PIFF Newsletter

Spring Edition: Succession Planning

PIFF | Purdue Initiative for Family Firms

March 2018

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.

The Purdue Succession Planning Team

This special edition of the PIFF Quarterly Newsletter focuses solely on succession planning within farm and family businesses. Authors in this newsletter are members of the Purdue Succession Planning Team. Read about the team below and visit this website to learn more!

Cultivating Strong Indiana Farm Families through the Succession Planning Process by Providing Educational Opportunities and Current Resources

The Purdue Succession Planning Team, comprised of Extension Educators and Specialists, was formed in 2011 to address the needs of families planning the continuation of farm businesses. The team mission is to cultivate strong Indiana farm families through the succession planning process by providing educational opportunities and current resources.

The team currently offers programming in three areas: Regional Workshops, an Introduction to Succession Planning Presentation and Farm Family Visits.

Regional Workshops

The team coordinates winter workshops held regionally across Indiana (attendees may be charged a fee). These workshops cover various topic areas including:

⇒ Beginning succession planning steps
⇒ Financial skills
⇒ Communication strategies
⇒ Business structures
⇒ Risk management tools
⇒ Options for asset transfer to the next generation
⇒ Management transfer plans

Workshop presenters include experienced professionals (i.e., attorneys and accountants), Extension specialists and Extension Educators. Team members may also hold family meetings with the workshop attendees to help them move forward with the next steps of their succession plans. Fees charged for these workshops have been lowered due to grant funding provided by the North Central Extension Risk Management Education Center.

Introduction to Succession Planning Presentation

Team members may deliver short presentations (approximately one hour in length) at educational workshops and other venues. The presentation covers basic steps and considerations for succession planning including:

⇒ Estate/succession planning definitions
⇒ Recent research studies
⇒ Feasibility of adding a family member
⇒ Elements of a family business
⇒ Options for business structures
⇒ Human resource risks
⇒ Management succession

Farm Family Visits

Families seeking advice on preparing succession plans can contact team members to schedule a family meeting of approximately one hour in length. These meetings can provide assistance with the succession planning process. The team members can advise families on preparing for meetings with accountants and attorneys. Note that a mileage fee may be charged for these meetings depending on the distance traveled by team members.

Buy-Sell Agreements (Sometimes Called a "Business Will")

Andrew B. Martin

A buy-sell agreement specifies who will buy a business, what price it sells for and how the interest will be bought. This agreement is a legally binding contract obligating an owner or owners to buy all or a portion of the business upon the terms of the contract. The agreement creates an immediate market for the owner's interests and creates orderly liquidation of the business. A buy-sell agreement can assure that the business remains in the hands of the current owner(s). Funding is an important aspect of this planning and can be accomplished with current cash flow, loans, life insurance proceeds or sale of other assets. The value of the business can be established in the buy-sell agreement.

Three Types of Buy-Sell Agreements:

Cross purchase agreement is an agreement in which each business owner buys a life insurance policy on the other owners with the obligation to purchase the business interests of the deceased. Someone has to die to make this work and if there many owners, there will be many policies. For example, in the event that there are 4 owners, there will be 12 individual life insurance policies.

Entity purchase agreement is an agreement in which the business buys insurance policies on each owner and is obligated to buy the interests of the deceased with the proceeds.

Wait and see buy-sell plan is an agreement in which the business itself has a first right of refusal. The remaining owners can purchase the shares personally or the business can purchase the interest. All remaining shares can be required to be purchased by the business if individual owners choose to buy only a portion of the shares.

Three Insights to Assure Buy-Sell Agreements Give Intentions Back to the Business:

Fixed valuation is not designed to protect against a business's possible changes in value. The value of a business is likely to change over time, thus an agreement can lose its appropriateness. To combat the incorrect valuation of a business, the buy-sell agreement should be updated regularly to reflect a business's current value. During the selling process, a third party might have to help negotiate a price if a value is not properly established by the buy-sell agreement. The buy-sell agreement can have its dynamics change over the years, mostly because the dynamics of parties in a business often change over time. The entry, exit, and changing roles of surviving owners, surviving spouses, ex-spouses, and other owners can result in an agreement losing its fairness. Keeping fixed valuations up-to-date is the key.

Inadequate funding or improper arrangement of the funding vehicle can be a costly mistake in buy-sell agreements. Available capital for buy-sell agreement might be in question if profits are lacking. Banks do not prefer asset lending. Make sure you can meet the commitments set under the buy-sell agreement. A rapid amount of growth may create a shortfall in keeping the agreement of funding the buy-sell agreement. The business can quickly gain value and then it is not as affordable to buy someone's share of the business.

Strategic Business Planning

Improper terms can have a huge impact on the agreement. Mandatory sale at the triggering event or first right of refusal on behalf of the survivors affect marketability and continuity in different ways. Does the original draft agreement meet the changing needs of the seller and the buyer? Is there fairness in all events or possible circumstances? A review of the buy-sell agreement can lead to stimulating thoughts and discussions of the succession planning process. Life events can quickly change circumstances, so be sure to review and discuss your buy-sell agreements regularly.

