Equal or Just?
Intergenerational Allocations within Family Farm Businesses

Authors

Kelly Y. Lange
Texas Tech University
Box 42132
Lubbock, Texas 79409-2132
(806) 742-2821
kelly.lange@ttu.edu

Dr. Jeffrey W. Johnson
Texas Tech University
Box 42132
Lubbock, Texas 79409-2132
(806) 742-2821
jeff.johnson@ttu.edu

Dr. Darren Hudson
Texas Tech University
Box 42132
Lubbock, Texas 79409-2132
(806) 742-2821
darren.hudson@ttu.edu

Dr. Phillip N. Johnson
Texas Tech University
Box 42132
Lubbock, Texas 79409-2132
(806) 742-2821
phil.johnson@ttu.edu

Dr. Bill Gustafson
Texas Tech University
Box 41210
Lubbock, Texas 79409-1210
(806) 742-9783
bill.gustafson@ttu.edu

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Abstract

A multi-disciplinary literature review was conducted in order to integrate multiple perspectives pertaining to family farm business transfer. Factors affecting perceptions of equality in family farm transfers were identified. Preliminary survey results analyze perceptions of equality within farm families and how these perceptions affect family farm transfer planning and implementation.

*Key Words:* family farm succession, intergenerational transfer

*JEL Classifications:* Q10, Q12
Introduction

Family farms are a specialized form of family business. Hoppe and Banker (2010) find that approximately 98% of U.S. farm businesses are family run ventures. Family farms face some unique issues when in structuring and managing the business as well as planning for the future of the business. Families engaged in a farm business must address not only the business aspects of running the farm, but must also ensure that familial needs are taken care of as well.

One of the biggest challenges that family farm businesses face is the process of passing the business on to the next generation. This process often involves many decisions that the family must make together in order to maintain the economic capabilities of the business. Issues central to the business transfer decision include deciding who will take over the business, how the business will be distributed among potential successors or heirs, and when the transfer will take place.

A potential problem that many families face is how to distribute the farm business to successors or heirs in a way that will satisfy all family members and still allow the farm to produce in a way that is economically feasible. This study provides a review of the relevant literature identifying factors which affect equality during the intergenerational transfer of family farm businesses. Additionally, this study evaluates responses from an initial survey in order to assess perceptions of equality in family farm business transfers. Finally, future research directions are discussed briefly.

Family Farm Business Continuity

Laband and Lentz (1983) found family farms can be up to nine times more likely to be passed on from one generation to the next than other types of family businesses. A survey conducted by Blau and Duncan (1967) found that approximately 82% percent of farmers came from a family
in which the father was also a farmer. Thus, a system of “occupational following” appears to occur more often within farm families, as the family farm is passed from one generation to the next, than with other types of family businesses. Additionally, sons of farmers were found to more frequently continue operation of the farm business rather than rent the land to an outsider or sell the family farm outright (Laband and Lentz 1983).

As potential successors are receiving formal education in school, they are also often simultaneously beginning to learn business management techniques of the family farm. During this time the younger generation is learning both the formal and informal skills necessary to run the business, yet the older generation is typically still very involved in the business as well. It is during this time period that the older generation is often shaping the younger generation to take over the business at some point in the future (Errington 1998).

Process of farm succession

Succession of a family business is often a process that creates significant problems (Keating and Munro 1989; Barnes & Hershon 1976). The method of transfer impacts the continued economic viability of the farm (Boehlje 1973). Specific methods by which farmers proceed with the succession process are largely unknown. This includes ways in which the farmer transitions out of the business, how and when successors are determined, and how the distribution of the business to the heirs is decided upon and instigated (Keating and Munro 1989).

Factors Affecting the Transfer Decision

Social norms within the family play an important role in the transfer decision. This includes things such as family communication methods and family decision making styles.

Due to multiple generations often working together in the farm business, decision making can create additional stress on family members in addition to the usual decisions that must be made
within the family unit. Business continuity and succession planning decisions are a common source of stress for farm families (Davis-Brown and Salamon 1987).

