Phase 2 – Readiness Assessment

Phase 2 – Readiness Assessment

Before you begin creating a transition plan, it is important to first determine if your group and farm are solidly enough positioned that your transition will have potential for success.

Transition planning requires a significant investment of time, effort, money and emotional energy. Your farm business may not be in a position to handle the level of investment required. It is far better to identify gaps in your readiness early so you can make adjustments **before** beginning to work through the plan development process. The Readiness Assessment Phase of the planning process will help you determine whether your farm business is ready to begin transition planning.

The Readiness Assessment Phase includes two chapters divided into the following 13 topics:

Chapter 4: Priorities

Topic 1: Goals

Having a clear understanding of your transition planning goals, as well as those held by everyone else involved in your transition planning process, is an extremely important part of transition planning.

Topic 2 and 3: Values - Individual and Family/Group

People differ in their values and beliefs, even in the closest of families. Learning where you agree and disagree with other transition planning participants will help minimize conflict.

Topic 4: Family First/Business First

Transition planning can be an intensive soul-searching exercise. Many major decisions require achieving balance between priorities. Should decisions be based on putting the family first or the business first? Before proceeding with a transition plan, it is important to know whether participants' opinions differ regarding this balance.

Topic 5: Retiring Generation

Early in the transition planning process, it is important that the farmers intending to transition out of farming take time to write down and talk about their initial thoughts, priorities, expectations, concerns and timelines regarding retirement.

Topic 6: Succeeding Generation

Before committing to the transition process, individuals transitioning into a farm's ownership and/or management should take time to write down and talk about initial thoughts on the transition planning process, including their priorities, expectations, concerns and timelines.

Chapter 5: Assessment

Topic 7: Financial Performance

It is extremely important to have a good understanding of each individual's and the farm business's financial situation before beginning transition planning.

Topic 8: Management

Transition planning involves transferring a farm business's management and/or ownership from one set of hands to another, typically when one generation passes a farm on to the next generation. Even within a family, management practices may differ between generations. Transition participants should assess their management practices and use that information to help guide the transition.

Topic 9: Personalities/Behaviours Audit

Understanding the differences between participants' personalities/behaviours can be helpful in transition planning and ongoing plan implementation.

Topic 10: Historical Business Development

Throughout a farm's history, certain events will occur that could be considered monumental or business altering. Writing down and discussing these events will help participants understand how and why the farm is where it is today.

Topic 11: Readiness Assessment Review Meeting

Regular and structured communication is critical to achieving your transition planning goals.

Topic 12: Decision Time

Is your farm ready for transition planning? This topic summarizes the exercises completed and determines whether you are ready to proceed with developing a transition plan.

Topic 13: Statement of Intent to Proceed/Defer

If your farm is ready for transition planning, participants must agree to get started or to defer the process until a later date. Formalizing that intention into an official statement introduces a degree of accountability to the planning process.

Chapter 4: Priorities

Topic 1: Goals

Goal setting is a powerful way to motivate yourself to turn a vision of your desired future into reality. Writing down goals will not only make them more concrete and precise, it can help you determine where you need to concentrate your efforts.

Goal setting is a two-part process: you first need to decide *what* you want to accomplish, and then you need to identify *how* you will accomplish it. Many people find that the 'how' part of goal setting is problematic: they know what they want to do but they have trouble creating a plan to get there. Remember that a goal without an accompanying action plan is rarely achieved.

All stakeholders who have a vested interest in the farm should complete the goal setting exercise.

Remember that there are no right or wrong goals. However, some of your goals may clash with your other goals, or other people's goals. Review all participants' goals to see where they align and where they clash.

The most effective goals consider SMART principles:

- S — Specific: explicitly define 'what', 'why' and 'how'
- M — Measurable: identify clear methods to measure progress so you can see when change occurs
- A — Attainable: analyze whether your goals are achievable, as goals that are too far out of reach will be frustrating and ultimately fail.

- R — Realistic: goals do not need to be easy, but they should be possible given resources and limitations.

- T – Timed: set a timeline to give you a target to work towards.

Why is this relevant?

Having a clear understanding of your own and other participants' goals is critical to transition planning and the ongoing success of the family farm. If participants' goals conflict, problems are likely to occur both between individuals and within the farm business. All participants need to discuss their individual goals and then determine how these goals can fit within the business goals.

How will this help transition planning?

1. Formalizing a goal setting process encourages people to invest time thinking through personal, group and farm business priorities.
2. Putting goals in writing can help make goals more 'real'.
3. Discussing goals can help unify a family/group and help everyone work together towards common priorities.
4. Establishing goals can help define ways to measure individual, family/group and farm business success.

Goal Setting Exercise

***Each person involved in your farm's transition planning and any other stakeholders who have a vested interested in the farm business should work independently to complete a separate goal-setting worksheet. Discuss the responses at your next Transition Planning Meeting.*

Instructions

1. List your goals, separated into three areas:
    - goals for myself
    - goals for my family/group
    - goals for my farm business

   Identify timelines for your goals by separating into short-term, intermediate-term and long-term. Depending on your unique circumstances and priorities, the timelines for these terms may differ. For the purposes of goal setting surrounding transition planning, many people define 'short-term' as up to one year, 'intermediate-term' as one to five years, and 'long-term' as 10 or more years.
2. Still working independently, review your goals using the SMART goal setting principles (above) and adjust your goals as necessary to meet the SMART criteria.
3. As a group, compare and contrast all participants' answers looking for areas of agreement

and disagreement. Consider using an external facilitator for this discussion if you are concerned about potential conflict.

4. Store the documents for future reference.

EXAMPLE:
Here is an example of what a partial Goal Setting Exercise might look like:

The following example is based on the Case Study found at start of this Guide (pages d-j). Once you review this example, complete the exercise on page 284 in the Appendix.

Name: *Faye Sample* Date: *Feb 14, 20xx*

Personal:

Short Term (one year)	*SMART
Talk to Rob to talk about our retirement plan twice a month.	*YES*

Intermediate Term (five years)	*SMART
Do more camping.	*NO*
(Re-written) Go camping two more times per year starting this year.	*YES*

Long Term (10 years)	*SMART
Spend more time with grandkids (hopefully)!	*NO*
(Re-written) Establish routine activities to do with the grandkids, like crafts, bicycling, baking, two to three times per month.	*YES*

***Review your goals to see if they meet the SMART guidelines.**

Make changes if necessary.

Name: *Faye Sample* Date: *Feb 14, 20xx*

Family/Group:

Short Term (one year)	*SMART
Get Carol graduated and off Sample Farm's payroll!	*NO*
Get Carol graduated and off Sample Farm's payroll by Spring 2014.	*YES*

Intermediate Term (five years)	*SMART
Go on one family vacation per year.	*YES*

Long Term (10 years)	*SMART
Stay close with our children and grandchildren.	*NO*
(re-written) Stay close with our children and grandchildren by communicating with them at least once per week via telephone or internet video chatting.	*YES*

***Review your goals to see if they meet the SMART guidelines.**

Make changes if necessary.

Name: *Faye Sample* Date: *Feb 14, 20xx*

Farm Business:

Short Term (one year)	*SMART
Find GOOD full-time help.	*NO*
(Re-written) Find GOOD full-time help by the end of this year.	*YES*

Intermediate Term (five years)	*SMART
Start implementing the transition plan.	*NO*
Start implementing the transition plan by following our action items list and maintaining open lines of communication with our advisors, and John and Rebecca.	*YES*

Long Term (10 years)	*SMART
Upgrade equipment.	*NO*
Upgrade equipment that requires upgrading, and take care not to push our cash flow to the limit.	*YES*

***Review your goals to see if they meet the SMART guidelines.**

Make changes if necessary.

How does this apply?

The goal setting exercise and resulting discussion will help all participants gain a better understanding of each other, and each person's priorities for life and the farm business. You will refer back to the goals identified in this exercise when creating your farm's vision.

KEEP IN MIND:

- There are no right or wrong answers in this exercise.
- Everyone who is actively involved in the business now and anyone who might be actively involved in the business at some point in the future should complete this exercise.
- Family members/others who are not currently actively involved and/or who are not planning on ever being actively involved in the business can optionally be included in this exercise.
- Consider using an external facilitator if you are concerned about potential for conflict during the discussion.

WHAT TO WATCH FOR:

- As you compare and contrast participants' answers, note:
  - Are there major differences that could lead to conflict or create a stumbling block to completing the transition plan?
  - Does this exercise identify any underlying reasons for existing conflict in your operation?

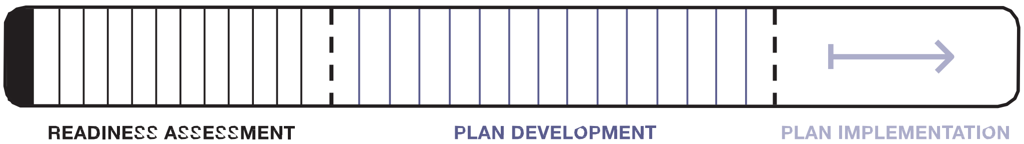
EXERCISE:

Complete the Goal Setting exercise on pages 284 of the Appendix.

