

# **Attitude of Flemish Farmers Towards Alternative Business Governance Structures**

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## **Attitude of Flemish farmers towards alternative business governance structures**

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### **ABSTRACT**

The Flemish agriculture is characterised by family farms in sole ownership. Alternative business governance structures occur in only 7 % of the cases, although they have advantages on fiscal, family and property grounds. The reason why partnerships don't work in Flemish agriculture are mainly situated at the knowledge and perception level of the farmers. The knowledge of the different structures exists only in a limited group of farmers. The subjective perception of governance structures enhances the limitation of transition to alternative business governance structures. Partnerships will be adapted by farmers who have a higher knowledge of alternative business governance structures and accept that the higher administration is compensated by a lower risk.

Keywords: agricultural company – agriculture – Flanders - governance structures - partnership – private company with limited liability - sole ownership

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## **1 INTRODUCTION**

In Flemish agriculture (Belgium), as in most other West European countries, most farms are run as family farms with sole ownership. This evolves from the past where agriculture was seen as a 'way of life', in which a lot of families found their living. In 2003, 93,5% of the 36 681 Flemish farms had the juridical configuration of sole ownership, although this form has a number of limitations such as high capital outflow of the sector at the moment of succession, personal liability in case of failure or financial problems, high labour pressure, the fiscal consequences and so on. To solve these problems, other legal and juridical possibilities have been developed such as 'private companies with limited liability' and 'agricultural companies' who give more financial certainty and possibilities for a fluent transfer of the family farm. But, notwithstanding the advantages of alternative business governance structures, the continuation of the sole ownership structure in a majority of the cases is observed. In this paper, we try to explain both on theoretical and empirical grounds why this is the case.

## **2 PROBLEM STATEMENT**

Juridical forms such as 'private companies with limited liability' and 'agricultural companies' have advantages for the Flemish farm sector both on fiscal, family and property arguments. In the sole ownership, farmers have no limited liability in case of financial problems, and at the moment of farm transfer, they want to preserve the unity of the farm, unless the equal shares between the heirs. Both examples show the financial consequences for the whole family. The main disadvantages of alternative business governance structures cited in literature are the difficulties for control, high transaction and agency costs (Boatright 2004, Van den Berghe and Carchon 2003), although these can be limited in the family based Flemish agriculture. But more important is that complicated fiscal regulations discourage these governance structures.

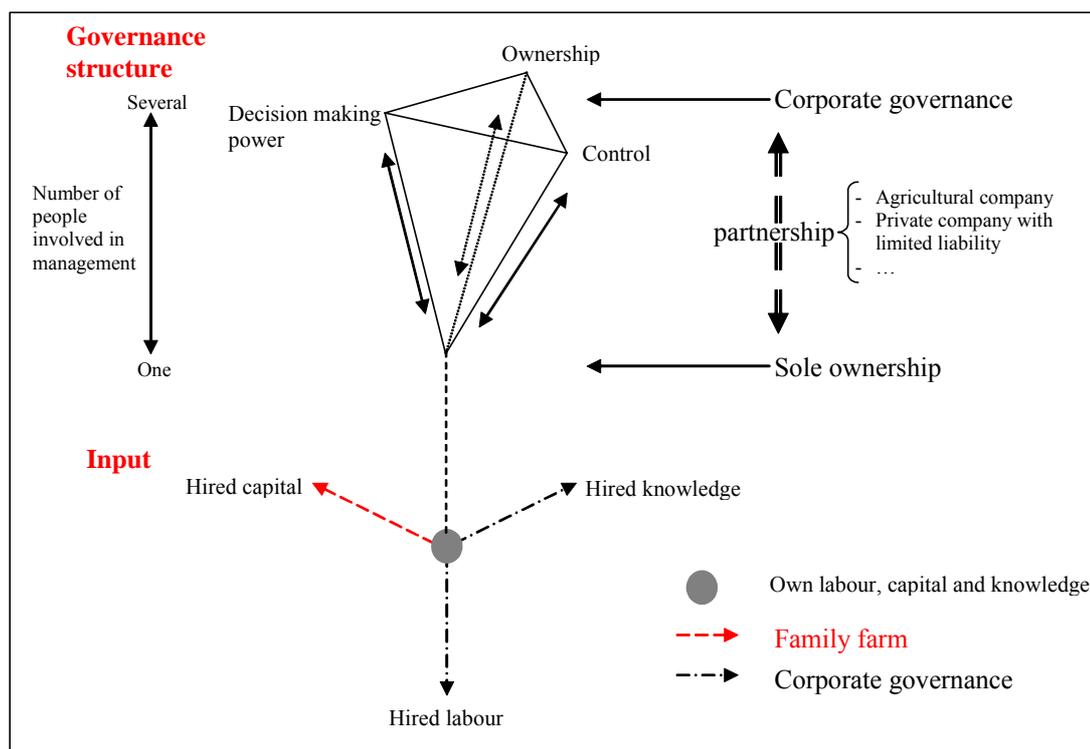
In order to know why alternative business governance structures, such as 'private companies with limited liability' and 'agricultural companies', don't break through in Flemish agriculture although for a number of family farms it should be a good solution, different hypothesis can be posed:

- A limited knowledge of alternative business governance structures is a major obstacle to implement such structures in agriculture
- The fiscal regulations in Flanders limit the transition to alternative business governance structures
- For most farmers, the net balance of sole ownership characteristics is better than the net balance of alternative business governance structures
- Transaction and administrative cost of adopting an alternative structure are an important element in the decision to keep sole ownership

## **3 ALTERNATIVE BUSINESS GOVERNANCE STRUCTURES**

In general, the governance structure of a firm is based on ownership, decision making power and control which can vary from sole ownership to corporate governance (Figure 1). But in all governance structures, the family business has an important role to play. Family firms distinguish themselves in terms of ownership, leadership and evolutionary dynamics. The governance structures that are current in the general economic landscape, can also be

found within the agricultural economic landscape: especially sole ownership and different forms of partnership (agricultural company, private company with limited liability) exist.



**FIGURE 1 Components of Governance Structure and Input**

Depending on the input of capital, knowledge and labour, different juridical structures can be distinguished: the variation in hired and own input will determine which kind of governance structure can be established.

In corporate governance, own capital will be available within the firm, and this makes it possible to hire labour to produce. The shareholders are equity capital providers with a claim on a firm's residual revenues, and their governance rights are safeguards for this kind of investment. Labour, which is provided by employees, is as important as capital as a factor of production, and employees also need governance rights to protect their stake in a firm, which is largely a claim for wages. If ownership and decision making power are separated, knowledge can also be hired by means of an employed manager (Boatright 2004). This governance structure is rare in – Flemish – agriculture.

Sole ownership, e.g. as family farm, has in general the required labour and knowledge available. Both are supplemented with hired capital, in order to be able to produce. According to Pollak (1985) the main disadvantages of the family as a production unit are conflict spill-overs from non-production into production activities, a propensity to forgive inefficient or slack behaviour, access to a restricted range of talents, and possible diseconomies of small scale. On the other side family farms benefit from their ability to withstand hard times, flexibility, low transaction costs and the opportunity cost of family labour (Gasson et al. 1988, Schmitt 1991). When agricultural tasks can be monitored easily in terms of inputs or outputs, family farms are often overshadowed by other forms of agricultural organisation (Schmitt 1991).

In between corporate governance and sole ownership, different forms of partnerships can be distinguished. Partnerships within the family farm can be seen as a form of employee governance. The term 'employee governance' covers various proposals for increasing the

control of employees over matters that affect them. This control may be exercised either directly through participation in decision making or indirectly through representation in decision-making bodies, such as a seat on the board of directors (Boatright 2004).

Most important partnership structures in Flemish agriculture are the ‘agricultural company’ (landbouwvennootschap) and the ‘private company with limited liability’ (BVBA) (Table 1). In general, partnership is the most common form of organisation in fields that involve highly specialized skills and knowledge (Boatright 2004) like is often the case in agriculture and horticulture.

Differences between sole ownership and partnerships are situated on fiscal, family and property basis.

- An important difference on fiscal grounds is the system of taxation in which partnerships have a fixed tax rate. This is profitable for larger companies, compared to the graduated tax rates for sole ownership. Another positive aspect is that profit and loss can be transferred to the next fiscal year. The remaining of the profit within the company will create a stable income and money is available for investments. In contrary, there is no reduction on tax rates of agricultural subsidies and, except for agricultural companies, accounting is obligatory.
- On family grounds, there is a safeguard for the continuity of the farm because there will be no crumble after the decease of the farm manager. There is the possibility to divide the farm by means of blocks of shares in which all the heirs are treated in the same way. The free transferability of shares is limited and partnerships can structure cooperation.
- The difference between sole ownership and partnerships on property basis is situated in the liability. The sole ownership has unlimited liability of both private and company property at present but also in the future. Partnerships have limited liability on property, except for the active partner in the agricultural company who has also unlimited liability.