Caring for the Caregiver

Linda Curley

Maintaining Family Bonds

As family members age, you could quickly find yourself transformed from son or daughter to the primary caregiver for your parent (or another family member). Life situations can quickly change, and roles in families can be drastically altered. The Purdue Succession Planning Team urges caregivers to focus on some main objectives for navigating these tricky situations. These objectives include: having the caregiver set realistic goals and expectations for the job ahead, establishing limits as they identify their goals and expectations, encouraging caregivers to reach out to others for assistance, and taking care of themselves so that they can better care for others as needed.

When asking caregivers to plan achievable goals and expectations, caregivers should first consider what they would like to accomplish. It is crucial to balance expectations; consider those that can be realistically achieved within a certain timeframe. The basic goals of caregiving are to assure the care receiver's quality of life, comfort, and safety. These goals can be accomplished in many ways. For example, you may be a "care manager" who arranges, coordinates, and monitors the services that the family member requires.

In setting goals, it is important to consider how caregiving is likely to affect other areas of your life. How is your health? What is your relationship with your spouse and children? What other demands and obligations do you have? Are you employed? Preventing caregiver burnout means accepting limitations of what you can accomplish. In addition to understanding yourself, you also need to know how the illness or disability affects your family member. Objectivity about your situation is important, but is not always easy.

Caregivers should be highly focused on their own health and strong relationships. Caring for others means realizing that we sometimes need to say, "No". We have to set limits for ourselves. Taking these steps, however, can be difficult, especially if you must make painful choices. There are times, of course, when it is necessary to go beyond limits. When additional resources simply are not available, you may not have a choice. However, providing care at the expense of your mental and physical health or relationships with other family members does not benefit anyone!

Another area of focus includes asking for and accepting help from others. There is no need to play "the martyr" when caring for others. Reach out and accept an offer for assistance whenever you can. Resistance to accepting help is a common cause of stress and depression among caregivers. In our culture, there is an emphasis on "independence" and "doing it alone." Caregivers view asking for help as a sign of helplessness, inadequacy, or failure. Actually asking for needed help is just the opposite. Knowing your limits and reaching out for assistance before you are beyond your limits is an important characteristic of a strong individual. It also helps ensure quality care for your family member.

Finally, caregivers should focus on taking care of themselves. Being a caregiver and seeing the decline of a loved one is not easy. Almost every caregiver experiences a wide range of emotions some of which are conflicting, confusing, and ambivalent. As changes occur in your family member, you may grieve for the loss of your relative as he or she used to be. Feeling unappreciated is sometimes a problem for the caregiver, particularly if the ill person expresses only dissatisfaction or is unable to show appreciation. Consider getting breaks early in caregiving. If you wait until you are "burned out," these breaks will not be enough. It is important to make a plan for regular breaks, decide on the time, date, and activity – then follow through!

Long Term Care

Jenna Nees

Long-term care (LTC) encompasses a variety of services, designed to help meet both the medical and non-medical needs of individuals with a chronic illness or disability. LTC helps those who cannot care for themselves for long periods. There is no way to know what your chances of needing LTC are; however, your likelihood of needing care increases as you age and also as your health declines. Long-term care can be provided in home, in a community, in an assisted living facility, or in a nursing home. Due to the varied levels of LTC available, the costs associated with LTC vary significantly.

As you think about the potential for LTC needs, you may begin to wonder about the cost, which is one of the major worries for older adults. The biggest fear is that the costs for LTC will exhaust an individual's life savings. Therefore, it is important to plan for the potential LTC costs that you may face. When planning, consider the five ways that you can fund LTC, including: Medicare, self-insurance, Medicaid, life insurance or annuities, and LTC insurance.

Medicare is a federal program that provides health coverage for individuals 65 years of age and older. It will help cover some short-term costs associated with a skilled nursing facility, if you transfer there following a 3-day qualifying hospital stay. However, it will cover nothing after the first 100 days have elapsed.

Self-insurance would include utilizing your current income, savings and investments, the sale of property or other assets, or even utilizing a reverse mortgage to cover the costs of LTC. Some individuals would include asking adult children and/or relatives to cover costs in this method. The issue with this idea is that it can create financial hardships for family members who have their own bills and family members may not feel it is their responsibility to help cover someone else's LTC costs.

Medicaid is jointly funded by federal and state governments but is managed by states. In order for an individual to have access to Medicaid, their income and asset levels must fall below a certain level. Additionally, there is a "look back" period associated with how long the income and asset levels must be below the designated level. The current "look back" period is 5 years.

Life insurance or annuities can be utilized to fund LTC by acting as an investment tool where you earn a minimum rate of interest. Overtime, this builds up a cash reserve that you can use to cover some LTC costs. If an individual utilizes this approach to funding LTC, they need to understand how the policy affects spouses and what happens to any unused funds.