Next steps

Congratulations on completing this topic. You are now a step closer to having a transition plan for your farm. You may now proceed to the next topic area of your Transition Plan. If this topic brought up any new 'To Do' items, don't forget to make note of them, assign them as tasks as necessary to participants in your group, and define timelines for completion.

Planning progress



Topic 2: Individual Values

People's values, beliefs and ideals differ, even in the closest of families. Effective transition planning depends on each participant understanding where their core values align or conflict with those held by the other participants in your transition planning group.

Why is this relevant?

A person's values, beliefs and ideals shape their goals, priorities and limitations. These core priorities set the tone for how an individual will:

- operate within the family and management group;
- direct and manage their business;
- prioritize decisions;
- present themselves and their business to the outside world.

Working to understand others' values, beliefs and ideals can help minimize conflict and improve tolerance and compromise. Recognizing differences in these core priorities among transition planning participants will set the tone for how the group will:

- make management and investment decisions;
- manage together as a group;
- allocate tasks and responsibilities;
- deal with conflict.

How will this aid in transition planning?

1. Writing down one's personal values, beliefs and ideals requires that an individual take time to think through what is important to them.
2. Discussing and prioritizing the values that will guide a farm business clarifies business direction, simplifies decision making and reduces conflict in a management team.
3. Offering employees the opportunity to identify and commit to a farm business's values will help them better understand their role in the business, which can foster 'buy-in' and improved performance.

Individual Values Exercise

***Each person involved in your farm's transition planning and any other stakeholders who have a vested interested in the farm business should work independently to complete a separate Individual Values Exercise. Then, reconvene as a group to discuss.*

Instructions

1. Individually complete all of the questions on the Individual Values Exercise.
2. Reconvene as a group and create a master list of everyone's top five values.
3. Analyze the master list to create a summary list of the top five values for the entire transition planning group.
4. Discuss both the master list and the summary list at your next transition planning meeting. Consider:
   - how the master list and summary list aligns or conflicts with each individual's personal list;
   - how these values will shape the business operations and priorities;
   - whether you want to keep these lists for internal (i.e.: participant only) reference, or whether you want to share these lists externally (with a wide stakeholder group, your customers, the general public, etc.)
5. Store the documents for future reference.

EXAMPLE:
Here is an example of what a finished Individual Values Exercise might look like:

The following example is based on the Case Study found at start of this Guide (pages d-j). Once you review this example, complete the exercise on page 287 in the Appendix.

1. Start by reading the list of common work and personal values below. Feel free to add any additional values that are important to you. Circle the **ten** values that are most important to you.

accomplishment/success
accountability
accuracy
adventure
all for one and one for all
appearance
beauty
belonging
best use of time/resources
calm/quiet/peace
challenge
change
cleanliness/orderliness
collaboration
commitment
communication
community
competence
competition
concern for others
connection
content over form
continuous improvement
co-operation
co-ordination
creativity
customer satisfaction
decisiveness
delight of being, joy
democracy
discipline
discovery
diversity
ease of use
equality
excellence
fairness
faith
faithfulness
family
family feeling

flair
freedom
friendship
fun
global view
goodness
gratitude
hard work
harmony
health
helping
honesty
honour
improvement
independence
individuality
inner peace/calm/quiet
innovation
integrity
intensity
intimacy
justice
knowledge
leadership
love, romance
loyalty
meaning
merit
money
openness
patriotism
peace/non-violence
perfection
personal growth
pleasure
power
Practicality
preservation
privacy
progress
prosperity/wealth

punctuality
quality of work
recognition
regularity
reliability
resourcefulness
respect for others
responsiveness
results-oriented
rule of law
safety
satisfying
others security
self-acceptance
self-control
self-giving
self-reliance
self-thinking
service (to others)
simplicity
skill
solving problems
speed
spiritual growth
stability
standardization
status
strength
success/achievement
systemization
teamwork
timeliness
tolerance
tradition
tranquility
trust
truth
unity
variety
will to succeed
wisdom

2. Once you have circled the ten values that are most important to you, analyze your selections and narrow your list down to the five that are most important. List them here.

   a. *Family*
   b. *Teamwork*
   c. *Communication*
   d. *Honesty*
   e. *Integrity*

3. Now imagine that you may only keep three key values. Which two would you give up? list the **remaining three** here.

   f. *Family*
   g. *Honesty*
   h. *Integrity*

4. Now eliminate two values to reduce your list to just a single key value. What is the one value on your list that you care most about?

   i. *Family*

5. Now return to the list you created in question #3 and prioritize those five top values, from most important to least important.

   j. *Family*
   k. *Integrity (the two values eliminated in question 5)*
   l. *Honesty (the two values eliminated in question 5)*
   m. *Communication (the two values eliminated in question 4)*
   n. *Teamwork (the two values eliminated in question 4)*

How does this apply?

Every farm has a set of values that shapes its operation, whether the operators of the farm are consciously aware of it or not. For example, a farm that is governed by values such as perfection, integrity and continuous improvement will operate very differently than a farm governed by values such as fun, adventure and relaxation.

In a company, the ownership group or board of directors determine what values will become core to the organization. On farms, the personal values of the operator(s) and other key stakeholders become the business values.

KEEP IN MIND:

- There are no right or wrong answers in this exercise.
- Everyone who is actively involved in the business now and anyone who might be actively involved in the business at some point in the future should complete this exercise.
- Family members/others who are not currently actively involved and/or who are not planning on ever being actively involved in the business can optionally be included in this exercise.
- Consider using an external facilitator if you are concerned about potential for conflict during the discussion.

WHAT TO WATCH FOR:

- When reviewing all participants' responses, watch for values that reoccur. You may want to include these in a values statement that defines your business vision.
- If participants cannot agree on a **top five** list, you can alternately agree to use a longer list. Be careful not to make too long of a list.
- Once your list of business values is established, it is extremely important to operate according to these values. Operating contrary to stated values may cause personal and/or business conflict and may damage your farm's reputation.
- As you compare and contrast participants' answers, note:
  - Are there major differences that could lead to conflict or create a stumbling block to completing the transition plan?
  - Does this exercise identify any underlying reasons for existing conflict in your operation?

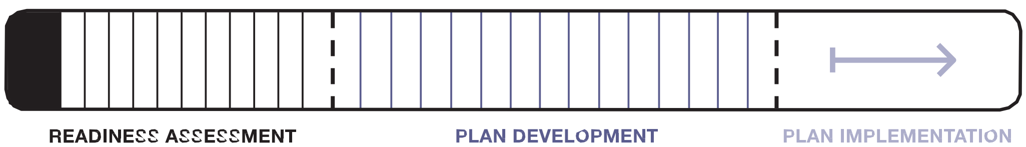
EXERCISE:

Complete the Individual Values Exercise on pages 287 of the Appendix.

Next steps

Congratulations on completing this topic. You are now a step closer to having a transition plan for your farm. You may now proceed to the next topic area of your Transition Plan. If this topic brought up any new 'To Do' items, don't forget to make note of them, assign them as tasks as necessary to participants in your group, and define timelines for completion.

Planning progress



Topic 3: Family/Group Values

Whether or not we are aware of or acknowledge them, our deeply-held values motivate and shape our decision-making. Because one's values, beliefs and ideals are strongly influenced by one's early experiences and environment, individuals within a family are more likely to share similar core attitudes and priorities. (Note: This is not always the case and should not be assumed). Be aware that individuals who join your family (through marriage or other connection) may find your family`s values very different from their own.

Why is this relevant?

People's values, beliefs and ideal differ. Effective transition planning depends on each participant understanding where their core values align or conflict with those held by other participants. Working to understand others' values, beliefs and ideals can help minimize conflict and improve tolerance and compromise.

How will this aid in transition planning?

1. Discussing and prioritizing the values that will guide farm business decisions clarifies business direction, simplifies decision making and reduces conflict in a management team.
2. Identifying and committing to shared values will help transition participants lead the business effectively.
3. Offering employees the opportunity to identify and commit to a farm business's values will help them better understand their role in the business, which can foster 'buy-in' and improved performance.
4. Identifying values provides context for making management decisions.

Family/Group Values Exercise

***Each participant should complete the following Family/Group Values exercise individually. Then, reconvene as a group to discuss at the next transition planning meeting.*

Instructions

Each line in the table below contains two opposing value statements. For each value statement pair, circle the number on the scale that best describes the strength of the **family/group's** values and beliefs (the overall family/group culture).

1. Compare and contrast each individual's answers, looking for areas of agreement and disagreement.
2. Store the documents for future reference.

EXAMPLE:
Here is an example of what a finished Family/Group Values Exercise might look like:

The following example is based on the case study found at start of this Guide (pages d-j). Once you review this example, complete the exercise on page 289 in the Appendix.

