Business Organization and Arrangements of Farms

Farmers use a variety of business arrangements. While most are sole proprietorships, they may have many formal or informal linkages to other firms. These linkages include arrangements to procure inputs (leasing land and machinery, custom work, hired or contract labor, forward pricing inputs), as well as marketing and production contracts. The extent of these linkages varies across the typology and by commodity.

Farmers use a combination of forms of business organization and business arrangements to structure a firm that meets personal, professional, and household goals. Readily recognizable forms of business organization include sole proprietorships, partnerships, and corporate businesses. In addition to these more traditional forms of organization, farms are also organized using other forms of organization, such as limited liability companies as well as trusts and cooperatives (table 5).

Moving beyond forms of business organization, farmers may choose to use a wide range of formal and informal business arrangements to gain access to technology, markets, equity capital, or other inputs important to achieving business or other goals. Commonly used arrangements include marketing and production contracts, joint ventures, strategic alliances, leases, and a variety of agreements and licenses.

Table 5–Organizational choices and business arrangements for farm operators

Farmers' choices of:	
Business organization	Business arrangements
Proprietorships	Independent producer
Modified proprietorships	Contract producer
Partnerships	Subcontract producer
Corporations	Strategic alliances
Family	Franchise agreements
Nonfamily	Licensing
Cooperatives, estates, and trusts	Alliances or joint ventures
Limited liability companies	Leasing

Farmers may use any or all of these business arrangements in various combinations. A farm may have a marketing contract with an elevator to market a row crop, a production contract with a processor to produce livestock, an arrangement with a farming neighbor to share equipment purchases or use, and an agreement with a relative to jointly rent land from another neighbor. Any formal or informal business arrangement can be used in conjunction with any of the various forms of business organization. Farmers intermingle business organization with a variety of business arrangements that may even differ among enterprises within the same firm. This flexibility allows them to build a business structure that accommodates their goals. Building a business that addresses personal and household goals–as well as business goals–explains why operators report that their spouses share in land acquisition and capital investment decisions (see the "Contributions by Spouses of Operators" section).

The complexity of today's farm business structure suggests that a farm's form of business organization alone is not sufficient to assess the extent of business linkages or the degree to which production or market integration may exist. This section reports information on the business organization and arrangements of farms, showing how arrangements vary for small and large farm businesses, household choices with regard to occupation, and stage in the life cycle of the family.

Business Organization

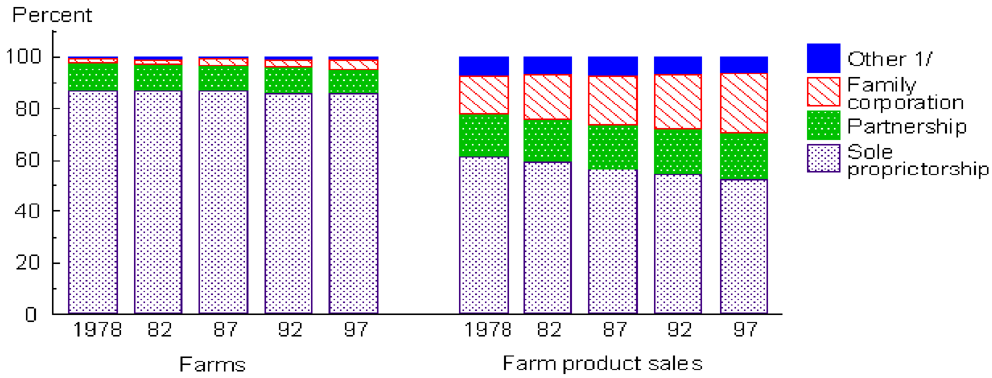
The most common form of business organization is the sole proprietorship. Data from the census of agriculture show that approximately 9 out of 10 farms have been organized as proprietorships for decades (fig. 8). Nonfamily corporations' share of agricultural sales has also been stable. The 1997 Census of Agriculture again confirmed the proprietorship as the dominant organizational form for farms. For the 1997 calendar year, 1.6 million or 86 percent of farms were organized using this form of business entity. Sole proprietorship operations generated 52 percent of farm product sales in 1997.

