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Transition and Estate Planning Traps and Tips

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The period from 2025 to 2040 will be known as the great transition of wealth and management. Some estimates indicate that up to $94 trillion in wealth will transfer in that 15-year window. In the agriculture industry, about $4 trillion of wealth could be transferred. Agriculture will be one of the first industries to enter the transition portal because of the rural nature and aging demographics. The following are some of the transition traps to avoid and tips to make the process more transformative.

No will

A visit with our lawyer to finalize our transition plan uncovered an interesting fact: over 75 percent of Americans have no will in place and in the agriculture industry it is estimated that over 50 percent have no will. In an asset intensive industry with many large families, this is a disaster waiting to happen. A recent visit with one of my former students found that he had no will despite having $18 million in assets with $15 million in equity. I proceeded to give him a cold stare of disappointment!

Life insurance not covering debt

One of the biggest mistakes one can make, particularly if there is borrowed money, is not having enough life insurance proceeds to cover the business' debt. Death can take both a financial and emotional toll on the business and managers, which can be felt for many years. Life insurance can provide a financial safety net and enough liquidity and working capital for the transition management or the sale of the assets on one's terms rather than a forced sale where assets are likely to be discounted in value.

Control

Often, the most difficult aspect of transition planning is the senior generation giving up control. They have spent many years building the business net worth and know the trials and tribulations along the way. There is an old saying that to maintain control, you must give up control. A well-orchestrated plan of delegating responsibilities and commitments to the next generation can reduce the financial and emotional shock to that business. Giving up control can be asset management and decision-making, or both. A third-party facilitator can be very useful in the facilitation process.

Profit sniff test
One of the biggest traps in business transition is when the next generation purchases rusted out, worn-out, and obsolete assets, often using borrowed capital, with undeveloped management skill sets. One of the first steps in the transition plan is to conduct a valuation exercise. Has the business been profitable and are the profits recurring and trending positively? Do not use tax records because the bottom line can be influenced by manipulating revenues, expenses, and depreciation schedules to minimize taxes. A tip is to conduct an accrual analysis with changes in accounts payable, inventories, accounts receivable, prepaid expenses, and accrued expenses to ascertain a more accurate assessment of profits and potential earnings. It has been my experience that the next generation who purchases a business that has been losing money or has worn-out, noncompetitive assets will hit the proverbial “wall" generally about three to five years after the transition takes place. A suggestion is to have a third party conduct a business valuation.

Getting started
In transition and estate planning, it is very easy to focus on the urgent versus what is important. Caring for the livestock, planting, and harvesting are often urgent. However, it is imperative that you have scheduled time to allocate to what is important such as transition and estate planning. The next generation will often comment that the parents and grandparents do not want to discuss or get the process started or that they are leaving them in the “twilight zone of business,” meaning that the transfer of the assets or the management responsibilities is too late in life for all of the generations to make the necessary capital management decisions to ensure competitiveness.

The following are a couple of tips I have discovered that can get people started in the estate and transition planning discussion.

- Have the grandchildren or younger siblings interview the vintage generation about the history and the legacy of the business. This will often be very informative for everyone and with the use of video technology the results can be communicated across all generations.

- Another method is the drop dead exercise. Place everyone's name in a hat and pull one name out. This person is now dead, how does the business move forward? Keep in mind that the name you draw out will not always be the oldest individual. Also, the dead person will often attempt to speak! I recommend you ask them to leave the room so the exercise is more realistic without their input.

Treating siblings equally
Treating all siblings equally is becoming more of an issue in transition and estate planning management as the value of farm assets, specifically land, have been inflated. In a globally competitive market, the profits and cash flow generated often make it prohibitive to economically purchase the business. Nonfarm family siblings often are disinterested in the farm up until the death of the seniors is about to occur. As one banker put it: nonfarm siblings are waiters, meaning they are waiting for the seniors to die. It is nearly impossible to treat all family members equally in today's economic environment. What often happens is the fragmentation of the farm where other larger businesses with ample resources outcompete the existing owners. This is one of the reasons that agriculture is rapidly consolidating in some states. One tip to solve this issue is to have the nonfarm siblings receive cash life insurance proceeds. Life insurance proceeds come with no risk and maximum flexibility versus the farm business that has considerable risk and competitive pressures. A rule of thumb is every one dollar of life insurance proceeds equals about three to five dollars of farm assets. For example, $500,000 of life insurance proceeds would equate to $1.5 to $2.5 million in farm assets.

Purpose
A subtle trap in transition planning is to lose sight of the purpose for the older generation transitioning out. Many individuals in the senior generation have difficulty transitioning into the next phase of life, which often results in a dramatic decline in physical and mental health. Carving out a role for the seniors is very critical in the process and its importance is often underestimated in the financial aspects and energy put into the whole transition process. A biology professor at Virginia Tech once stated that farmers will often live to an old age as a result of having purpose.

Communication
Transition and estate planning are often very emotional. Understanding the communication styles of the individuals involved and hiring a third-party facilitator can be very useful in the transition management process. The DiSC personality profile or another communication assessment can be a valuable tool. A neutral third-party can guide one through the process and help to maintain focus on the lighthouse or the “North Star” of the transition destination.

Final thoughts
Transition planning is the transfer of management responsibilities while estate planning is the passing of the estate’s assets and wealth. This process can either be regenerative and invigorating and take the business to the next level or emotionally and financially draining leading to demise. It is your choice!