Tips on Developing a Business Exit Strategy for Your Farm or Ranch[1]

When should you have a farm business exit strategy?

Now! There are readily anticipated reasons to leave a business (such as retirement), as well as unexpected reasons (financial hardship, injury, disability, death). If you start planning today for what tomorrow might bring, you can have a successful transfer. Success may mean passing on a profitable business to an heir, selling your business to generate retirement income, or transferring your agricultural land and water to another producer who will keep the business in operation.

How do you develop an exit strategy?

Build your farm or ranch transition plan into your business plan, starting with your values and goals that will frame elements of your plan (such as the wishes for continuing the business in the family, qualities desired in a subsequent non-family management team, and land and water management strategies you feel underpin your business). Then build your production, financial and marketing plans, keeping your transition goals in mind. Having a plan helps you manage for risk, and increases the likelihood that you will be able to design and complete a successful business transition, when you need to do so.

Framing a successful transition

1. Make a timeline for implementing your plan and develop a schedule so you know which steps need to be carried out, who is in charge of each step, and when you want those steps completed.
2. Think of your eventual exit as a process over time, not an event. What steps do you need to take to end up in a successful exit position? How do you define a successful transitionn?
3. Identify and evaluate all possible strategies and understand your risk tolerance. How will timing influence your outcomes, the success of your strategy, and who will benefit?
4. Define your “post-exit” goals. What are your long-term income goals and estate goals? Do you want to:
    a. Finance your retirement? Finance your heir’s start-up enterprise?
    b. Launch a new business?
    c. Stay on in an advisory management capacity?
5. Have a contingency plan. What is your plan if, when you are ready to exit, the value of your business isn’t what you anticipated?

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6. Write your plan down and communicate it to your other managers, family members, etc. Better yet, involve them in developing your plan, when appropriate.
7. Decide who will be involved in your decision to exit. Your business structure will determine who must be involved legally (for example, a sole proprietorship where you make the business decisions versus a corporate structure where there is a designated management team). Good communication with your family members and business partners is important, regardless of your business structure and transition plan.
8. Form a transition team. This could include your management team, a certified public accountant, legal counsel, banker/lender as well as others.

Designing your exit strategy and preparing for it

a) Organizational issues

1. Assess whether your business structure is optimal for the exit you are planning. Will there be tax implications from a certain structure but not from another (i.e., corporate vs. partnership).
2. Should you sell or spin-off part of your business to enhance profitability of the rest of the business? Would this attract another business person since there is the potential for creating/growing a new business? For example, adding flour milling (a value-added enterprise) to your small grains production offers new production and marketing opportunities but may be beyond what you desire to be directly involved in managing.
3. Plan your exit for the general time of year that will enhance the value of your assets (after harvest, after processing, with animal breeding in mind).
4. Understand the weaknesses and threats to your business and how a transition to different managers/owners may address those challenges. This will help you look proactive to prospective buyers or partners (or family members!).
5. Make provisions to maintain your business records for up to 7 years after its sale, closing or other transfer.

b) Financial management and recordkeeping

1. Document all procedures, and contractual arrangements (employees, vendors, customers, liabilities).
2. Maintain audited financial statements, and keep your business plan up-to-date.
3. Make sure you have a retirement plan and health insurance.
4. Examine your financial positioning. Do you have significant debt? Cash flow problems? Low profit margins? Understanding the cause of any financial issues will help you develop a better exit strategy.
5. Do you want any financial and/or management involvement in the business after the exit process? If so, for what time frame and for how much compensation?

Considerations in selling your business

1. You will need to know your business's value (get an appraisal). Are there comparables to which your business might be evaluated? If you get an appraisal early on, this can help you pinpoint problems or issues and help you make changes to improve operations and the overall value of your business.
2. Have documentation that demonstrates the value of your business (i.e., tax returns, depreciation calculations), and its positioning for future (continued) growth in the marketplace. Do your historical earnings reflect profitability, and the potential for future profitability?
3. Conduct a strong financial analysis. What is the financial position of your business in terms of liquidity and solvency?
4. Determine whether a sale is a financially viable option by assessing what your proceeds will be after you deduct your costs. What are the tax implications of a sale?
5. Decide if you want to sell the business outright or have a gradual sale where the assets are transferred over time to the future buyer.
6. Decide what is and is not included in the sale.
7. Have a written agreement containing all the terms of the purchase, including assets, intellectual property, brand names, trademarks, customer lists, etc.
8. Remember that a sale may change relationships among employees, customers and/or vendors. Therefore, the buyer may not be able to retain the entire business customer base developed by the seller and no assurances should be given in a purchase contract.

Considerations for closing your business (ceasing all operation)

1. Know what you have (and what you owe). Make a complete inventory of current business assets and any liabilities. Make sure equipment is clean and in working order prior to sale. Plan for how the business' liabilities (short-term and longer-term debts) will be paid off.
2. List your intangible assets (business licenses, permits, trademarks that may be transferrable). Is there a market for your customer lists? Company name? Other transferable assets?
3. Know what you can expect to receive from the sale of a comparable business.
4. If you are dissolving your business you may have to file documents to state and federal authorities to legally dissolve your business (for example, for an LLC or corporation).
5. Keep track of all licenses and permits operated under your business so you can cancel them when you cease operating.
6. Keep all of your employment records up to date, so you can notify your employees in advance of your closing and make sure that all employment taxes are paid.
7. Will the business end or continue in some form? If the business is ending, you must decide if you will gradually close down, by diminishing operations over time, or if you will sell the assets of the fully functioning business, and then close, or use up the assets and close, extracting all profits as they are realized.

Considerations for transitioning your business to an heir or to an incoming farmer/rancher

1. Remember to communicate your values, goals and plans to your family, and to your current and new management team.
2. Examine the capabilities of the person taking over. Will you need to train them? If so, for how long and in what areas? Will this be part of the purchase agreement?
3. Analyze the financial position of the person taking over. Do they have equity to invest in the operation? Will they be able to generate a living from the business or are there expansion possibilities so that they can do so?
4. Understand the tax implications for both parties of transferring real estate, livestock and other assets. There are different mechanisms including gifts, remainder trusts, lease arrangements, and sales (gradual or lump sum). What are the impacts on your respective income and self-employment tax situations?

Additional Resources

- U.S. Small Business Administration, short articles on business exit: http://www.sba.gov/category/navigation-structure/starting-managing-business/managing-business/getting-out.
- SCORE, Developing a Succession Plan: http://www.score.org/resources/developing-succession-plan.
- University of Minnesota-Extension, Transferring the Farm Series: http://www.extension.umn.edu/distribution/businessmanagement/M1177.html.
- University of Minnesota-Extension, Estate Planning Series: http://www.extension.umn.edu/distribution/businessmanagement/M1178.html.
- Iowa State Center for Law and Taxation offers objective information to producers, professionals and agribusinesses concerning the application of important developments in agricultural law and taxation (federal and state legal opinions of relevance, as well as critical legislative developments), through articles, seminars and publications. http://www.calt.iastate.edu/.
- Western Farm Management Extension Committee, Lasting Legacy courses 1 and 2 provide a starting point for families to start planning for the future of their farm or ranch businesses: http://www.rightrisk.org/. A workbook is also available.
- U.S. Internal Revenue Service checklist for closing a business, by type of business structure: http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Closing-a-Business-Checklist.
- National Farm Transition Network supports programs that foster the next generation of farmers and ranchers. The Network develops programs that link retirement and farm exit approaches with farm entry strategies, and programs have been established in at least twenty states have established Farm Link programs to "link" beginning and retiring farmers. http://www.farmtransition.org/.