While virtually all families undergoing an intergenerational transfer of a farm business will experience some form of stress during the process, there is a difference between stress that can be resolved and stress that creates disruption within the family unit. Hedlund and Berkowitz (1979) found that the decisions surrounding intergenerational transfer of the family farm are significant stressors for farm families. Differences in opinions between multiple generations regarding the ownership and management practices of the farm can create disruptive stress among family members. If these disruptions are exacerbated, there can be a tremendous negative impact on both the relationships between family members as well as the economic viability of the farm business.

The stress of both planning and implementing an intergenerational transfer of a farm business or alternatively being forced to arrange for the sale of the farm business can prove to be disruptive to family harmony. Additional stress due to changing roles within the family business during the transfer process can also be troublesome to families.

Sibling rivalry can sometimes be present as a source of stress when undergoing a farm transfer. While some conflicts can be resolved through family communication, others are more difficult to resolve in a manner which is acceptable to all family members (Hedlund and Berkowitz 1979).

Two primary factors found to be important in managing family stress include communication and decision making style. Communication among family members provides a method of mediation for conflict and potential conflict. In general, the more open the communication style within the family, the less stress that occurs and the easier it is to address
stress that does occur. Closed communication styles in which family members are not encouraged to share their feelings and opinions openly, tend to result in more stress within the family unit (Hedlund and Berkowitz 1979).

Additionally, family decision making style contributes to the family’s ability to deal with stress and resolve conflict. Hedlund and Berkowitz (1979) observed two types of decision making style. The first was shared decision making in which all family members were encouraged to participate in the decision making process by sharing their thoughts and feelings regarding business decisions. This type of decision making style tended to be characterized with either less stress or no stress noted within the family. Alternatively, an authoritarian decision making style, in which one family member was primarily responsible for decisions, tended to be represented by increased incidence of stress within the family. In situations where an authoritarian decision maker was in charge, other family members were not encouraged to voice their opinions regarding important business decisions.

The overall health of the economy in general and economic conditions within the agricultural sector also factor into the short run and long run capability of the farm to continue to operate in an economically feasible way. The economic status of the farm itself is a large determinant of how and when a transfer can occur. If the goal is to provide multiple successors with a piece of the business, the farm must be economically capable of providing for multiple successors. Likewise, if the farm is intended to support both the younger generation and the older generation simultaneously, it must be in a financial position to do so (Gasson and Errington 1993).
Theories of Farm Transfer

Errington and Gasson (1993) consider the intergenerational transfer of family farm businesses to be comprised of three phases. Each phase is distinctive, yet all three phases are interrelated. Inheritance is the transfer of legal ownership of business assets, including land. Succession is the transfer of management control of business assets. Retirement occurs when the current manager departs from active management roles or labor roles within the business.

Succession and retirement have an inverse relationship. As the younger generation takes over managerial roles within the business, the older generation will withdraw. Inheritance, the transfer of ownership of assets, implies that managerial control will shift at the same time. Additionally, these events do not occur at one point in time, but rather, are an ongoing process. The farm transfer process is frequently initiated by the older generation which works to establish the younger generation as the upcoming manager and owner of the business (Gasson and Errington 1993; Errington 1998).

The transfer of managerial control can take place in many ways. Gasson and Errington (1993) identify four primary patterns by which managerial control is shifted in European family farms. These patterns include Stand-by Holding, Separate Enterprise, Farmer’s Boy, and Partnership.

Stand-by Holding is characterized by the older generation equipping the younger generation on a separate farm, where the younger generation learns the skills necessary to succeed at farming. This set up does not require the original farm to support two generations; instead the method provides the younger generation with a way to build up its own financial independence. When the older generation retires, the younger generation may either receive the older generation’s farm as an addition to the younger generation’s holdings or the generations
may switch holdings, so that the younger generation acquires the larger farm and the older
generation gets the smaller farm.

A Separate Enterprise occurs when one farm is large enough to support two generations concurrently. The older generation continues the primary operations of the business, while the younger generation has the ability to pursue separate and additional enterprises. This method also allows the younger generation to acquire the skills necessary to successfully run the business, while also providing a source of income.