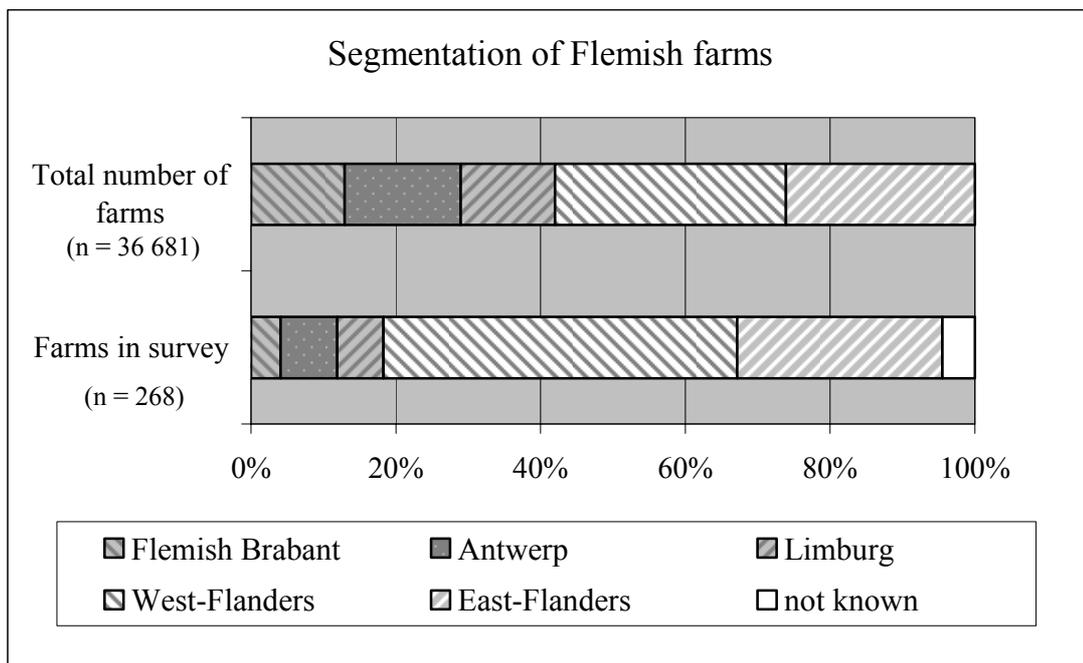
The ‘agricultural company’ is a less strict form of partnership, compared to the ‘private company with limited liability’, but has also less advantages on fiscal and property grounds.

**TABLE 1 Basic Characteristics of Private Company with Limited Liability (BVBA) and Agricultural Company (LV)**

<b>Private Company with Limited Liability</b>	<b>BVBA</b>	<b>Besloten Vennootschap met Beperkte aansprakelijkheid</b>
<ul style="list-style-type: none"> <li>• In a BVBA the partners are only liable for the company assets.</li> <li>• The capital is tied up in registered and not freely marketable shares. This way it is avoided that shares are transferred to outside parties without approval of the joint partners and that the family character of the company is lost, for example.</li> <li>• A BVBA is set up by notarial deed and has to comply with a number of accounting and administrative obligations</li> </ul>		
<b>Agricultural Company</b>	<b>LV</b>	<b>Landbouwvennootschap</b>
<ul style="list-style-type: none"> <li>• The agricultural company is a very specific type of organisation for the purpose of operating an agricultural or horticultural business.</li> <li>• An agricultural company is automatically subject to the personal income tax if: <ul style="list-style-type: none"> <li>• it counts fewer than three partners</li> <li>• or if its capital is below € 30.950</li> </ul> </li> <li>• In other instances, the company may select to pay personal income tax or, conversely, corporation tax.</li> </ul>		

## 4 METHODOLOGY

The empirical data for the research of the attitude of Flemish farmers towards alternative business governance structures, are the result of a questionnaire that was held at the Flanders' agriculture fair at the beginning of January 2005. Participants of this fair were asked to complete a questionnaire related to their governance structure. More than 280 farmers completed the form, but only 268 questionnaires were restrained of which 11,6% was partially filled in. The sampling technique was based on non probability sampling in which the participants of the fair where asked in the first place if they are farmer or not. In case of a positive answer on the first question, they were asked to fill in the questionnaire. Approximately 70% of the approached farmers were willing to do so. Due to distance to the fair, farmers from Flemish Brabant, Antwerp and Limburg are less represented in the survey, then in the general distribution of the farms in Flanders (Figure 2).



**FIGURE 2 Segmentation of Flemish Farms in Survey and in General**

The questionnaire consists of three parts. In the first part, some general information of the farm is asked, related to the farming type, labour, education, succession and the aims of the farm. The second part assesses the knowledge about different juridical forms of farming with a focus on the sole ownership, the agricultural company (LV) and the private company with limited liability (BVBA). These three forms are most common in Flemish agriculture. The last part of the questionnaire is oriented towards the own juridical form of the farm.

In the first place, the questionnaire is analysed on basis of descriptive statistics. In the second part of the research, discriminant analysis is used to explain the difference between sole ownership and alternative business governance structures.