The ARMS confirms that the sole proprietorship is the most prevalent form of business ownership (table 6). Consistent with the census, 90 percent of the expanded number of farms represented by the 1998 calendar year survey reported the sole proprietorship form of organization.

Figure 8

Distribution of farms and farm product sales, by business organization, 1978-97

Most farms are sole proprietorships



1/ Includes nonfamily corporations, cooperatives, estates or trusts, and institutional farms.

Source: Census of Agriculture, various years.

Other traditional forms of business organization include partnerships (general and limited), corporations (farm and nonfarm), and cooperatives, estates, and trusts. In any given year, partnerships typically account for 5 to 6 percent of farms. Some persons or entities associate to produce commodities or services but are not legally organized as partnerships. These informal associations or alliances are typically considered to be proprietorships, but more than one household shares in the asset base and income of the farm.

Current data indicate that about 7 percent of farms have more than one household providing assets to the business. These households may be those of partners (in more formal business organizations), sons and/or daughters, or neighbors in more informal partnering. All typology groups, even very small and retirement-focused operations have some farms where multiple households contribute to the asset base of the farm. The presence of multiple households is more prevalent among very large family farms, where up to a fourth of farms receive assets from and provide income to multiple households. Corporations, cooperatives and other forms of business organization account for the remaining 4 to 5 percent of farms. While considerable attention is paid to potential expansion in the number of large nonfarm corporations and their share of production, the predominant form of corporate farm in terms of numbers of farms has traditionally been, and continues to be, the family corporation. The 1998 ARMS showed that 77 percent of the combined group of corporations, cooperatives and other nonproprietor or nonpartnership farms were organized as family corporations. Confirming numbers were reported in the 1997 Census of Agriculture where 76,100 of the Nation's 84,000 farming corporations (90 percent) were family-held operations.

Choice of form of business organization varies across the farm typology. Dahl (1995) and Boehlje and Lins (1995) indicate that several factors are important in the choice of one type of business organization over another. These factors include simplicity of forming the business, control over business and financial decisions, business continuity, owner liability, business and personal tax liability, estate transfer issues, and access to capital. The stage of life cycle for the business, the operator, and his or her household, and goals held for the business and the household may also affect choice of business organization (Thomas and Boehlje, 1991). More complex forms of organization, such as partnerships and corporations, are typically associated with larger farms where decisions and business issues regularly extend beyond the production and disposition of agricultural commodities to include other key concerns.

Table 6–Business organization of farms, by typology group, 1998

Item	Small family farms[1]					Large family farms[1]	Very large family farms[1]	Non-family farms[2]	All farms
	Limited-resource[3]	Retire-ment[4]	Residential/ lifestyle[4]	Farming-occupation[4]					
				Low-sales	High-sales				
	Number								
Total farms/operators	150,268	290,938	834,321	422,205	171,469	91,939	61,273	42,296	2,064,709
	Percent								
Percent of farms	7.3	14.1	40.4	20.4	8.3	4.5	3.0	2.0	100.0
Business organization:									
Sole proprietorship	97.8	97.2	94.5	92.4	85.4	68.7	59.1	31.0	90.4
Partnership	d	d	4.6	5.2	8.2	11.9	23.9	*2.5	5.3
Corporation or cooperative	d	d	*0.9	2.4	6.4	*19.5	17.1	66.6	4.3
Family corporation	d	d	*0.9	2.4	6.4	*19.5	17.1	16.8	3.3
Nonfamily corporation or other[5]	na	na	na	na	na	na	na	49.8	1.0
Multiple households providing assets[6]	2.3	4.0	7.6	6.1	12.0	14.9	24.7	na	7.0

d = Data suppressed due to insufficient observations. na = Not applicable. * = Standard error is between 25 and 50 percent of the estimate.

[1]Small family farms have sales less than $250,000. Large family farms have sales between $250,000 and $499,999. Very large family farms have sales of $500,000 or more.

[2]Nonfamily farms include nonfamily corporations or cooperatives, as well as farms operated by a hired manager.