Long-term care insurance allows an individual to spend money on premiums now on the chance it will save money later. Individuals would want to obtain a LTC insurance policy when they are younger and before their health starts to decline. Once again, this approach requires an individual to look at the policy and see how it will affect their spouse and what triggers determine when the policy goes into action, along with other factors.

To know which method is best for you to fund your LTC needs, you should seek the advice of an Elder Care Attorney. Elder Care Attorneys specialize in understanding the laws that affect older adults and can help guide you through the process of selecting the best way to fund LTC without losing your life savings. Many law practices have Elder Care Attorneys within their practice; therefore, you may be able to have your succession-planning attorney and your elder care attorney meet jointly to ensure all legal documents are harmonious.

Retirement Planning

Amanda Dickson

In recent years, an increasing number of farm and ranch businesses have been pursuing an objective of continuation of the farm or ranch beyond the lifespan of the founders. A succession plan provides helpful guidance as individuals move into and out of the farm or ranch business with their own life cycles. One component of a succession plan is retirement planning. Retirement planning for farm families should be done as early as possible and revisited yearly to make sure that they are on track.

Retirement planning for farm families is complicated. Their income is often tied to their land and other assets and many times, farm families do not have any outside pensions or health insurance. Once the family decides to stop farming, their income stops as well. Farming is an integral part of their life to the point where the distinction between work and life is indistinguishable. Because of the demands of farming, many times farm families fail to develop hobbies or other interests outside of the farm business. Once the farming is done, it becomes difficult for them to retire successfully.

Many farmers make the same mistakes when planning for their retirement. The first is not taking into consideration how long they will need income in retirement. Right now, a 65 year old individual is expected to live for 20 more years. Making sure you plan for 20 years of income is crucial. Often times, farmers have a hard time envisioning retirement so they postpone it and wait too long to make succession planning decisions. The second mistake is banking on unsure things. The market is ever changing, and we can not count on the sale of a house or business to fund our retirements. Inheritances can vaporize and investments can shrink. Another common mistake is underestimating retirement living expenses. Many times expenses balloon in retirement, especially during illness or extended stays in skilled nursing facilities.

These four considerations are the primary elements that need to be contemplated in having sufficient funds for retirement. Early retirement requires greater financial assets to finance your living expenses for those extra years. Inflation is often discounted by many people, but it is real and retirement plans need to factor inflation. The main goal when considering inflation is to safeguard against spending assets down too quickly and running out of money prior to death. Depending upon your retirement age, withdrawal rates need to be conservative so you do not allow your cash and/or investments to dwindle at a value that will not support your living expenses. Since we do not know the future, it is wise to be conservative in your spending and not use up capital for living expenses any sooner than necessary.

During our in-person presentations at the 2018 Succession Planning Workshops, participants looked at an example farm family and their retirement income streams. The couple in the example had retirement benefit resources from different areas, land, pensions, social security and ending current assets. If we peel some of those revenue streams away (such as lower social security benefits, smaller land rental base, and asset liquidation), then the income potential for retirement can change significantly. Everyone’s retirement situation and needs are different; it is important to assemble a professional team of accountants, financial planners, and attorneys to help you plan for your future.

Estate & Personal Financial Planning

Meet PIFF & the Authors

Maria I. Marshall

Email: mimarsha@purdue.edu

PIFF Director & Professor

Purdue University

Department of Agricultural Economics

Renee Wiatt

Email: reneewiatt@purdue.edu

Family Business Management Specialist

Purdue University

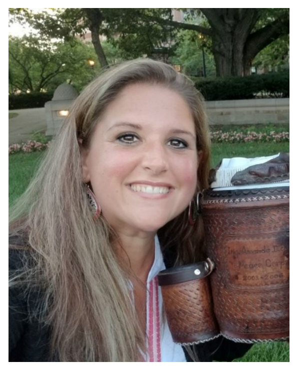
Department of Agricultural Economics

Linda Curley

Email: lcurley@purdue.edu

Health & Human Sciences Educator

Purdue Extension, Lake County

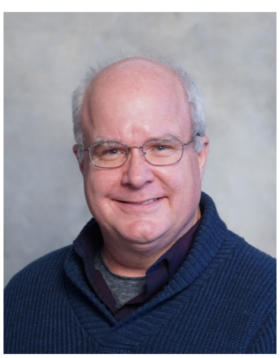


Amanda Dickson

Email: dicksona@purdue.edu

International Extension Program Coordinator

Purdue International Programs in Agriculture



Andrew B. Martin

Email: andrewmartin@purdue.edu

Agriculture & Natural Resources Educator

Purdue Extension, Newton County

Jenna Nees

Email: smith535@purdue.edu

Agriculture & Natural Resources Extension Educator

Purdue Extension, Putnam County

PIFF | Purdue Initiative for Family Firms