The Farmer’s Boy pattern is characterized by the younger generation working for the older generation, often for many years, yet being involved in little to none of the managerial aspects of the business. This method results in the younger generation lacking sufficient managerial skills when the succession process is complete.

Partnerships may be formed even when the younger generation is working directly on the primary farm and may not have any additional farms or enterprises. Partnerships often begin as informal agreements in which the younger generation is working with the older generation, and are frequently developed into formal business partnership agreements.

All succession methods do not fall neatly into these four patterns. Rather, variations of these patterns are typically present when the actual succession process takes place. The economic situation of the farm business and the family often dictate which method or variation of method will be used when determining how succession transfers will take place (Gasson and Errington 1993; Errington 1998; Blanc and Perrier-Cornet 1992).

Bennett and Kohl (1982) describe family farm businesses as cyclical events. They outline three phases that a family farm business goes through. The first phase is an entry phase by which a person enters into a family farm business, typically by succession of the business
from the older generation to the younger generation. The next phase is the growth phase where
the business continues to expand and ownership and management responsibilities have been fully
undertaken by younger generation. Finally, the exit phase consists of the current owner and
manager departing from the business. This phase of the cycle can take many forms.

The current owner and manager may exit the business entirely in a short time period,
transferring both the ownership and management to another individual at one time.
Alternatively, the business transfer may take place over an extended time period, with the
ownership and management being transferred in phases rather than all at once. Many
combinations of these transfer methods can also be used.

Keating and Munro (1989) found that when farmers entered the exit phase of the cycle,
the first change was that farmers decreased the amount of work that the operator was responsible
for performing. Reduction in livestock assets and a reduction in production involvement
followed, along with a reduction in the financial decision making. The final step included a
reduction in land holdings and land leases and farm equipment. Additionally, when the farm
operator decreased the amount of the involvement in the business, he or she was more likely to
share decision making with other family members. Farm operators who expected the farm to be
passed on to the younger generation tended to pass on management responsibilities earlier than
operators who did not expect the farm to be passed on. Farm operators expected to pass the farm
on often did not simply give their land to their heirs outright, but rather it was expected that they
implement some type of agreement, such as a buy-sell agreement or lease arrangement (Keating
and Munro 1989).

Laband and Lentz (1983) considered the intergenerational transfer of human capital in
family farm businesses. Human capital is the specific skills and knowledge required by a person
to succeed in a technical type of occupation. Human capital can be transferred from one
generation to another by methods similar to other types of wealth.

Human capital required for success in an occupation can be obtained by two methods.
Skills can be learned by working in the occupational field itself. Expertise can also be acquired
through formal or informal education programs. In the case of farming, often the child receives
much of the human capital required to succeed in the agricultural occupation long before the
skills required for success in another occupation would have been acquired. Due to the nature of
agriculture being an extremely hands on profession, it is an optimum occupation through which
to study the transfer of human capital.

Laband (1981) identified two types of agriculture specific human capital. First, farm-
general human capital, which encompasses knowledge of the tools and machinery required in
agricultural production, without regard to a specific parcel of land. Second, farm-specific, or
soil-specific, human capital is employed by a farmer for use on a specific plot of land which has
particular requirements for agricultural inputs in order to maximize production.

Laband and Lentz (1983) found that “occupational inheritance” in farming was primarily
due to the transfer of farm-specific human capital which ultimately increased the worth of the
physical farm assets transferred from one generation to the next. This suggests that human
capital of agricultural knowledge can be transferred from one generation to another in an
efficient method.

**Successor Selection**

A primary reason for having a successor is to ensure the economic viability of the farm business.
One or more successors may be dependent on the farm to provide a livelihood for their family
while the older generation may be depending on the farm for their retirement funding. Lifestyle
is also a major reason for the selection of a successor. Certain lifestyles, such as the Yeoman Farmer lifestyle, are extremely important to farm families (Salamon and Davis-Brown 1988). The continuation of the business also provides a way of leaving behind a legacy for some individuals. Often the land which is farmed has greater meaning to the family than the business of farming itself. Strong emotional ties to the land provide another reason why the designation of a successor is important to many farming families.