Freedom is defined by rules.	4	3	2	1	0	1	2	3	4	Freedom is defined by personal choice.
An overall leader is essential.	4	3	2	1	0	1	2	3	4	Groups can provide their own leadership.
Use great caution when trusting others.	4	3	2	1	0	1	2	3	4	Trust others until they prove unworthy.
Security is more important than adventure.	4	3	2	1	0	1	2	3	4	Adventure is more important than security.
Experience is more important than creativity	4	3	2	1	0	1	2	3	4	Creativity is more important than experience.
Hard work is the key to success.	4	3	2	1	0	1	2	3	4	Planning is the key to success.

How does this apply?

Every farm has a set of values that shapes its operation, whether the operators of the farm are consciously aware of them or not. For example, a farm that is governed by values such as perfection, integrity and continuous improvement will operate very differently than a farm governed by values such as fun, adventure and relaxation.

In a company, the ownership group or board of directors determine what values will become core to the organization. On farms, the personal values of the operator(s) and other key stakeholders become the business values.

This exercise and resulting group discussion is intended to help participants gain a better understanding of each other's views of the family/group's overall value system.

KEEP IN MIND:

- There are no right or wrong answers in this exercise.
- Everyone who is actively involved in the business now and anyone who might be actively involved in the business at some point in the future should complete this exercise.
- Family members/others who are not currently actively involved and/or who are not planning on ever being actively involved in the business can optionally be included in this exercise.
- Consider using an external facilitator if you are concerned about potential for conflict during the discussion.

WHAT TO WATCH FOR:

- Each participant should select answers based on how the farm currently operates, **not** how they hope it would operate or how it could operate in future.
- As you compare and contrast participants' answers, note:
  - Are there major differences that could lead to conflict or create a stumbling block to completing the transition plan?
  - Does this exercise identify any underlying reasons for existing conflict in your operation?
- Refer to this exercise when creating your farm's vision.

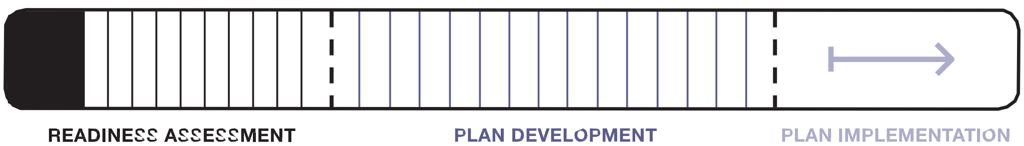
EXERCISE:

Complete the Family/Group Values Exercise on page 289 of the Appendix.

Next steps

Congratulations on completing this topic. You are now a step closer to having a transition plan for your farm. You may now proceed to the next topic area of your Transition Plan. If this topic brought up any new 'To Do' items, don't forget to make note of them, assign them as tasks as necessary to participants in your group, and define timelines for completion.

Planning progress



Topic 4: Family First/Business First

Transition planning is the process of planning to transfer the ownership (capital), management, and operations (labour) of an agribusiness to a child(ren), relative or other successor. If your intended farm transfer occurs in-family, there are many obvious benefits. However, there are also additional considerations that must be analyzed and carefully managed in order for transition to be successful.

A family and a business strive for very different goals. Whereas a family ideally prioritizes belonging and relationship, most businesses prioritize the translation of resources into profit. Blending family and business blurs the lines that distinguish one system from the other. Unless carefully managed, this blurring can cause conflict between relationship and business goals.

Participants in every family-based farm business must figure out how to balance family and business goals. Achieving this balance can be easier when participants analyze where they stand on a family first/business first scale, including:

a. Membership: who belongs?
b. Income (compensation): what are members paid?
c. Leadership or promotion: how are members chosen for promotion / leadership positions?
d. Basis of operation: what underlying values drive operations?
e. Training: how do members decide what training they need?

Category	Family System	Business System
Membership	Unconditional, based on blood (examples: direct relatives, children, spouses)	Conditional, based on qualifications and performance (examples: employees, managers, customers)
Income (compensation)	Often based on equality	Based on responsibilities and contribution to the business
Leadership or promotion	Often based on family position, birth order or gender	Based on merit (earned)

Basis of operation	Emotion based	Task oriented
Training	Based on notion of fairness or as needs dictate	Based on potential gain or earnings (return)

Why is this relevant?

Understanding your family's approach to business can minimize the potential for conflict in day-to-day farm operations and particularly during farm transition. Working together to find a balance between family and business priorities can help establish an agreed upon business culture and vision.

Family First/Business First Exercise

***Each participant should complete the following Family First / Business First exercise individually. Then, reconvene as a group to discuss at the next transition planning meeting.*

Instructions

1. For each category, mark an 'X' in the column to the left of the statement that you feel is a higher priority to your farm business.
2. Count your 'X's to identify whether the majority of answers fall under 'Family First' or 'Business First'. This represents where on the Family First/Business First scale you feel your family farm business should stand.
3. Compare and contrast each individual's answers, looking for areas of agreement and disagreement.
4. Store the documents for future reference

EXAMPLE:
Here is an example of what a finished Family First/Business First Exercise might look like:

The following example is based on the Case Study found at start of this Guide (pages d-j). Once you review this example, complete the exercise on page 290 in the Appendix.

Category	X	Family First	X	Business First
Membership	X	There is a place for each and every family member		If you're qualified to do the job, you can join and belong
Income (Compensation)		Family members are paid more (or less) than the going rate for the job, sometimes based on their or the business's needs	X	Pay is determined by responsibilities and performance
Leadership or Promotion		Leadership is bestowed. Title / office is bestowed by birthright	X	Leadership is earned. Company officers control day-to-day operations
Basis of Operation	X	Business resources are used for the family's enjoyment and benefit		Business resources are used to grow and enhance the business
Training	X	Outside experience may be less valuable than years of service in the family business		Outside experience is more important than years of service in the family business

How does this apply?

Every farm is governed by priorities that fall somewhere on a family first/business first scale, whether the operators of the farm are consciously aware of them or not.

This exercise and the resulting family discussion can help participants gain a better understanding of each other and their respective views on the family business's role within the family, and the family's role within the farm business.

KEEP IN MIND:

- There are no right or wrong answers in this exercise.
- Everyone who is actively involved in the business now and anyone who might be actively involved in the business at some point in the future should complete the goal setting exercise.
- Family members/others who are not currently actively involved and/or who are not planning on ever being actively involved in the business can optionally be included in this exercise.
- Consider using an external facilitator if you are concerned about potential for conflict during the discussion.

WHAT TO WATCH FOR:

- Each participant should select answers based on how they believe the farm should operate, **not** how they hope it currently operates or how it is likely to operate in future.
- As you compare and contrast participants' answers, note:
    - Are there major differences that could lead to conflict or create a stumbling block to completing the transition plan?
    - Does this exercise identify any underlying reasons for existing conflict in your operation?
- Refer to this exercise when creating your farm's vision.

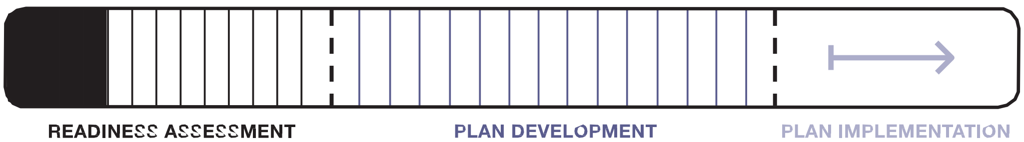
EXERCISE:

Complete the Family First/Business First exercise on page 290 of the Appendix.

Next steps

Congratulations on completing this topic. You are now a step closer to having a transition plan for your farm. You may now proceed to the next topic area on your Transition Plan. If this topic brought up any new ‘To Do’ items, don’t forget to make note of them, assign them as tasks as necessary to participants in your group, and define timelines for completion.

Planning progress



Topic 5: Retiring Generation

Very early in the transition process, it is important that the individuals expecting to transition out of actively operating the farm **write down** their initial thoughts on retirement, the transfer of ownership and management, and their estate distribution.

One key area that should be considered by the retiring generation is how much money they will need in retirement and what lifestyle they expect to live. Typically, farmers transitioning out of a farm business will take some money from the business to finance their retirement. Multiple online calculators are available that can help retiring farmers estimate how much money they will require in retirement. Better yet, a retiring farmer should make time to speak with a financial planner.

Why is this relevant?

Discussing early in the transition process what each participant envisions will help identify common and conflicting priorities and expectations, and areas where additional research, thought or discussion is required. Taking the time to clarify expectations at the front end of the transition process will make the rest of the planning process far smoother.

How will this aid in transition planning?

