

Keeping The Dairy In The Family

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More often than not, family businesses generally last only one generation.

Numerous studies have found that fewer than one in three family-owned businesses survive to the second generation, and only one in 10 are passed on to a third generation. Other studies have long pointed out that businesses usually fail because of a management breakdown such as incompetence, inexperience or other human frailties. There is a relationship here — the failure of the family business to make an effective transition in ownership from parent to child is a type of management failure.

Passing a family-owned dairy from one generation to the next requires a planning process, and the sooner it is begun the better the chances are for a successful conclusion. There may be no end to the process, because events and circumstances will constantly necessitate reshaping and redesigning of plans.

Since there will be some difficult choices to make, many dairymen may simply put off making them. Making a decision carries with it a cost — perhaps financial and perhaps emotional. If the alternatives appear too difficult, the option that is frequently chosen is to wait. In our experience, this is the number one reason for the

failure of family businesses: behind the management breakdown there was a plan that was not begun, or a decision that was postponed.

The issues in any business succession planning process are issues of emotion as well as of finance, love, sibling rivalry, times and seasons, and of fairness versus equality.

Looking at some of the family issues, we frequently discover that the dairyman is extremely reluctant to let go of the business reins. Someday, of course, he or she wants the kids to take over, but 'someday' is often vague and thoroughly undefined. We have also worked with parent-owners who desperately want to step out of the business and relinquish control to a child, but they simply cannot figure out how to do it due to a number of thorny questions, including:

- Fairness vs. equality. It is very common that the key family asset is the dairy, and only one of the children has made it his or her life's work, while the other brothers and sisters have taken on other pursuits. The parent-owner wants to be sure the interested child gets the business, yet still treat the others equally. Even if the dollar value of the assets can be mathematically divided into equal shares, will any distribution truly be fair when one child gets a business and the others get cash or other assets?

Fairness and equality are not easy to define. 'Equality' carries with it the notion of a quantitative, measurable sameness in the shares of the estate's assets. 'Fairness' in our vocabulary is best translated as 'equitable'. After taking all things into consideration, we want to do the right thing for each of our children, but the result may not always be mathematically equal.

For lack of a better solution, a dairyman may sometimes be tempted to leave the business in fractional shares to all of the children, without regard for the fact that only one may be involved in it. We feel this is usually disastrous to family harmony as well as to the long-term health of the business. In such instances, we have identified two classes of siblings as they view each other:

- 'Parasites and plunderers'. Those brothers and sisters not involved in the dairy

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will look at the one running it as a plunderer: "Look at him, earning all that money and fighting us for every dollar our shares are worth!" Meanwhile, the sibling who is running the dairy sees the others as parasites: "I work 14 hours a day and they want me to share the profits with them!"

A natural conflict could occur where one child receives the cattle and the non-participating siblings receive the land. Here, it would be essential to have a long term lease agreement so as not to force the active sibling to pay excessive rents. Otherwise, it could lead to a forced relocation that could be unfortunate for all concerned.

Then again, as one attorney we know has stated, there cannot be a long enough lease that won't eventually have problems because of the natural conflict between the two sides. Because of this, the attorney has often recommended that a survivorship life insurance policy be taken out on the parents—partly to pay estate taxes when they are due, and also to give the participating child tax-free proceeds to use as a down payment to purchase the land from his/her siblings over a number of years.

While a separation of management from ownership may be normal and even essential in large public corporations, it can be the cause of fatal controversy in smaller family-owned businesses. We consider it extremely important that ownership control be placed in the same hands that have previously been entrusted to manage the family enterprise. The challenge is to find other ways to be fair to the other family members.

How is one to handle a situation where the parent/owner's heir is as yet unqualified to take over management of the business? A specially designed family trust, with care taken to find appropriate and experienced non-family trustees, may be part of the answer to provide a kind of advisory group during the transition years.

• Estate liquidity and business succession. Sometimes, the planning priorities themselves can be a source of conflict or confusion. Today, even a modest size family dairy can be valued in the millions of dollars for federal estate tax purposes. Advisors are quick to point out the need for insurance-related funding of the estate tax, but without really addressing the problem of ownership succession. Of course, finding a way to pay the estate tax is vitally important. But any estate plan will fail if there is not a mechanism in place to preserve and protect the continuity of the busi-

ness from the parents to the children.

Sometimes, financial planners will advise dairymen on business continuation questions without giving much thought to gift and estate tax concerns. If you have been advised to set up a partnership capital account for your son or daughter, extreme care must be taken to properly characterize this transaction for purposes of federal gift and estate taxes. With proper valuation issues, particularly involving intra-family transfers, the IRS (with recent changes in the tax laws) will want to make sure that accurate values and records have been put into place. Otherwise, you risk having the full value of the dairy being thrown back into the parent's estate. We suggest you at least obtain a second opinion before taking this step.

Experienced estate planners have a number of tools they can use to address the issues presented here. A few of the most important are buy-sell agreements, various wills and arrangements, "private annuities", installment sales, charitable remainder trusts, family partnerships and irrevocable life insurance trusts. Just as every family business is unique, there will never be one single solution to fit all circumstances, and every plan will likely consist of several interrelated components.

One option that we have used more than any other is the family buy-sell agreement. A legally binding contract is made between the parent/owner and his or her adult child, which provides for the sale of the parent's interest in the business at an agreed-upon price. The trigger date for the purchase is normally the parent's death or retirement, whichever comes sooner.

If such a plan is properly funded in advance, the child will have the money to buy the business and the parent-owner or his estate will receive cash. This is one of the most valuable uses for life insurance—as a funding vehicle for the family buy-sell. Now, funds will be there to provide for retirement and/or equitable distribution of the estate to other members of the family.

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