaining the family farm.
- The former is an investment in an illiquid, long term, appreciable fixed asset and the latter is a business.
- **If inheriting farmland creates a farmer, then inheriting economic books creates an economist.**

<b>Continuation of Farm Family Business</b>	<b>Continuation of Family Ownership of Business Assets (e.g., Land)</b>
<b>Succession Plan</b>	<b>Estate Plan</b>
<b>Orderly transfer of business ownership</b>	<b>Process of accumulating, conserving, and distributing of one's assets during lifetime and at death</b>
<b><i>Avoids financial and managerial disruptive risk</i></b>	<b><i>Avoids surprises and helps mitigate conflict</i></b>

# Two Different Systems

- Family
  - Inward Looking
  - Avoids Risk
  - Focuses on Emotions
  - Seeks Stability
  - Does Not Count Cost
- Business
  - Outward Looking
  - Manages Risk
  - Focuses on Work
  - Seeks Change
  - Tracks Cost

# The Family System

- Attributes of a successful family:
  - Loving
  - Loyal
  - Affectionate
  - Supportive
  - Empathetic
  - Understanding
  - Enduring
  - Communicative

# The Business System

- Attributes of a successful business:
  - Efficient
  - Profitable
  - Goal Directed
  - Effective
  - Aggressive
  - Evaluative
  - Innovative
  - Proficient

# Structure

- The Structure of the Family Does Not Change
  - What is the family tree?
- The Structure of a Business Must Change
  - What is the organizational chart?
- **Succession Planning is the Planned Change of the Organization Chart**

# What is Fair?

- **Your children are not the same!**
  - Different motivations
  - Likes
  - Dislikes
  - Different needs
  - Different causes for problems

# Dividing Business Income

## Common Income Sharing Models

- **Contributions Model**

- Net income is divided in the same proportion as the relative value of each party's contribution of resources to the business.

- **50/50 Model**

- A return is paid to each party for his/her contribution of resources to the business. Any remaining profit or loss is shared equally.

# Dividing Business Income

## Contributions Model

- **Compute the annual value of each party's contribution of resources to the business.**
  - Land and Buildings
  - Machinery, Equipment, and Livestock
  - Working Capital
  - Labor
  - Management
- **Net income is shared in the same proportion as each party's respective contribution to resources.**

# Dividing Business Income

## 50/50 Model

- Each resource is paid a return similar to a rental payment or wage.
  - Land and Buildings
  - Machinery, Equipment, and Livestock
  - Working Capital
  - Labor
  - Management
- The remaining return (or loss) is shared equally among the parties.

# What is Sweat Equity?

- The term “sweat equity” is used frequently in discussions of the contributions of an on-farm heir to the value of a family-owned business.
- Sweat equity arises in part when an on-farm heir is paid less than their true opportunity cost to work for the business.
- The term also arises in situations where the business has grown substantially in value due to the managerial ability of the on-farm heir.

# Sweat Equity Example

Adapted using information from David Goeller,  
University of Nebraska-Lincoln

# Putting A Value on Sweat Equity

- Let's use a family situation to illustrate a few key points.
- Mom and Dad want to keep the “farm in the family”.
- The youngest of three children, Michael, came back to the farm in 1990. Unfortunately, if the farm business were divided into three equal pieces, it would not be of adequate size to create a viable enterprise.

# Putting A Value on Sweat Equity

- When Michael came back to the family farm in 1990, the fair market value of the business was \$420,000.
- At that time, Mom and Dad agreed that the contribution of each child up to 1990 was equal. Dividing the \$420,000 by three results in a contribution of each child of \$140,000.

# Putting A Value on Sweat Equity

- Today's fair market value of the business is \$1,680,000. If we divide by three, \$560,000 would be left to each child. However, the contributions of the three children have not been equal since 1990.
- There were very few promises made to Michael when he returned to the farm. However, decisions were made because he came back (e.g., land was purchased).

# Putting A Value on Sweat Equity

- Mom, Dad, and Michael know that his contribution to the family farm has resulted in Michael developing a sizeable investment of “sweat equity” into the farm business.
- There are two dilemmas present in this example.
  - Treating each child fairly
  - Farm assets have increased dramatically

# Putting A Value on Sweat Equity

- **First Dilemma**

- We don't want the non-farm kids to feel that they have been mistreated or slighted, but if you were divide the farm business into equal pieces would each slice be large enough to create a viable business.
- What about the contribution of the farming child to the growth or success of the business?

# Putting A Value on Sweat Equity

- **Second Dilemma**

- Earning adequate income to pay for the increased value of the assets may be difficult, if not impossible, for a successor to accomplish.
- For Michael to be successful, both the income the business generates, and the market value of the farm assets need to be considered.

# Putting A Value on Sweat Equity

- **Resolution**

- After careful consideration, Mom and Dad decided that they would equally divide the 1990 value of the farm business between the three children.
- They also decided that Michael was responsible for 50 percent of the growth since 1990 (value of business grew from \$420,000 to \$1,680,000 or \$1,260,000).

# Putting A Value on Sweat Equity

- **Asset Distribution in Estate Plan**
  - Michael receives \$980,000
    - \$140,000 (1/3 of 1990 value)
    - \$630,000 (50% of growth)
    - \$210,000 (1/3 of parent's contribution to growth)
  - Non-farm siblings receive \$350,000 each:
    - \$140,000 (1/3 of 1990 value)
    - \$210,000 (1/3 of parent's contribution to growth)

# Putting A Value on Sweat Equity

- **Contributions Equal Compensation**

- The family business looks different today because Michael came back to the farm.

- **Caveats**

- It is often difficult to determine how much “sweat equity” contributed to the increase in the value of the business.
  - The level of Michael’s annual compensation is an important consideration when valuing “sweat equity”.

# Key Take Home Messages

- **Equal is not always fair.**
- **An equitable division needs to address on-farm heir compensation and the ability of the on-farm heir to maintain the family business.**

# Questions, Comments

[www.ag.purdue.edu/commercialag](http://www.ag.purdue.edu/commercialag)