1. Writing down initial thoughts on retirement:
   a. requires that people take the time to think through what's really important to them;
   b. helps to get the retiring generation(s) on the same page;
   c. helps to identify issues and/or raise questions that require additional information;
   d. helps to ensure that issues, concerns, expectations and priorities don't fall through the cracks;
   e. is an excellent way to formulate thoughts and prioritize intentions prior to group discussion.
2. Calculating the future living costs of the retiring generation helps to ensure adequate funds are available for retirement and allows the business to plan for withdrawals.
3. Identifying and discussing initial thoughts on retirement helps all participants enter the transition planning discussion from a similar starting place, and helps non-farming family members stay informed and included in the discussion.

Retiring Generation Exercise

*** Each member of the retiring generation should complete the following Retiring Generation Exercise individually or together. Each member of the succeeding generation should complete the Succeeding Generation exercise (Topic 6) at the same time. Then, reconvene as a transition planning group to discuss at the next transition planning meeting.*

Instructions

1. Download an online retirement calculator (consider using the one available at www.manitoba.ca/agriculture) and work through the retirement calculator exercise.
2. Write answers to each of the questions below or mark them as N/A if they are not applicable in your specific situation.
3. If you opted to write answers independently from any other individuals who will be retiring with you (e.g. a spouse, business partner, etc.), review and discuss your answers with those individuals.
4. Compare and contrast your answers to the answers written by the succeeding generation in their Topic 6 questionnaire. Discuss where the retiring generation's answers align or conflict with the succeeding generation's answers.
5. Follow-up any areas that require additional information, research or clarification.
6. Store the documents for future reference.

EXAMPLE:
Here is an example of what a partial Retiring Generation exercise might look like:

The following example is based on the case study found at start of this Guide (pages d-j). Once you review this example, complete the exercise on page 291 in the Appendix.

Personal and Lifestyle:

1. What do you envision yourselves doing in retirement?

   Spending more time with our grandkids and taking more vacations.

2. How much income will you need to live this way?

   $40,000 - $50,000 per year.

Successor:

1. Who is taking over the family business?

   We know that our son and daughter-in-law will be involved. There may be others.

2. Will he/she/they need additional training to do so and if so, what type(s)?

   Our son comes from a farm background and has an agriculture business degree. Our daughter-in-law is a nurse. And our daughter is currently in University. They all have good educations, but will require on-the-job training as it pertains to our specific farm operations and financial recordkeeping.

Communication:

1. Have you spoken with the successor(s) regarding the transfer of the farm? Yes.

   a. If yes, what specifically has been discussed?

      We've spoken about the timeline for our transition out of managing the farm, but not much more than that.

   b. If yes, have the discussions been formal (ie: with notes recorded)?

      No.

How does this apply?

Many agricultural producers dream of the day they will pass the reins of a thriving agribusiness on to their child(ren) or other successor. But planning for life after retirement is equally important.

A successful transition not only depends on a healthy transition *into* farm ownership and management by the succeeding generation, it also depends on a healthy transition *out* of farm ownership and management by the retiring generation. The exiting generation must have clear expectations and intentions for their post-farming future, including an organized retirement financial plan.

KEEP IN MIND:

- There are no right or wrong answers in this exercise.
- Everyone who is actively involved in the business now and anyone who might be actively involved in the business at some point in the future should complete this exercise.
- Family members/others who are not currently actively involved and/or who are not planning on ever being actively involved in the business can optionally be included in this exercise.
- Consider using an external facilitator if you are concerned about potential for conflict during the discussion.

WHAT TO WATCH FOR:

- As you compare and contrast participants' answers, note:
  - Are there major differences that could lead to conflict or create a stumbling block to completing the transition plan?
  - Does this exercise identify any underlying reasons for existing conflict in your operation?
- When members of the retiring generation share their answers with the succeeding generation, consider:
  - Are you discovering others' needs / wants that you were not aware of?
  - Are there issues / concerns / questions that will require more exploration, research or discussion?
  - Are there areas that will require compromise?
  - Are there areas where you or others are absolutely not willing to compromise?

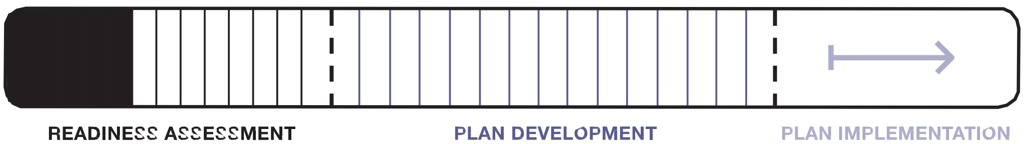
EXERCISE:

Complete the Retiring Generation Exercise on pages 291 of the Appendix.

Next steps

Congratulations on completing this topic. You are now a step closer to having a transition plan for your farm. You may now proceed to the next topic area on your Transition Plan. If this topic brought up any new ‘To Do’ items, don’t forget to make note of them, assign them as tasks as necessary to participants in your group, and define timelines for completion.

Planning progress



Topic 6: Succeeding Generation

Very early in the transition planning process and before any commitments are made, it is important that the individuals expecting to transition into farm management and ownership **write down** their initial thoughts on transition.

Why is this relevant?

Discussing early in the transition process what each participant envisions will help identify common and conflicting priorities and expectations, and areas where additional research, thought or discussion is required. Taking the time to clarify expectations at the front end of the transition process will make the rest of the planning process far smoother.

How will this help transition planning?

1. Writing down initial thoughts on transition:
    a. requires that people take the time to think through what's really important to them;
    b. helps get all members of the succeeding generation(s) on the same page;
    c. helps to identify issues and/or raise questions that require additional information;
    d. helps to ensure that issues, concerns, expectations and priorities don't fall through the cracks;
    e. is an excellent way to formulate thoughts and prioritize intentions prior to group discussion.
2. Identifying and discussing initial thoughts on transition helps all participants enter the transition planning discussion from a similar starting place and helps non-farming family members stay informed and included in the discussion.

Succeeding Generation Exercise

***Each member of the succeeding generation should complete the following Succeeding Generation Exercise, ideally individually. Meanwhile, each member of the retiring generation should complete the Retiring Generation Exercise (Topic 5). Then, reconvene as a group to discuss at the next transition planning meeting.*

Instructions

1. Write answers to each of the questions below or mark them N/A if they are not applicable in your specific situation.
2. If you opted to write answers independently from any other individuals who will be transitioning into farm management and ownership with you (e.g. a spouse, business

partner, etc.), review and discuss your answers with those individuals.

3. Compare and contrast your answers to the answers written by the retiring generation in their Topic 5 questionnaire. Discuss where the retiring generation's answers align or conflict with the succeeding generation's answers.
4. Follow up any areas that require additional information, research or clarification.
5. Store the documents for future reference.

EXAMPLE:
Here is an example of what a partial Succeeding Generation exercise might look like:

The following example is based on the case study found at start of this Guide (pages d-j). Once you review this example, complete the exercise on page 293 in the Appendix.

Personal and Lifestyle:

1. What do you envision yourself doing during your working years?
   - Working hard, raising a family, being active in sports (my own and my family's).
2. How much income will you need to live this way?
   - $70,000 to $80,000 between my spouse and me.
3. If your future is farming, will your income decrease or stay the same?
   - Depends on the salary I negotiate with my parents.

How does this apply?

A successful transition depends on everyone's needs being met. Both generations need to have clear expectations and intentions regarding how much the farm will support them financially, and what their lifestyle goals include.

KEEP IN MIND:

- There are no right or wrong answers in this exercise.
- Everyone who is actively involved in the business now and anyone who might be actively involved in the business at some point in the future should complete this exercise.
- Family members/others who are not currently actively involved and/or who are not planning on ever being actively involved in the business can optionally be included in this exercise.
- Consider using an external facilitator if you are concerned about potential for conflict during the discussion.

WHAT TO WATCH FOR:

- As you compare and contrast participants' answers, note:
  - Are there major differences that could lead to conflict or create a stumbling block to completing the transition plan?
  - Does this exercise identify any underlying reasons for existing conflict in your operation?
- When members of the succeeding generation share their answers with the retiring generation, consider:
  - Are you discovering others' needs / wants that you were not aware of?
  - Are there issues / concerns / questions that will require more exploration, research or discussion?
  - Are there areas that will require compromise?
  - Are there areas where you or others are absolutely not willing to compromise?

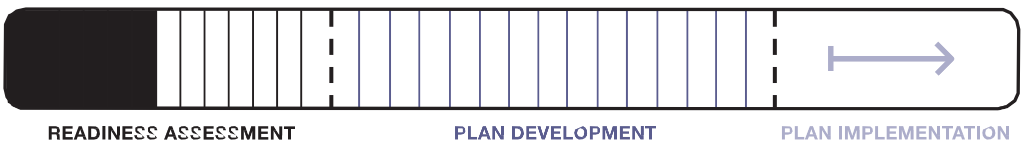
EXERCISE:

Complete the Succeeding Generation Exercise on pages 293 of the Appendix.