[3]Limited-resource farms have household income less than $20,000, farms assets less than $150,000, and sales less than $100,000.

[4]Small farms other than limited resource farms are classified according to the major occupation of their operators. Operators of retirement farms are retired. Operators of residential/lifestyle farms report a nonfarm occupation. Operators of farming-occupation small farms report farming as their major occupation. Farming-occupation farms are further divided into low-sales (sales less than $100,000) and high-sales (sales between $100,000-$249,999).

[5]"Other" includes estates, trusts, and cooperatives.

[6]Data are from the 1996 Agricultural Resource Management Study, version 1.

Source: USDA, Economic Research Service, 1998 Agricultural Resource Management Study, version 1.

Proprietorships are generally the simplest form of business organization to use and understand. In effect, individuals (or married couples) establish a business and operate as a proprietorship, unless they take steps to operate using another form of organization. The individual or couple forming the business hold managerial control, are liable for debt and business decisions, and receive income produced by the business. Other forms of business organization are more complex as a result of shared management, differences in tax treatment and liability, distribution of income among multiple owners, and legal documents needed to establish life for the organization that may transcend that of the owners.

Business Arrangements

In the 1998 and 1996 ARMS, farmers were asked about their use of a variety of business arrangements and strategies to acquire inputs and market commodities, along with their use of selected coordinated activities. Farmers reported arrangements to procure inputs that included leasing arrangements for land and machinery, use of custom work, the use of hired and contract labor, forward pricing inputs, and the ownership of a business that provided inputs to the farm. Specific survey questions about coordinated activities focused on participation in either production or marketing contracts and purchases or sales through farmer cooperatives. From a marketing perspective, questions were asked to determine whether farmers sold their crops and livestock through cash markets only, without relying on contracts. These data help establish a perspective about the first four business arrangements highlighted in table 5. Information about farmers' use of alliances and joint ventures to network their farm has not been collected to date.

Farms across the typology incorporate a variety of business arrangements (table 7). Nevertheless, certain practices do tend to be relatively more common on certain classes of farms. For example, methods of acquiring production inputs vary dramatically. Land ownership is the most common mode of access to land by all typology classes. Land ownership, however, is more common among small farms, with 93 percent or more of retired, residential/lifestyle, or low-sales farms reporting that they owned some amount of land.

An examination of differences between higher and lower performing small farms suggests that lower debt burdens could increase the profitability of small farm operations. One strategy that could be used by small farms is to lease farm land and farm equipment, which helps relieve the need for capital financing. Rental of land, for either cash or shares, is most prevalent among family farms with sales greater than $100,000, namely high-sales small farms, large family farms, and very large family farms. Share renting is largely a tool of cash grain farms. Forty-two percent of cash grain farms share rent, and cash grain farms account for 64 percent of all share renters. Given their heavy specialization in cash grain (see "Attributes of Small and Large Farms" section), the high proportion of share rentals among high-sales small farms and large family farms is not surprising.

More than half of large and very large family farms also reported that they forward-priced inputs (contract or agree on prices of inputs to be delivered in the future). Of small farm groups, the high-sales group of farms reported use of pricing tools at a similar rate. These farms, like their large family farm counterparts, tend to produce corn, soybeans, wheat, and other row crops. These are commodities for which inputs such as seed, fertilizers, or chemicals may be more commonly priced for future delivery. Since these farms also tend to produce hogs, cattle, and milk, they may also use forward pricing to help control feed costs. Using cash sales only to market crops or livestock (no production or marketing

Table 7–Selected input procurement and production arrangements, by typology group, 1998

