Business Structures in Agriculture

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Introduction

The global agri-food industry is becoming increasingly competitive with rapidly changing technology and developments in production, business and marketing environments. The result is that businesses are forced to become more flexible and responsive, seeking new resources and strategies for success. Developing relationships and working with other businesses in the supply chain by forming collaborative partnerships and linking design, production, processing and marketing of products and services to meet market demands, can offer significant competitive advantages.

Formalising relationships (with other suppliers and/or customers) can be critical to success. These structures can underpin investment decisions, offer a vehicle to build and share equity and ensure that all parties have a common understanding and contribute in a transparent way to the common goals.

The following information on business structures aims to provide a guide to the key business structures suitable for Tasmanian agribusinesses and provide an understanding of their advantages and disadvantages. In addition, it outlines a range of agreements involving several parties within an agribusiness chain that can support existing structures and collaborative projects.

Partnership

A partnership is formed when there is an agreement (written or verbal) between two or more persons, sole traders or business entities to carry on business together. Each partner is individually responsible (and potentially liable) for the activities of the partnership. It is possible that, in the absence of any other formal structure, or formal agreement, a collaborative business venture may be legally deemed to be a partnership.

Advantages of partnership structure

- establishment and administration is informal and inexpensive
- uniform and low level of regulation
- the flexibility to organise the partner's own affairs
- tax losses are available for use by individual partners
- franked dividends flow through the partnership to the individual partners
- it is simple to understand
- there is limited external disclosure.

Disadvantages of partnership structure

- there is unlimited liability of each partner including personal assets for all properly incurred debts of the partnership
- it may not be eligible for the 125% deduction for R&D
- each partner is bound by the acts of the other partners within authority
- possible unanimity required on entry/exit
- capital gains tax rules as they apply to partnerships are cumbersome and difficult in their application
- it lacks permanence.

Corporation/Company

The general features of a company are related to its independent legal status and include:

- ability to enter into contracts in its own name
- ability to sue and be sued in its own name
- perpetual succession
- ability to hold, acquire and dispose of property and incur debts in its own name.

The Corporations Law provides for three variations in types of companies relevant to supply chain situations: a proprietary company limited by shares, a public company limited by shares and a public company limited by guarantee.

A proprietary company limited by shares is by far the most common type of company. In this structure, each member's interest in the company is represented by the number of shares the member holds in the capital of the company.

Among other things, the liability of members is limited to the unpaid amount (if any) on each share. Creditors of the company cannot access the personal assets of the shareholders. Also, the directors of the company, by making a 'call' on the shares, can require the members of the company to pay to the company the unpaid amount on their shares.

A company limited by guarantee has no share capital. Each member agrees to guarantee the debts of the company up to a fixed amount but is under no obligation to provide capital to the company while it is a going concern. Accordingly, the company limited by guarantee is not normally used in commercial or trading transactions. It is suitable for non-profit organisations where the primary objective is to grant membership and obtain limited liability.

Apart from being classified as limited by shares and guarantee, companies are further classified as proprietary or public companies. Most companies in Australia are proprietary companies.

A proprietary company has a minimum of one and a maximum of fifty shareholders. It has restrictions upon the right to transfer shares and it cannot raise finance from the public.

A public company has a minimum of five shareholders. Its shares are freely transferable and it can raise finance from the public. The likely choice of appropriate company type for a value chain venture would be closely linked to the participants of the venture.

Proprietary Company Limited by Shares would be an appropriate structure if the shareholders have the value chain venture as a separate venture in its own right as their principal objective.

Public Company Limited by Shares, would be an appropriate structure if the venture is packaged as an investment opportunity for small investors (such as local farmers or the wider regional community), perhaps through a prospectus. However, this is a costly process involving the creation of a "Responsible Entity" and a substantial set of documents for obtaining licenses and registration with the Australian Securities and Industries Commission (ASIC).

Public Company Limited by Guarantee, would be an appropriate structure if the venture was to be a not for profit entity, perhaps on behalf of a growers group, a local government authority, a regional organisation, or a "cluster" group with multiple activities that may require additional structures under the company "umbrella".

Advantages of company structure

- separate legal personality
- limited liability for members and directors unless personal guarantees are given
- familiar form of business structure especially overseas. Financial institutions will more readily deal with it
- uniform regulation throughout Australia
- permanent as they have perpetual succession
- facility to obtain funds is greater as non-debt finance may be obtained
- lower tax rate (flat rate)
- taxation deduction for research and development is available to companies
- dividend imputation.

Disadvantages of company structure

- expensive and complex structure to both establish and maintain
- high level of regulation
- public exposure (disclosure and registration of information and directors, etc.)
- additional responsibilities under Corporations Law for any directors associated with the company
- once money is invested as share capital, it is difficult to withdraw other than through a liquidation
- decision making process may be more cumbersome, depending on the number of people involved
- losses are trapped within the company and cannot be accessed by shareholders
- loss of capital gains tax indexation on distribution
- repatriation of profits by any other means than as a dividend is difficult.

Cooperative

Like a company, a cooperative is a registered legal entity. It differs from a company in that it requires at least five shareholders, each of whom holds equal voting rights. Cooperatives apply the concepts of sharing, democracy and delegation in order to benefit all members. Generally, all members are expected to participate and share the responsibility of running the organisation.