Next steps

Congratulations on completing this topic. You are now a step closer to having a transition plan for your farm. You may now proceed to the next topic area on your Transition Plan. If this topic brought up any new ‘To Do’ items, don’t forget to make note of them, assign them as tasks as necessary to participants in your group, and define timelines for completion.

Planning progress



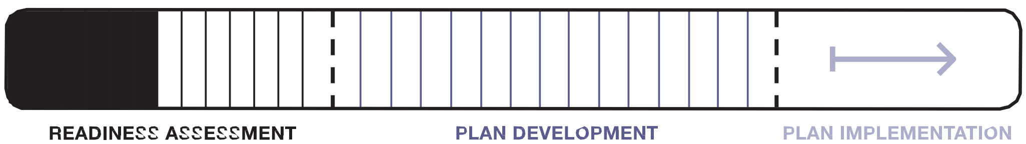
EXERCISE:

Complete the Succeeding Generation Exercise on pages 293 of the Appendix.

Next steps

Congratulations on completing this topic. You are now a step closer to having a transition plan for your farm. You may now proceed to the next topic area on your Transition Plan. Don't forget to add any assigned tasks that were generated by working through this topic.

Planning progress



Chapter 4: Recap Checklist

Complete the following checklist as you work through the Chapter 4 topics. For each topic, mark the 'Red Flag' or the 'Green Light' checkboxes that best suit your planning group's status upon completion of the topic's exercise. Red Flag marks indicate that your group may need to discuss this topic further or seek professional support.

n

	Red Flag	Green Light	Follow-up Necessary?	
			Yes	No
Topic 1: Goals	☐ We were unable to complete this topic's exercise. ☐ We have conflicting goals and/or expectations regarding transition planning. ☐ This topic resulted in significant unresolved conflict/disagreement within our planning group.	☐ We completed this topic's exercise. ☐ We each understand what the other planning participants expect from transition planning. ☐ Our goals and expectations for transition planning generally align.		
Topic 2: Individual Values	☐ We were unable to complete this topic's exercise. ☐ We have conflicting individual values relating to transition planning. ☐ This topic resulted in significant unresolved conflict/disagreement within our planning group.	☐ We completed this topic's exercise. ☐ We each understand how the other planning participants' individual values will shape transition planning. ☐ Our values for transition planning generally align.		
Topic 3: Family/Group Values	☐ We were unable to complete this topic's exercise. ☐ We do not generally align on a set of family/group values. ☐ This topic resulted in significant	☐ We completed this topic's exercise. ☐ We generally align on a set of family/group values.		

	Red Flag	Green Light	Follow-up Necessary?	
			Yes	No
	unresolved conflict/disagreement within our planning group.			
Topic 4: Family First/Business First	☐ We were unable to complete this topic's exercise. ☐ We disagreed / were unable to identify where our group falls on a Family First/Business First scale. ☐ This topic resulted in significant unresolved conflict/disagreement within our planning group.	☐ We completed this topic's exercise ☐ We generally agree on where our family falls on a Family First/Business First scale.		
Topic 5: Retiring Generation	☐ We were unable to complete this topic's exercise. ☐ We do not have a good understanding of / disagree with the retiring generation's post-retirement priorities and estimated financial needs. ☐ This topic resulted in significant unresolved conflict/disagreement within our planning group.	☐ We completed this topic's exercise. ☐ We have a good understanding of the retiring generation's post-retirement priorities and estimated financial needs, and generally agree that their plans are within reason.		
Topic 6: Succeeding Generation	☐ We were unable to complete this topic's exercise. ☐ We do not have a good understanding of the succeeding generation's post-transition priorities and estimated financial needs. ☐ This topic resulted in significant unresolved conflict/disagreement within our planning group.	☐ We completed this topic's exercise. ☐ We have a good understanding of the succeeding generation's post-transition priorities and estimated financial needs, and generally agree that their plans are within reason		

Notes:

From **Topic 1, Chapter 4 (**Phase 2: Readiness Assessment)

Goals

Name: Date:

Personal:

Short Term (one year) *SMART

Intermediate Term (five years) *SMART

Long Term (10 years) *SMART

***Review your goals to see if they meet the SMART guidelines.**

Make changes if necessary.

Name: Date:

Family/Group:

Short Term (one year) *

SMART

Intermediate Term (five years) *

SMART

Long Term (10 years) *

SMART

***Review your goals to see if they meet the SMART guidelines.**

Make changes if necessary.

Name: Date:

Farm Business:

Short Term (one year) *SMART

Intermediate Term (five years) *SMART

Long Term (10 years) *SMART

***Review your goals to see if they meet the SMART guidelines.**

Make changes if necessary.

From **Topic 2, Chapter 4 (**Phase 2: Readiness Assessment)

Individual Values

1. From this list of values circle the ten that are most important to you.

accomplishment, success	flair	punctuality
accountability	freedom	quality of work
accuracy	friendship	recognition
adventure	fun	regularity
all for one and one for all	global view	reliability
appearance	goodwill	resourcefulness
beauty	goodness	respect for others
belonging	gratitude	responsiveness
best use of time and	hard work	results-oriented
calm, quietude, peace	harmony	rule of law
challenge	health	safety
change	helping	satisfying others
cleanliness, orderliness	honesty	security
collaboration	honour	self-acceptance
commitment	improvement	self-control
communication	independence	self-giving
community	individuality	self-reliance
competence	inner peace, calm, quietude	self-thinking
competition	innovation	service (to others,
concern for others	integrity	simplicity
connection	intensity	skill
content over form	intimacy	solving problems
continuous improvement	justice	speed
co-operation	knowledge	spiritual growth
co-ordination	leadership	stability
creativity	love, romance	standardization
customer satisfaction	loyalty	status
decisiveness	meaning	strength
delight of being, joy	merit	success,
democracy	money	systemization
discipline	openness	teamwork
discovery	patriotism	timeliness
diversity	peace, non-violence	tolerance
ease of use	perfection	tradition
efficiency	personal growth	tranquility
equality	pleasure	trust
excellence	power	truth
fairness	practicality	unity
faith	preservation	variety
faithfulness	privacy	will to succeed
family	progress	wisdom
family feeling	prosperity, wealth	

2. Once you have circled the ten values that are most important to you, analyze your selections and narrow your list down to the five that are most important. List them here.

a. ______________________________

b. ______________________________

c. ______________________________

d. ______________________________

e. ______________________________

3. Now imagine that you may only keep three key values. Which two would you give up? List the remaining three here.

a. ______________________________

b. ______________________________

c. ______________________________

4. Now eliminate two values to reduce your list to just a single key value. What is the one value on your list that you care most about?

a. ______________________________

5. Now return to the list you created in question #3 and prioritize those five top values, from most important to least important.

a. ______________________________

b. ______________________________

c. ______________________________

d. ______________________________

e. ______________________________

From **Topic 3, Chapter 4 (**Phase 2: Readiness Assessment)

Family Values

For each value statement pair, think of your extended family/planning group, and circle on the scale which one of the statement pairs is more descriptive of your family/group's values and beliefs (the overall family/group culture)?

Freedom is defined by rules.	4	3	2	1	0	1	2	3	4	Freedom is defined by personal choice.
An overall leader is essential.	4	3	2	1	0	1	2	3	4	Groups can provide their own leadership.
Use great caution when trusting others.	4	3	2	1	0	1	2	3	4	Trust others until they prove unworthy.
Security more valued than adventure.	4	3	2	1	0	1	2	3	4	Adventure is more important than security.
Experience is more important than creativity.	4	3	2	1	0	1	2	3	4	Creativity is more important than experience.
Hard work is the key to success.	4	3	2	1	0	1	2	3	4	Planning is the key to success.

From **Topic 4**, **Chapter 4 (**Phase 2: Readiness Assessment)

Family First / Business First

For each category, mark an 'X' in the column to the left of the statement that you feel is a higher priority to your farm business.

Category	X	Family First	X	Business First
Membership		There is a place for each and every family member.		If you're qualified to do the job, you can join and belong.
Income (Compensation)		Family members are paid more (or less) than the going rate for the job, sometimes based on their or the business's needs.		Pay is determined by responsibilities and performance.
Leadership or Promotion		Leadership is bestowed. Title / office is bestowed by birthright.		Leadership is earned. Company officers control day-to-day operations.
Basis of Operation		Business resources are used for the family's enjoyment and benefit.		Business resources are used to grow and enhance the business.
Training		Outside experience may be less valuable than years of service in the family business.		Outside experience is more important than years of service in the family business.

From **Topic 5, Chapter 4 (**Phase 2: Readiness Assessment)

Retiring Generation

Personal and Lifestyle:

1. What do you envision yourselves doing in retirement?
2. How much income will you need to live this way?
3. Do you have (or plan to have) retirement income sources other than the farm? If so, what percentage of your retirement income will come from the farm?
4. Have you thought about inflation pressures on costs of living and how this might impact your retirement needs?
5. Are you planning to purchase any costly items in the foreseeable future (first five years after retirement), such as a house, cottage, extensive travel, etc.
6. Do you wish to create a legacy as part of your transition?
7. Have you thought about yourself first?

