

# Business Structures

## Governance

Governance is the role of making sure a business is well run, maximising value for the owners, and aligned with the overall purpose and investment objectives of the owners. The role of governance is carried out by the trustees, directors, partners, or sole trader.

Governance can be as simple as a husband and wife putting a morning aside to talk about their goals and aspirations. Governance can also be as formal as a meeting of the board of directors. There is no “right way” to do it and it should be tailored to the style and capability of the people involved. Where governance is less formal, the use of a trusted advisor can be helpful to separate the governance conversation from day to day management and operations.

### Key components of good governance

- Understand the values, purpose and intention of the owners – why is this business here?
- Have a clear plan to achieve the purpose and intention – typically a strategic plan is for three or more years
- Employ and empower the right people in the business to execute the plan – management
- Accountable to owners.

## Management

Management is the role of using the resources within the business to achieve the strategic plan. This requires a shorter term “tactical” focus and more attention to detail. Managers should have well-defined job descriptions that detail the responsibilities, decision-making, authority, and reporting requirements.

### Key components of good management

- Accountable to governance
- Well-defined job descriptions
- An annual plan consisting of production targets and budgets – these should align to the strategic objectives
- Tactical plans that break down what is required to achieve the annual plan – what is most important right now?
- Systems in place to capture the right management information (to inform decision making)
- Ability to make timely decisions
- Able to review performance and identify areas for improvement.

## Operations

The role of operations is the “doing” part of the business. A key component in a successful farming business is doing the day to day operations to a very high standard. Having good links with management helps people doing the operations to understand the value of each day’s work in achieving the targets for the year and ultimately the long-term goals of the owners. This ensures that time is spent on areas that have the most impact on the performance of the business.

### Key components of good operations

- Accountable to management
- Well-defined job descriptions
- Good time management
- Necessary technical skills
- Ability to observe and record what is happening on farm.

### Definition

Business structures are operating structures within the business used to achieve the objectives of the owners. These structures include governance, management, operations and ownership. Each of these components has a significant role in a successful business.

In many farming businesses an individual has more than one role and it can be challenging to make sense of the conflicting needs they face. In addition, it is rare for an individual to be very good in all areas of the business. People tend to spend more time in the areas they are better at or more comfortable. For example, farmers who are strong at governance and strategy may have grown successful and large businesses, but they are not necessarily known as the best “farmers” in the region.

### Ownership

Ownership structures are less fluid than the other three. They are the legal entity or combination of entities used to hold assets and trade the business. Decisions are typically based on asset protection; personal liability; and tax management. This decision is made at the outset and not part of the annual conversations.

Ownership structures should be dictated by the needs of the individuals and not the other way around.

### Further resources

Ministry of Business, Innovation & Employment: [www.mbie.govt.nz](http://www.mbie.govt.nz)

Red Meat Profit Partnership (RMPP): [www.rmpp.co.nz](http://www.rmpp.co.nz)

## Sole trader

Sole trader is a simple form of ownership structure and is common for people who are self-employed. Sole trader structures are suitable for small businesses with a limited number of employees.

### Advantages

- Cost effective
- Easy to establish
- The individual retains full control.

### Disadvantages

- The business and the individual are one legal entity and therefore the individual is liable for all debts and obligations of the business.

## General partnerships

- Like a sole trader a general partnership (commonly called a partnership) is simple and allows two or more people to run a business together sharing the assets, liabilities and skills. A formal agreement is not required but it is advised.

### Advantages

- Simple and cost effective
- Minimal compliance required.

### Disadvantages

- Partners are jointly and severely liable for debts incurred by the other partners
- Personal assets may be put at risk
- Succession of partners or death of partners can be complicated.

## Limited Partnerships (LPs)

The Limited Partnerships Act (2008) was established to provide a flexible and convenient business structure. Being new it has sought to cherry pick benefits offered via company and partnership structures. It is a separate legal entity and is able to carry out all forms of business, activities, and transactions within and outside of New Zealand. It can provide limited liability for investors and the LPs taxable income flows directly to investor partners without the company tax layer.

### Advantages

- Limited liability for limited partners (subject to qualifications)
- Limited partnership agreements are more flexible than requirements for company constitutions
- Limited partnership agreements are not publicly filed so privacy is maintained
- Changes in ownership are more clearly defined than in general partnerships
- Flow through tax treatment.

### Disadvantages

- There is potential in some circumstances for partners to have personal liability. Note the distinction between limited partners and general partners.

### Model diagram



Individual



Capital Labour Skills



Partners



Capital Labour Skills



Partners



Capital Labour Skills



New Entity (LP)

## Companies

A company is a separate legal entity and able to conduct all forms of business, activities and transactions within New Zealand. Companies are made up of shareholders (owners with a financial interest) and directors (governance) with clearly defined responsibilities. Limited liability companies (LLC) have proven the most popular business structure. Look through companies (LTC) are in most ways a normal company but profits and losses from the company are passed through to shareholders (as with limited partnerships).

### Advantages

- Long established – a proven structure
- A separate legal entity providing a layer of protection for shareholders and personal assets
- Continuity is simple through sale or transfer of shares
- Tax options with LTC and company tax rates.

### Disadvantages

- Compliance requirements are significant
- Directors need to be fully aware of their responsibilities.

## Trusts

A trust is not a legal entity, but more relationship established when a person (the settlor) places assets under the control of another person (the trustee(s)) for the benefit of another person (the beneficiaries) or a specific purpose. The trust can own the assets directly or own shares in a company. A trust can also be used for trading a business. Trusts are commonly used for protection of assets and management of assets through generations by taking away the absolute ownership of the asset from the individual.

### Advantages

- Asset protection
- The ability to pass on assets to future generations
- Easy administration of estates
- Income can be spread to beneficiaries.

### Disadvantages

- The control of the assets is transferred which some people find challenging (although it can be managed)
- Trusts have a limited lifespan of 80 years
- Trustees must be fully aware of their obligations and duties.