Previous studies indicate that several different aspects of successor selection have been investigated. Studies have focused on the question of whether a family will select a successor, while other studies have investigated situations in which a successor has been definitely selected. Additional studies have focused on situations in which the successor has already been selected and is already working on the farm (Harrison 1975; Gasson 1984; Errington and Tranter 1991).

Three factors impacting successor selection include family characteristics, farm characteristics, and the economic position of the farm. Family characteristics include the number of children that the farmer has. More specifically, the number of male children compared to the number of female children may have an impact on the selection of a successor, due to many farmers desiring to have a son take over the family farm (Errington and Tranter 1991). When there are multiple sons in a family, the choice of successor may become more complicated (Gasson and Errington 1993).

When considering farm characteristics, the size of the farm is one of the most important considerations. Because the processes of inheritance, succession, and retirement typically take place over time, rather than all at once, the farm must be of an adequate size to support two or more families financially (Shucksmith et al. 1989).
The general economic environment also has an impact on successor selection. If the economy as a whole is not thriving, this may make the option of taking over the family farm unattractive to a potential successor. Another consideration may be that potential successors have better employment or lifestyle opportunities outside the farming industry and may opt to not take over the family farm (Fennell 1981).

**Optimal Timing of Farm Transfers**

Optimal timing is also crucial to transfer success. If the farm business is intended to provide for the retirement of the older generation, then it is important that enough of the ownership is retained by the older generation in order to ensure that retirement is funded. However, the older generation must be diligent to not retain too much ownership for too long a time, otherwise this may discourage the younger generation from wanting to wait to take over the business (Gasson and Errington 1993).

The timing of distribution can occur either while the business owner is still alive, as an inter-vivos transfer, or after the business owner has passed way, as a bequest. Bequests are typically specified in the decedent’s will. Factors affecting the timing of a transfer include the owner wanting to retain some ownership late into life as a means of providing income and concerns over whether children’s marriages will last. Often, the farm owner is reluctant to pass on large shares of the ownership of the farm to the child in case the child’s marriage ends in divorce and the son or daughter-in-law then has some legal right to a portion of the farm after the marriage is dissolved (Gasson and Errington 1993).
Distributions in Intergenerational Farm Transfers

Farm Business Asset Distribution

Partibility indicates how business assets are distributed among the successors in a family farm business. There are a multiple types of partibility patterns. Strict impartibility occurs when the farm assets and land are passed on in entirety to one individual. Often this type of transfer is one of primogeniture, in which the oldest son receives all farm assets and land. This type of transfer is common in UK farm families (Gasson and Errington 1993).

In contrast to primogeniture, partibility of assets includes other methods. In some cases financial help provided by parents may be offered in order to help an heir purchase the farm from the parents, thus providing the parents with a source of retirement income. Alternatively, the farm may be passed on to one successor in exchange for that child providing for the parents during retirement. In some instances, the farm may be undervalued when the assets are being distributed to the successors. Another option is that the farm may be divided equally among successors, but one successor is granted the opportunity to lease land from other successors. A final alternative may be that the owner possesses other types of financial assets which may be distributed to heirs that do not receive a portion of the farm business (Gasson and Errington 1993; Boehlje and Eisgruber 1972).

The degree to which a farm and its assets are partible or impartible depends on legal and financial situations both for the individual family as well as on a general level. Tax implications can have an enormous impact on the decisions of when and how to transfer the business to successors (Gasson and Errington 1993).
Equality versus Justice in Farm Transfers

The decision of how to best distribute the farm business among successors or heirs is one that must be approached carefully. Often the transfer decision is discussed in terms of what is fair or not. However, a problem is encountered when using the term “fair”. Fairness is ambiguous and does not mean the same thing to every person. Different family members may have different perceptions of fairness. One family member may believe that equal distributions of the family farm business are fair, while another family member may feel that equitable distributions, based on contributions to the farm business, are fair. Different perceptions of “fairness” have been associated with family conflict when determining optimal family farm distributions strategies. Because of these perception differences, the concept of “fair” is not useful for identifying optimal distribution strategies (Taylor and Norris 2000). A better term that can be used is “just” or “justice”. Philosophically defined, “justice” means that one gets what one deserves (Schurter and Wilson 2009).