Successor:

1. Who is taking over the family business?
2. Will he/she/they need additional training to do so and if so, what type(s)?

Communication:

1. Have you spoken with the successor(s) regarding the transfer of the farm?
    a. If yes, what specifically has been discussed?
    b. If yes, have the discussions been formal (ie: with notes recorded)?
2. Have you spoken to any advisors regarding the transfer of the farm?
    a. If yes, what specifically has been discussed?
3. Do you have regular business or family meetings about business in general?
    a. Specifically about transition?
4. Have you spoken to your non-farming successors regarding the transfer of the farm?
    a. Is it important to you that all successors be given the opportunity to talk about their own expectations, goals and objectives, both personal and for the farm?
5. Are you worried about the potential for conflict?

Estate:

1. What does your current will say?
2. Does it accurately reflect your thoughts on transition?
3. Have you appointed a Power of Attorney?
4. Are you considering using (or do you have in place) life insurance as a vehicle to assist with transition?
5. Are you considering passing some of your estate to grandchildren?
6. Are you concerned about being fair and equitable to all successors?

Ownership, Labour and Management:

1. Who will own the farm assets post transition?
2. Who will be working on the farm?
   a. Specifically, what role(s) will you have?
3. Who will be the manager of the farm?
4. What are the expectations for involvement from other successors?
5. Will the farm require management or ownership by anyone other than your successors?

Farm Financial:

1. Does the farm have a current business plan?
2. Do you know if the farm can financially support everyone's needs / priorities including the successors' living costs?
3. How will the transition be financed?
4. Do you know what tax implications are related to your transition?

Timeline:

1. When will you retire?
2. When do you want your transition plan to be completed?
3. When will the actual farm transition begin (implementation of your transition plan)?
4. Will the transition be gradual or all at once?

From **Topic 6, Chapter 4 (**Phase 2: Readiness Assessment)

Succeeding Generation

Personal and Lifestyle:

1. What do you envision yourself doing during your working years?
2. How much income will you need to live this way?
   a. If your future is farming, will your income decrease or stay the same?
3. Are you planning to purchase any costly items as part of or soon after farm transition, such as a house, cottage, other family recreation items, etc.?
4. Are you worried about the retiring generation not adequately looking after their interests?

Communication:

1. Have you spoken with the retiring generation regarding the transfer of the farm?
   a. If yes, what specifically has been discussed?
   b. If yes, have the discussions been formal (ie: with notes recorded)?
   c. Have you been identified as the successor to the farm business?
2. Have you spoken to any advisors regarding the transfer of the farm?
   a. If yes, what specifically has been discussed?
3. Have you spoken with your future business partner (spouse, brother etc.) regarding the transfer of the farm?
4. Do you have regular business or family/group meetings?
   a. About business in general?
   b. Specifically about transition?
5. Have you spoken to any non-farming siblings/successors regarding the transfer of the farm?
6. Do you think it is important that all successors be given the opportunity to talk about their own expectations, goals and objectives, both personal and for the farm?
   a. Have you been given this opportunity?
7. Are you worried about the potential for conflict?

Education/Training:

1. Have you taken any management development training?
   a. If so, describe it.
2. Have you taken/attended any other courses/workshops (university degree, college diploma, seminar etc.)?

Estate:

1. Do you have a current will?
    a. If yes, what does it say?

Ownership, Labour and Management:

1. Who will own the farm assets post transition?
2. Who will be working on the farm?
    a. Specifically, what role(s) will you have if you are actively involved?
3. Who will be the manager of the farm?
4. What are the expectations for involvement from other successors?
5. Will the farm require management or ownership by anyone other than the successors?

Financial:

1. Does the farm have a current business plan?
2. Do you know if the farm can financially support everyone’s needs / priorities including the successors’ living costs?
3. How will the transition be financed?
4. Do you know what tax implications are related to your transition?

Timeline:

5. When will the farm transition begin (implementation of the transition plan)?
6. When will it be completed?
7. When will the retiring generation retire?
8. Will the transition be gradual or all at once?

From **Topic 7, Chapter 5 (**Phase 2: Readiness Assessment)

Financial Performance Ratios Explanation

Current Ratio

Definition:
The current ratio is calculated by dividing the current assets by the current liabilities and is a measure of liquidity.

The current ratio provides an indication of the liquid assets available to meet the next twelve months of financial commitments (the current liabilities). Working capital and the current ratio reveal strengths and weaknesses in liquidity (the ability of a farm to generate cash flow to meet obligations).

A higher number indicates better performance.

Financial Performance Thresholds:

>2.0:1	The optimum current ratio is a ratio of 2:1 or better, which indicates that the farm would have two dollars of current assets for every one dollar of current liabilities. Results in this threshold indicate strong liquidity. If results in this ratio approach or exceed 4.0:1, performance may be compromised as the business may have idle cash.
>1.5:1	A current ratio of 1.5:1 and greater is considered to be strong. A current ratio of 1.2:1 – 1.5:1 is considered to be marginal. Current ratios can change significantly with each production year. Liquidity can erode quickly on a farm, but results in this threshold indicate adequate or manageable liquidity.
<1.1:1	A weak or negative current ratio generally results in cash flow problems, presenting as inability to pay bills as they come due or make scheduled debt payments. Poor liquidity adversely impacts management decision making. Results in this threshold should be reviewed to see if restructuring the debt would be an appropriate option.

Working Capital

Definition:

Working capital is calculated by subtracting the current liabilities from the current assets. The result is the surplus or deficiency of current assets available to meet the current liability obligations of the business over the upcoming year.

When analyzing liquidity, it is important to calculate and analyze the amount of available working capital. The current ratio may indicate a ratio of 1.5:1, yet working capital may not be adequate because the quantified values of current assets and current liabilities may be relatively small. In other words, a farm with a 1.5:1 current ratio may have actual working capital of $20,000 or $200,000.

Working capital provides an indication of liquidity in terms of dollars, not just a ratio. This is a valuable measure but further analysis is required. Working capital expressed as a percentage of expenses quantifies the indicator as it relates to the size of the operation (ex: a larger operation requires more working capital).

Working capital as a percentage of expenses is calculated by dividing the available working capital by the year's cash expenses (not including amortization or depreciation). A higher percentage indicates better performance.

Financial Performance Thresholds:

>50%	A 50 per cent result means that the farm has half of the funds required to operate the farm for the next year. Any value less than 100 per cent means that the farmer will have to source additional working capital. Results in this threshold generally indicate that the working capital requirements for the next year will not be a problem. Typical sources of additional working capital in this threshold include operating loans and inventory advances.
25%	As results near this threshold or fall below it, there will be increasing challenges in securing the working capital required to manage cash flow for the farm. Typical sources of working capital in this threshold still include operating loans and inventory advances but will also require pre-selling more of next year's inventory. There will likely be a need to increase operating loan limits. Where this is not an option, managing accounts payable becomes necessary
<10%	Results in this threshold indicate inadequate working capital, increasing cash flow challenges and related stress. Management decisions are negatively affected, meaning farmers will be forced to do things they wouldn't ordinarily want to do. Operating loans and inventory advances generally do not offer sufficient funds, resulting in overdue accounts payable, credit card balances, deferred principal payments (or payments not made) and pre-selling of next year's inventory.

Debt Structure Ratio

Definition:

The debt structure ratio is a liquidity measure and is calculated by dividing the current debt (liabilities) by the total liabilities. The purpose of this ratio is to determine what percentage of the farm's total debt is current (due) in the next 12 months.

Shareholder loans (for incorporated farms), related party transactions and future tax may be factored out of the calculation to get a better picture of the real debt structure position. Sometimes (imminent transition for example) these items have a defined repayment structure and, therefore, should be left in the calculation.

A lower percentage generally indicates better performance.

Financial Performance Thresholds:

<20%	An optimally structured balance sheet (given a farm that has an appropriate level of total debt) would reveal a debt structure ratio of 20 per cent or less, meaning that the farm is committed to repaying 20 per cent of its total debt in the next 12 months. Liquidity will generally not be adversely affected due to current liability commitments.
25%	Results in this threshold are often acceptable, so long as liabilities are not too large. If cash flow (liquidity) is a challenge, management should determine if the debt structure can be adjusted to reduce the current commitment to repaying liabilities, thereby improving cash flow available for operations.
>30%	Farms with a high debt structure ratio often experience cash flow problems unless they have little or no long term debt. Liquidity challenges can be a function of insufficient current assets (see working capital and current ratio) or current liabilities that are too large, often associated with an aggressive debt repayment commitment.

Equity Ratio

Definition:

The equity ratio is calculated by dividing market value equity by total assets.