Item	Small family farms[1]: Limited-resource[3]	Retire-ment[4]	Residential/ lifestyle[4]	Farming-occupation[4]: Low-sales	Farming-occupation[4]: High-sales	Large family farms[1]	Very large family farms[1]	Non-family farms[2]	All farms
				Number					
Total farms/operators	150,268	290,938	834,321	422,205	171,469	91,939	61,273	42,296	2,064,709
				Percent					
Percent of farms	7.3	14.1	40.4	20.4	8.3	4.5	3.0	2.0	100.0
Input Procurement:									
Own land	70.5	98.6	92.8	95.9	88.6	81.7	85.6	85.9	91.4
Share rent land	*6.9	*3.1	6.4	12.9	35.8	45.6	28.6	10.2	12.2
Cash rent land	27.3	8.6	22.8	31.5	64.3	76.0	63.4	29.4	30.1
Hired labor	19.9	28.5	28.0	43.5	71.4	84.6	89.9	63.7	39.3
Custom work	36.1	33.6	31.5	42.5	68.9	70.8	57.8	51.8	40.4
Machinery leasing	**3.0	*1.3	5.8	5.6	23.3	29.8	36.1	21.0	8.7
Open credit line[5]	31.5	31.2	54.1	53.6	76.3	84.6	77.7	*50.4	51.9
Business owned by farm[5]	d	d	*1.0	*4.4	*2.1	*3.8	*8.1	d	*2.1
Forward price inputs[5]	*8.3	8.7	12.8	16.5	46.7	58.4	52.4	*23.4	19.4
Marketing Options:									
Cash sales only[6]	98.8	97.1	96.2	91.6	66.0	56.9	35.1	74.3	89.1
Options	*2.4	6.9	8.2	8.4	20.9	29.2	25..6	*15.5	10.3
Direct sales to individuals	14.6	6.6	15.4	12.5	9.0	9.5	8.9	*14.5	12.5
Direct sales to retailers	*1.0	*2.0	*3.2	4.2	5.3	*6.2	8.3	*7.7	3.6
Coordinated Activities:									
Production contracts	0.0	**0.5	0.5	*1.2	6.9	10.1	32.3	2.5	2.6
Marketing contracts	*1.2	2.4	3.4	7.2	29.0	35.1	37.1	24.6	8.8
Cooperative membership									
Marketing coop	*6.2	8.7	8.5	15.8	28.6	32.0	28.3	22.3	13.4
Supply coop	15.5	23.8	24.9	34.8	55.4	60.1	45.4	31.1	30.9

d = Data suppressed due to insufficient observations. * = Standard error is between 25 and 50 percent of the estimate.
** = Standard error is between 51 and 75 percent of the estimate.

[1]Small family farms have sales less than $250,000. Large family farms have sales between $250,000 and $499,999. Very large family farms have sales of $500,000 or more.

[2]Nonfamily farms include nonfamily corporations or cooperatives, as well as farms operated by a hired manager.

[3]Limited-resource farms have household income less than $20,000, farms assets less than $150,000, and sales less than $100,000.

[4]Small farms other than limited-resource farms are classified according to the major occupation of their operators. Operators of retirement farms are retired. Operators of residential/lifestyle farms report a nonfarm occupation. Operators of farming-occupation small farms report farming as their major occupation. Farming-occupation farms are further divided into low-sales (sales less than $100,000) and high-sales (sales between $100,000-$249,999).

[5]Data are from the 1996 Agricultural Resource Management Study, version 1.

[6]No production or marketing contracts.

Source: USDA, Economic Research Service, 1998 Agricultural Resource Management Study, version 1.

contracts) tends to be more common among limited-resource, retired, and residential/lifestyle operators than among operators of high-sales, large, and very large farms. Yet, 57 percent of large family farms used only cash sales to market their products.

Options, while used by some operators of retirement, residential/lifestyle, and low-sales farms, were more common on high-sales small farms, large family farms, and very large family farms. High-sales and large family farms also tend to be principal producers of grain and oilseeds, commodities for which use of contracts and commodity exchange pricing tools are more common.

Seven to 15 percent of farms sell directly to consumers through farmers' markets, roadside stands, mail-order, door-to-door marketing, and pick-your-own operations. Some operators sell farm products to retailers (or wholesalers) who then resell the farm product directly to consumers without processing or changing the form of the product. For example, an operator may sell fresh fruit to a supermarket or restaurant.