The question of farm business distribution often becomes one of deciding whether to divide the business equally or justly among successors or heirs. Equal division occurs when all successors or heirs receive an approximately equal share of the farm business. Justice in this situation means that the farm business distribution is decided based on how much work each potential successor or heir has put into the business. Thus, in a just distribution, one child who has spent many years working on the farm should receive a proportionally larger share of the business than a sibling who has not been to the farm in many years.

When planning a farm transfer, the primary decisions that the older generation must make include determining which successors should receive a stake in the business and how to divide
ownership and management responsibilities among successors in an optimal way (Gasson and Errington 1993).

Some parents may feel that the most “fair” way to distribute the business is to provide each heir with an equal piece. However, distributing farm assets in this way may ultimately have a detrimental effect on the production capabilities of the farm. In contrast, when one heir receives a proportionally larger share of the business, he or she may also receive a proportionally larger share of outstanding debts which may be difficult to repay by oneself. This type of transfer may also create debts in which one family member is then responsible for repaying other family members. These situations can prove unfavorable for the future economic success of the business (Gasson and Errington 1993; Salamon and Davis-Brown 1988).

Taylor and Norris (2000) conducted surveys of siblings, one being the farm successor and one off farm sibling. This study investigated how perceptions of justice, or fairness, among farm successors impacted the success of the family farm succession transition.

The results of this study indicated that when a farm family business is distributed equally among all heirs, this represents a distribution based on equality. There are alternate methods of business distribution, as well. An equitable distribution of the farm business among the heirs is characterized as one in which the portions allocated to each heir are based on contributions to the business made by that individual. Thus, the distribution is based upon one’s equity in the business (Taylor and Norris 2000). Another alternative could be distributions made based on the amount of wealth that each individual possesses. Thus, heirs that have less accumulated wealth receive a larger portion of the farm business, while heirs that have more accumulated wealth receive a smaller piece. This distribution method is seen as a way to equalize the heirs based on their approximate accumulated wealth.
Taylor and Norris (2000) introduced a justice motive model of transfer. This model considers perceptions of fairness determined by four “rules of fairness”. These rules include the distribution of the farm business determined by who needs the most in order to be brought up to the level of the other heirs, division of assets equally among all family members (equality), division of assets determined by the amount of effort put into the business (equity), and the family member who dominates the others and “wins” the most from the farm business distribution. The closeness one family member feels to another is often an indicator of which “rule of fairness” is selected by multiple family members as being used in their family.

The findings from Taylor and Norris (2000) include the result that greater conflict between siblings during farm transitions is noted when siblings tend to select different “rules of fairness”. Another finding was that improved family communication tended to provide a mediation factor during times of conflict in family farm succession. Poor family communication was often noted when families indicated that the family farm business did not remain within the family after a transition. One unusual finding was that although siblings might agree on a particular “rule of fairness”, they did not necessarily agree that the farm transfer method was fair. A possible explanation for this dichotomy was that there was perhaps a difference between what siblings perceived as their family’s “rule of fairness” in general and the fairness rule applied during the actual farm transfer. Additionally, there is a possibility that the parents deciding the distribution of the farm business were using a different “rule of fairness” than their children were. Thus, the parents distributed the farm in a method they deemed as fair, yet the children did not perceive the division to be fair at all. This unusual finding suggests that a greater depth of research in this area is necessary.
Overall, this research suggests that while the determination of equal or equitable distributions of family farm business are indeed important, communication among family members in order to determine the underlying family beliefs concerning what is fair is an important first step to determining whether the business distribution should be either equal or equitable (Taylor and Norris 2000).