Equity represents the total assets actually owned (by shareholders in the case of a corporate farm). Typically, a statement reporting assets valued at estimated market values more accurately represents the owners' or shareholders' net worth, where asset values would be valued considerably higher than at cost.

In corporate farms, productive assets (usually land and quota) can be held outside the company and therefore are not included in the financial statement equity. An adjustment to include such assets can be made to the analysis of the statements so as to provide a more complete understanding of financial performance.

A higher percentage indicates better performance.

Financial Performance Thresholds:

>70%	A farm with an equity position, as presented in a consolidated statement of net worth, of 70 per cent and greater is considered to have a strong equity position. Farms in this threshold typically (but not always) have manageable liability commitments. They have financial strength to draw upon if they encounter a production crisis that requires a working capital infusion or if they encounter an opportunity that requires financing and additional security.
50-70%	Farms with results in this threshold generally can be categorized as being in a comfortable equity position. As results trend toward the lower spectrum (50 per cent), farms become more sensitive to liquidity (cash flow) challenges resulting from production shortfalls or management decisions causing additional debt commitments.

<50%	Threshold results below 50 per cent indicate a farm's equity position is marginal. As equity in a farming operation decreases, risk increases. Low equity usually correlates to challenges in liquidity. Management decisions will be negatively affected as there is, in practical reality, no available security to offer for any restructuring or to secure financing for new investments. The margin for financial error for farms with results in this threshold is very narrow.

Debt to Equity Ratio

Definition:

The leverage ratio is calculated by dividing total liabilities by the equity in the business.

This ratio indicates the relationship between the use of debt and equity to finance the farm business, and is a measure of longer term risk. Because payments to the debt holders (lenders) are normally more fixed than payments to the equity holders (the farmer), a higher leverage ratio indicates a higher fixed commitment (less flexibility), and therefore, higher risk. The leverage ratio can be calculated reporting assets at original cost (less applicable depreciation) or at market value (values derived from a statement of net worth). For purposes of this analysis, market value (net worth) of assets is assumed.

As the leverage ratio increases, risk increases. A lower percentage indicates better performance.

Financial Performance Thresholds:

< 0.4:1	A leverage ratio of 0.4:1 (four hundred dollars of debt for every thousand dollars of equity) or less, derived from a net worth statement, is considered to be a strong leverage ratio. Less debt as a percentage of equity correlates to less risk.
0.65:1	As results approach this threshold, there is an increasing amount of debt compared to equity. Leverage is increasing but the farm will generally not yet be affected adversely by the amount of debt it is carrying. However, as results deteriorate past this threshold, the effect of carrying the additional debt will start to become an issue. In any situation where an investment is going to include a significant increase in financing (leverage), farmers should calculate before and after leverage ratios; which quantifies financial risk in the transaction. There is very little room for financial error.
>1:1	Results in this threshold indicate a highly leveraged farm and indicate that creditors and lenders have more at stake in the business than the farmer. Greater financial risk results in increased costs of capital (higher interest rates and administration fees), increased scrutiny on the file, financial statement preparation requirements and difficulty (or impossibility) in securing additional financing.

Debt Servicing Ratio

Definition:

The debt servicing ratio is calculated by dividing debt servicing capacity by annual principal and interest payment commitments.

The debt servicing ratio indicates the earned ability of the operation to service (repay) its debt by making scheduled principal and interest payments.

The length of the term (years of payments) of the loan is important. The longer the term of the loan, the greater the chance for fluctuations in farm earnings over the term and, therefore, the greater the risk as the debt servicing ratio weakens.

Debt servicing capacity is calculated by adding amortization (non-cash cost) and long term interest expense to net income. For unincorporated farms where management salaries are not a deductible expense, living costs should be subtracted from the total, as should any known income tax payment amounts.

All farms should calculate before and after scenarios for debt servicing ratios for new loans. The exercise helps to quantify longer term risk in the transaction.

Financial Performance Thresholds:

>2.0:1	A result in this threshold indicates that for every dollar of debt (principal and interest) payment, the farm expects to have two dollars available. Results in this threshold indicate very strong performance.
1.5 : 1	For grain or livestock operations, a 1.5:1 ratio and better is generally adequate. The ideal ratio may vary depending on the type of operation. For example, a 1.25:1 ratio might be comfortable for a dairy farm, given its relatively strong price and cash flow certainty. Caution should be exercised where financing a purchase results in debt servicing ratios that begin to approach 1.2:1. In this situation, the length of the term of the loan should be very carefully considered (see comments above). Note that the debt servicing ratio is very sensitive and directly tied to earnings. Decreasing net income decreases the debt servicing ratio. Past trend line performance is important.
<1.1:1	Farms with results in this threshold will have difficulty generating the earned income required to make principal and interest payments. Farms may not be able to make payments as scheduled or, if they do, may be forced to do so by weakening liquidity indicators (increasing operating loans or selling additional inventory). Transactions that require additional financing and that cause the ratio to fall into this threshold will be very difficult to finance and should be pursued very carefully — **especially** if the equity ratio is weak.

Return on Assets Ratio

Definition:

Return on assets is calculated by dividing net income plus long term interest expense by total assets.

There are two options for the calculation: calculating based on assets valued at original cost (less accumulated amortization where applicable), and calculating based on assets valued at fair market value. The latter values are generally greater.

Incorporated farms will have financial statements with assets valued at cost. These farms typically own assets (land) personally. An adjustment should be made to include personally-held assets (farm business related) such as land.

For purposes of this analysis, financial performance thresholds are based on net worth (market value of land and quota assets, with equipment values not included in the adjustment).

An adjustment should also be made to account for unpaid or extraordinarily high family wages or management salaries.

This ratio is a measure of the return on investment made in the business and includes a return to capital appreciation. Year-over-year changes in this indicator tend to be smaller due to the large investment in assets required to operate a farm.

A larger number indicates better performance.

Financial Performance Thresholds:

>6%	Results in this threshold over a longer-term period generally represent good performance. A six per cent return on assets means that a farmer who has $1 million in assets will have a net income of $60,000. Farmers who are considering expanding their operation should determine if this performance is acceptable and, if not, determine what can be done to improve performance or search for different investment opportunities.
2%	All farmers should determine what portion of the return comes from operations and what portion comes from capital appreciation. This calculation is particularly important for farmers whose return on assets is in or near the two per cent threshold. If the portion of the return due to land and quota is two per cent or greater, no return came from earnings attributed to business operations. In this situation, a farmer must determine what can be done to generate a positive return from operations. Businesses that cannot generate a longer term positive return from operations will fail.
<0%	Farmers with longer term results in this threshold will be challenged financially and the likelihood of longer term survivability in the farm's existing form will be very poor. Farms with results in this threshold will, in almost all situations, be reporting net losses. Financial efficiency ratios (gross margin/contribution margin/net operating profit margin) should be analyzed to determine what can be done to improve earnings. It is important to note the number of years in the trend line. Farms with good debt to equity performance can usually manage through periods of low or negative return on assets. This becomes more difficult as debt to equity performance deteriorates.

Return on Equity Ratio

Definition:

Return on equity is calculated by dividing net income by equity (or retained earnings).

There are two options for the calculation: calculating based on valuing assets at original cost (less accumulated amortization where applicable) and calculating based on valuing assets at fair market value. The latter values are generally greater.

Incorporated farms will have financial statements with assets valued at cost. These farms will very likely own assets (land) personally. An adjustment should be made to include personally-held farm business assets such as land.

For purposes of this analysis, financial performance thresholds are based on net worth (market value of land and quota assets with equipment values not included in the adjustment).

An adjustment should also be made to account for unpaid or extraordinarily high family wages or management salaries.

Return on equity (ROE) provides information on how efficiently the farm is using debt in its capital structure. Return on equity should exceed return on assets (ROA) for farms that borrow money. If return on assets is greater, it indicates that the farm is not earning enough to pay its interest cost on borrowed money. ROE equals ROA when there is no debt.

Year-over-year changes in this indicator tend to be smaller due to the large investment in assets required to operate a farm.

A larger number indicates better performance.

Financial Performance Thresholds:

>10%	Results in this threshold over a longer-term period generally represent good performance. A 10 per cent return on equity means that a farmer who has $1 million in market value equity will have a net income of $100,000.. Farmers who are considering investing in or expanding their operations should determine if this performance is acceptable and, if not, determine what can be done to improve performance or search for different investment opportunities.
6%	All farmers should determine what portion of the return comes from operations and what portion comes from capital appreciation. This calculation is particularly important for farmers whose return on equity is at or near the six per cent threshold. If the portion of the return due to land or quota appreciation is three per cent or greater, then three per cent came from earnings attributed to business operations. For many farmers, this level of performance (especially over a longer term trend line) is acceptable.
<2%	If the return on equity increase due to land or quota appreciation is two per cent or greater, **no** return came from earnings attributed to business operations. If this is the situation, then the farmer should determine what can be done to generate a positive return from operations.