Production contracts have become relatively common in the production of select commodities, such as broilers and processing vegetables.[3] More recently, contracts have played an increasing role in the production of commodities such as hogs. While a larger portion of very large family farms report use of production contracts, about 1 in 10 high-sales small farms and large family farms use these arrangements as a part of their business plans as well. The remaining typology groups use production contracts much less frequently.

The use of marketing contracts is more common among farmers than the use of production contracts. The most dramatic differences in the use of marketing contracts versus production contracts occur for small farms and large family farms. For example, 1.2 percent of low-sales farms reported production contracts, but 7.2 percent reported marketing contracts, a sixfold difference. Similarly, five times as many high-sales farms reported marketing contracts as production contracts. This difference in reported use of marketing and production contracts reflects the grain and dairy production emphasis of these farms, since marketing contracts are more common among these enterprises. As was the case with production contracts, while farmers in each typology group report use of marketing contracts, larger farms use them most commonly.

Summary

Farmers across the typology use a variety of business links and arrangements. Although the data are not shown, partnerships and family corporations have many kinds of business linkages with farm and nonfarm entities, as one would expect. Proprietorships, even though owned and operated by a single owner (or single family), also have a variety of formal business linkages with landlords, contractors, cooperatives, other farm and farm-related businesses, and nonfarm businesses (fig. 9). As another

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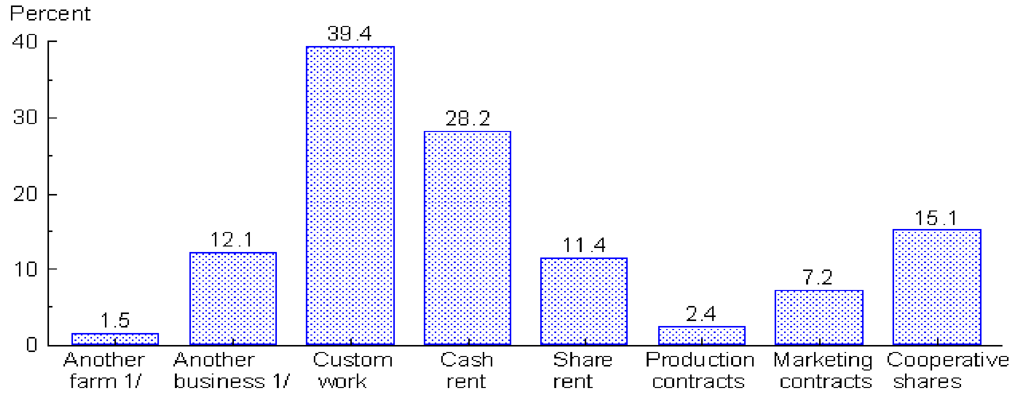
[3]Farms frequently enter into two types of contracts. A *production contract* is a legal agreement between a farm operator (contractee or agent) and another person or firm (contractor or principal) to produce a specific type, quantity, and quality of agricultural commodity. The contractor usually owns the commodity being produced and the farm receives a service fee. Under a *marketing contract*, the contractor buys a known quantity and quality of a commodity from a farm for a negotiated price. The farm owns the commodity while it is being produced and receives a price reflecting the value of the commodity.

Figure 9
Business arrangements of sole proprietorships, 1998
Even sole proprietorships have business linkages



1/ Data are from the 1996 Agricultural Resource Management Study, version 1.

Source: USDA, Economic Research Service, 1998 Agricultural Resource Management Study, version 1.

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example, 34 percent of high-sales farms had production or marketing contracts (table 7), even though the overwhelming majority of these farms (85 percent) were proprietorships (table 6).

The complexity of today's business arrangements means that a focus on business organization of farms by itself is not sufficient to assess the extent of business linkages or the degree to which production or market integration may exist. Farm ownership may reside with a single farmer or family, but proprietorships also have informal arrangements with others to share farm assets, debt, and income.

Traditional classifications of farms by business organization need to be supplemented by information that indicates the degree to which farms participate in alternative business arrangements to gain access to markets and production inputs. These arrangements not only shift production, marketing, and financial risks among participants, but also affect control of decisions, the use of farm resources, and the distribution of income among farm families and other households or business entities.