Survey on Perceptions of Equality

A preliminary survey was conducted in order to analyze perceptions of equality within farm families. This survey was used to determine how perceptions of equality might affect family farm transfer planning and implementation. A sample of undergraduate students enrolled in a Farm and Ranch Management Class at Texas Tech University participated in this study. The survey included questions pertaining to current family farm management practices, farm transfer planning, family involvement in the transfer planning process, family communication, and beliefs about equality among family members.

A total of 37 students participated in the survey. Of the participants, 33 were male and four were female. The average age of survey participants was 22. Survey respondents reported an average of two siblings, with the maximum number of siblings being six. Seventeen of the 37 participants surveyed (approximately 46%) reported that their family owned a farm or ranch business. Those that reported owning a family farm or ranch business indicated that the business had been in the family for an average of three generations, with three families having owned the business for five generations. Further results from respondents whom indicated their family owned a farm or ranch business are discussed below.

Fourteen of the seventeen respondents (approximately 82%) indicated that their families expected to pass the business on to the next generation. Four respondents (approximately 23%)
reported that their families had discussed a succession plan for the family business. Two respondents (approximately 12%) reported that their families had implemented a succession plan.

Six respondents (approximately 35%) indicated that their family tended to allocate resources equally among family members. Eleven respondents (approximately 65%) reported that their family tended to allocate resources among family members in a just way, based on who had contributed the most. Thus, family members who contributed more to an endeavor received a larger share of the reward.

Five respondents (approximately 29%) reported that they believed the farm or ranch business should be divided equally among all successors or heirs. Eight respondents (approximately 47%) indicated that they believed the farm or ranch business should be divided justly among the successors or heirs, based upon individual contributions to the business. One respondent (approximately 6%) was undecided as to how the family farm or ranch business should be allocated among the successors or heirs. Table 1 summarizes survey results.

**Future Research**

The study of how wealth is transferred from one person to another has long been of interest to economists. Becker (1974) proposed a theory of why persons transfer wealth to others. This article suggests that one person will make a transfer of their wealth to another because that individual cares about the welfare of the other. That is, one individual derives utility in part from the utility of another individual. The individual making the transfer is motivated by altruism for the other individual.

Transfers between parents and children are often believed to be motivated by altruism. In instances where a parent has multiple children, and is motivated purely by altruism, theory
suggests that the parent will make transfers to each child in order to equalize the children’s well being. So, the parent may transfer more wealth to the child who has the lowest income in an effort to equalize that child with other children who have higher incomes. Children with higher incomes will tend to receive less wealth through transfers. Thus, altruistically motivated parents transferring wealth to their children will often make transfers they feel are just, depending on each child’s personal financial situation.

In contrast to altruistic motivation for wealth transfers, others have proposed that transfers are exchange motivated. Bernheim, Shleifer, and Summers (1985) suggest that intergenerational transfers of wealth are actually compensation for some type of services rendered.

In the case of parents and children, this suggests that parents will allocate wealth transfers based on some sort of services provided to the parent by the children. Services can include many things, but often if the child provides for the parent during retirement or old age it is believed that the parent will allocate an appropriate proportion of wealth transfer to the child to compensate for the services provided.

Research suggests that exchange motivated parents tend to allocate an equal amount of wealth to be transferred to each child. Thus, exchange motivated transfers tend to be depicted by equal transfers to all persons, rather than one person receiving more or less than another (Bernheim, Shleifer, and Summers; Cox 1987; Cox and Rank 1992).

Currently very little research has been conducted using economic theories of intergenerational transfers to investigate family farm business transfers. Future research will include examining family farm transfer decisions using economic intergenerational transfer models in order to determine how farm families are motivated when deciding to transfer the farm
business to the next generation. Specifically, the issues to be analyzed include determining whether farm families are altruistically motivated or exchange motivated when making business transfers. By determining how farm families are transfer motivated, it can then be determined whether family farms are more likely to be distributed equally or justly among successor or heirs.
References


Table 1: Survey Results

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