Farms with results in this threshold will, in almost all situations, be reporting net operating losses (unless land or quota values decrease). Farmers with longer term results in this threshold will be challenged financially, starting with liquidity management. The likelihood of longer term survivability in the farm's existing form will be very poor. Financial efficiency ratios (gross margin/contribution margin/net operating profit margin) should be analyzed to determine what can be done to improve earnings.

Asset Turnover Ratio

Definition:

Asset turnover is calculated by dividing gross revenue by total assets.

This ratio indicates the extent to which a business uses its assets to generate revenue. The higher the ratio, the better the assets are being used. The ratio can vary with business type and geographic location (ex: inflated land values).

For purposes of this analysis, assets are based on net worth (market value assets, but only land and supply managed quota as equipment has not been adjusted for market value).

Note that profitability ratios (return on equity and return on assets) indicate performance as a function of net income. Asset turnover uses gross revenue as the function of profitability. Neither is better or worse; they each provide a different context regarding financial performance.
A higher percentage indicates better performance.

Financial Performance Thresholds:

>40%	Results in this threshold indicate that for every $1,000 in assets, there should be $400 generated in gross income. Farms achieving this level of performance are very efficient in how they use their assets to generate gross revenue.
20%	Farms with results in this range will report very typical performance. A larger investment in assets, especially land and newer equipment, generally makes it more difficult to achieve optimal performance in this ratio. Poorer performance in this ratio can be attributed to excess investment in capital, new or overcapitalization in equipment or less than optimum gross revenue generation. Lower gross revenue, coupled with increased interest costs due to financed asset purchases or additional amortization on new equipment, can reduce net income.
<10%	Results in this threshold indicate that a farm is not efficiently generating a return (as expressed by gross revenue) on its assets. The business needs to consider increasing gross revenue (yield or price) or decreasing investment in assets. The decrease in assets can be accomplished in the shorter-term by disposing of assets (lease options) or in the longer-term by not replacing equipment as frequently (lower value).

If asset turnover performance falls into poorer performance thresholds, first determine the root cause. If the issue is that land in the area is overvalued, less emphasis should be placed on this indicator.

Gross Margin Ratio

Definition:

Gross margin is calculated by subtracting seed and seed treatment, chemicals (herbicides, fungicides, pesticides), fertilizer, production insurance (for grain operations) and veterinary, medicines, feed and market animals (for livestock operations) from gross revenue, and then dividing that number by gross revenue.

This ratio measures the financial efficiency of a farm in terms of how it uses its production inputs.

Gross margin trend lines provide an excellent efficiency indicator that is worth monitoring as a farm grows in size or complexity.

A higher percentage indicates better performance.

Financial Performance Thresholds:

>65%	Results in this threshold indicate that the farm is very efficient at utilizing its production inputs. Gross margin ratio is one of the most important indicators to calculate and analyze. Farmers with longer-term trend lines at this level of performance can confidently proceed with expansion plans.
55%	Farms reporting results in this threshold should determine why performance is less than desired and what can be done to improve it. The reasons for poor performance fall into the production (yield and inputs) and marketing (price) management areas but may be outside of a farmer's control (ex: weather). Because uncontrollable negative events such as severe weather do not usually occur regularly, performance trends should be analyzed. Deteriorating gross margin performance often accompanies expansion and transition. Many farmers have trouble managing their operation as carefully as it grows, so production can suffer as a result. Farms with these results should proceed with any expansion plans very carefully.
<50%	It is critically important that farms reporting results in this threshold determine why performance is less than desired. Farms that are not able to generate gross margin performance will not achieve acceptable levels of net operating performance. Further, they will almost always report net losses.

Contribution Margin Ratio

Definition:

Contribution margin is calculated by subtracting operating expenses (fuel, repairs, custom work, direct labour, supplies, etc.) from the gross margin. The ratio is calculated by then dividing the margin by gross revenue.

This ratio measures the financial efficiency of a farm in terms of how it uses its operating cost inputs.

After efficiency over production expenses has been calculated (gross margin), a farmer can determine how efficient he is at using the other variable costs. The contribution margin ratio provides this determination.

Adjustments should be made to account for unpaid or extraordinarily high wages.

A higher percentage indicates better performance.

Financial Performance Thresholds:

>50%	Results in this threshold indicate that the farm is very efficient at using its variable operating inputs.
45%	Poor results in gross margin performance will usually translate into poor contribution margin performance. A farm that reports results in this threshold but has acceptable gross margin performance should determine why performance is less than desired and what can be done to improve it. Unlike gross margin performance, the reasons for poor contribution margin performance **do not** fall into the production (yield and inputs) and marketing (price) management areas, and are within a farmer's management control.
<40%	Assuming acceptable gross margin performance, results in this threshold require management attention. Poor performance usually translates into less than desired net operating profit margins.

Net Operating Profit Margin Ratio

Definition:

Net operating profit margin is calculated by subtracting overhead and administrative costs (fixed) from the contribution margin. The ratio is calculated by then dividing the margin by gross revenue.

This indicator examines how efficient a farmer is at using his investment in fixed costs.

Adjustments should be made to account for unpaid or extraordinarily high wages or management salaries.

Amortization (depreciation) rates can have significant impact on performance. They should be calculated based on management rates (not tax rates) and applied on a straight line basis.

This indicator compares very well to non-farm businesses. A higher percentage indicates better performance.

Financial Performance Thresholds:

>20%	Results in this threshold indicate a very efficient farm in terms of generating net profit from its core operations.
10%	Farmers with results in this threshold have room for improvement. Remember that the denominator is gross revenue. This means that if a farm's net operating profit margin is $100,000 and its gross revenue is $1 million, its net operating profit margin ratio is 10 per cent. Performance should ideally be 20 per cent ($200,000) or better, which means that a farm with a net operating profit margin ratio of 10 per cent is leaving $100,000 - money could be used for investment and growth, to repay debt or for personal needs – on the table. Because farms with better performance have access to this money, those farms have a significant competitive advantage.
<5%	Farmers with results in this threshold should determine what can be done to improve performance. A performance trend in this threshold will translate into

liquidity and solvency issues and will negatively affect management decisions.

Note: when gross margin and contribution margin performance meet acceptable thresholds but the net operating profit margin is low, a farmer might consider expanding the productive asset base, effectively spreading fixed costs over more productive units. This will improve net operating profit margin performance, providing that the expanded production base does not result in poorer gross margin performance or require additional fixed costs such as interest on term debt or amortization.

Interest Expense Ratio

Definition:

The interest expense ratio is calculated by dividing interest expense by gross revenue. Farms with more debt will have higher interest expense ratios.

The ratio is a good indicator of potential problems related to leverage (debt).

A lower number may indicate better performance. However, if a farm can effectively manage the risk associated with leverage (debt), including interest, then it is more important to analyze the return that is generated by using borrowed capital and managing its repayment.

Financial Performance Thresholds:

<10%	Farms with results in this threshold are generally not adversely affected by interest costs. Calculating before and after scenarios where additional loans are planned helps to quantify how interest will affect financial performance.
15%	As in most ratios, farms with results in this threshold should monitor for deteriorating performance on performance trends. As this ratio weakens, more and more of the revenue generated (gross revenue) will go to pay interest, diverting it from other uses.
>20%	Results in this threshold warrant management attention. If the ratio is 20 per cent, $200 of every $1,000 of gross revenue will be required just to pay interest. There will very likely be increased sensitivity to interest rate increases.

Amortization Expense Ratio

Definition:

The amortization expense ratio is calculated by dividing amortization expense by gross revenue.

The ratio measures the amount of amortization (depreciation) relative to the level of sales (gross revenue).

A farm with newer equipment assets will have a higher amortization expense ratio. This indicates management priorities and investment guidelines.

The amortization expense ratio performance trend is important to monitor. A downward trend may indicate that capital replacement is lagging, while an upward trend might indicate an aggressive capital replacement policy. There is direct correlation between the amortization expense ratio and return on assets and return on equity, as greater amortization expense (higher amortization expense ratio) will result in lower net income.

A lower number may indicate better performance.

Financial Performance Thresholds:

<10%	Farms with results in this threshold are generally not adversely affected by amortization costs. However, it may reveal other issues. A lower number can reveal aging equipment that usually results in increased operating costs (repairs and maintenance). Aging equipment can result in production delays, which may have negative impacts on yield, gross revenue and, ultimately, net income
15%	Farms with results in this threshold should monitor for deteriorating performance trends relating to this ratio. As this ratio weakens, more and more of the revenue generated (gross revenue) will have to pay amortization costs. Net operating profit will be reduced. However, amortization is not a cash cost. Therefore, while net operating profit (profitability) may be reduced, cash flow (liquidity) may not be significantly affected.
>20%	Farms with results in this threshold should look for poor performance linkages in return on assets and equity ratios, debt to equity ratio, net operating profit margin ratio and asset turnover ratio to help determine the extent of the impact of amortization costs on financial performance.

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