Essentially, a co-operative is an organisation whose primary aim is to advance the economic and/or social goals of its members. Historically, co-operatives have played an important role in Australian business, most notably in the areas of agricultural trade, housing finance to low income earners, and the provision of community services.

The statute law specifically relating to co-operatives consists of various pieces of legislation in each State and Territory. The various Acts are administered by a Registrar of Co-operatives in each jurisdiction. There are many different types of co-operatives including agricultural societies and credit unions.

The distinguishing features of a co-operative are contained in the 'co-operative principles', including:

- democratic control of the co-operative, with each member possessing equal voting rights
- voluntary and open membership to be offered without discrimination
- equitable division amongst members of the society's surplus
- limitation upon the interest received on shares.
  - membership
  - anyone can apply to be a member of a cooperative, with the directors making decisions about the suitability of applicants. Directors are nominated and elected by members and have specific duties that are defined by common and statutory law. Any member may choose to nominate themselves as director.
  - legislation
  - cooperatives are subject to Corporations Law.

Advantages of cooperative structure

- limited liability
- separate legal personality
- tax advantages as cooperatives are taxed like companies
- establishment is not very complex
- it is generally cheaper to register a cooperative than a company
- all shareholders have an equal vote at general meetings regardless of their shareholding or involvement in the cooperative
- shareholders, directors, managers and employees have no responsibility for debts of the cooperative unless those debts are caused recklessly, negligently or fraudulently
- members, other than directors, can be under 18, though these members cannot stand for office and do not have the right to vote
- a cooperative is member owned and controlled, rather than controlled by investors
- all members and shareholders have to be active in the co-operative.

Disadvantages of cooperative structure

- high minimum numbers in some jurisdictions
- high level of reporting requirements
- some cooperatives will not be eligible for concessional taxation deductions for research and development
- lack of uniform regulation
- inflexible membership structure
- there must be a minimum of five members
- there is a usually a limited distribution of surplus (profits) to members/shareholders and some
- cooperatives may prohibit the distribution of any surplus to members/shareholders
- as cooperatives are formed to provide a service to their members rather than a return on investment, it may be difficult to attract potential members/ shareholders whose primary interest is a financial return
- even though some shareholders may have a greater involvement or investment than others, they still only get one vote
- members/shareholders have to be actively involved the cooperative
- cooperatives require ongoing cooperative education programs for members.

Joint Venture

A joint venture is a relationship that exists between parties carrying on a particular commercial undertaking in common for their individual gains as opposed to mutual gain.

Advantages of joint venture structure

- no direct regulation
- very flexible in application to different businesses
- co-venturers are taxed separately, the 125 per cent taxation deduction for R&D is available to the individual co-venturers if they are eligible companies (i.e. body corporates incorporated under a low of the Commonwealth or State)
- joint venturers are not responsible for the acts of co-venturers (unlike in a partnership).

Disadvantages of joint venture structure

- limited liability can only be achieved if the joint venturer's personally have limited liability
- expensive and complex to establish
- possible classification as a partnership with the associated consequences.

Agreements and codes of practice

There is a range of possible agreements suitable for an agribusiness chain including rules, articles, a constitution (these would normally be required for an incorporated structure); a code of practice; a shareholders agreement; a memorandum of understanding (MOU); a heads of agreement (HoA); a license agreement; a sales agreement; and a confidentiality agreement.

Purpose of agreements

- to ensure everyone is "on the same wavelength" in terms of the proposed venture or project. A formal agreement clarifies issues that could be misunderstood, or have a different meanings if not put into writing
- to provide an understanding and schedule of commitments, for an initial (or interim) project that could lead to a new business structure being created, subject to the success of the project. It can also be used in the initial period for participants to work together to develop trust or to establish if there are any difficulties in collaborating
- to fill a gap that is not provided just by a new structure (ie. used to clarify and supplement the business structure)
- to formalise a venture that is not (or is not yet) covered by a business structure
- to protect assets (soft and hard) and clarify risk
- a chain to stakeholders, investors and financiers
- to provide a legal enforcement device (only as a last resort option).

Codes of practice

As well as decisions about formal structures it is often important to develop and establish a Code of Practice for both the equity holders/partners and other participants. A Code of Practice specifies rules, and formalises expected behaviour which participants agree to meet. Governance issues cannot be treated independently from any legal structure. Therefore codes of practice will vary according to the possible structure (eg company, trust or incorporated arrangement). For example, the decision to incorporate part of the group or chain as a new company, will partially determine the content of the code of practice, as will any concerns about "partners" promoting themselves as representatives of the chain.

The following checklist is a guide to developing a code of practice between collaborating businesses or value chain members:

- entry and exit rules
    - cost of entry after initial members are in place
    - payment or penalties for exist
    - valuing the chain when taking on new entrants
- quality standards (are they needed)
- exclusivity in markets or geographic regions covered by the chain
- agreed disciplinary procedures (eg. for poor quality, failing to meet deadlines, breaching rules)
- committee and board membership and voting arrangements
- circumstances for non-member participating in the chain
- financial reporting and financial contributions or levies
- information exchange
- dealing with assets and intellectual property including:
    - the name of the group and its entities
    - databases/market intelligence
    - promotional programs and brands
    - knowledge/know-how
- conflicts of interest among members (eg. engaging other agents/distributors to work in the same market as the chain).

Chain members should seek legal advice in the drafting and execution of any of the legal structures and documents discussed above.

Disclaimer

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