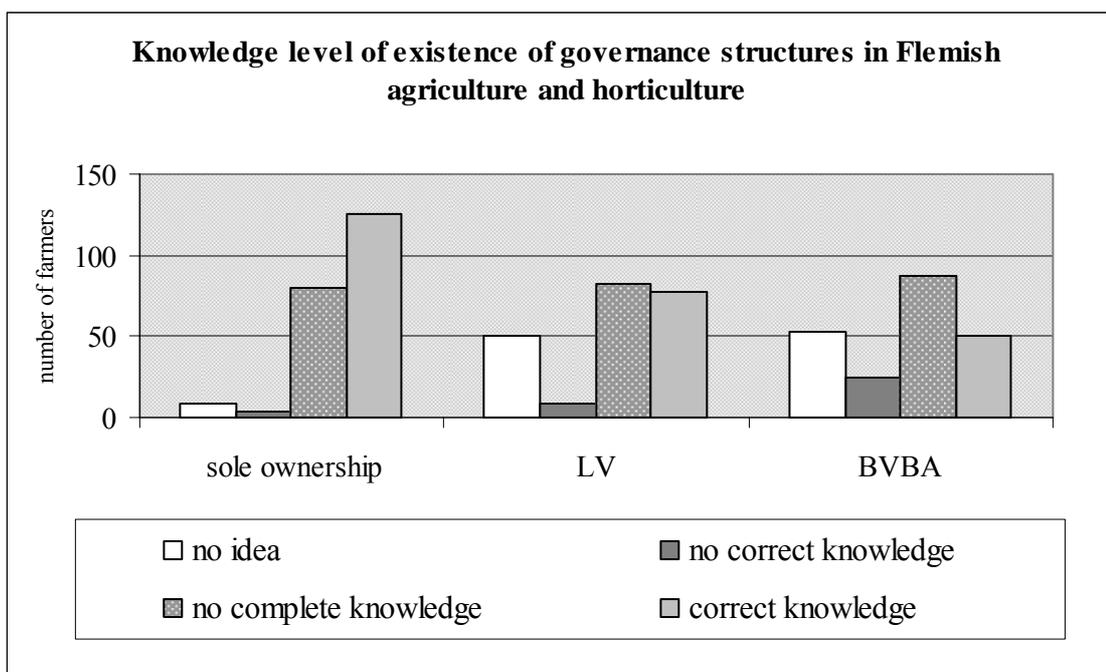
## 5 RESULTS

The sole ownership is the most important governance structure in Flanders. In the questionnaire, 89,3% of the farmers works under sole ownership, 7,3% has an alternative business governance structure and 3,4% does not know the juridical configuration. If farmers

don't know their governance structure, it will probably be the sole ownership. A total of 92,7% sole ownership in the survey approaches the 93,5% of the 36 681 Flemish farms that had in 2003 the sole ownership as juridical configuration.

### 5.1 Limited knowledge of alternative business governance structures

The attitude towards alternative business governance structures is related to the knowledge of the different governance structures. The information towards farmers about the different possibilities of juridical forms in Flanders is very limited. Extension services give no priority to this information which is reflected in the knowledge level of the existence of the governance structure (Figure 3): 24% of the farmers has no idea of the existence of alternative business governance structures in agriculture. Approximately 40% knows that the juridical forms exist in Flemish agriculture and horticulture, but their information about the economic farm size on which the juridical form is applicable is not correct. The correct knowledge is available in 58% (sole ownership), 35% (LV) and 24% (BVBA) of the cases. This shows that information about the existence of alternative business governance structures in Flanders is limited.



**FIGURE 3 Knowledge Level of Existence of Governance Structures**

The knowledge of the different governance structures in agriculture is relatively low for farmers in sole ownership: they do not search for information about other juridical forms, and even the knowledge of their own farming structure is limited.

In the private company with limited liability (BVBA) the level of knowledge is relatively high. These farmers have selected the governance structures that suited best their needs, and are able to compare the different structures on an objective basis. Within the agricultural company (LV) the knowledge of the own governance structure is high, but contrary to the BVBA, their knowledge of other juridical forms is low (Table 2).

**TABLE 2 General Knowledge of Governance Structures**

	farmers in juridical farm structure:			F-value
	sole ownership (n = 205)	LV (n = 9)	BVBA (n = 5)	
knowledge of sole ownership	5,63 ab	3,56 a	7,00 b	3,456 *
knowledge of BVBA	4,35	4,14	6,40	0,857
knowledge of LV	3,96 a	7,29 b	4,60 ab	3,802 *

(scale 0 – 10: 0: no knowledge of governance structure 10: perfect knowledge of governance structure)  
(\*: significance < 0,05)

There is only a limited group of farmers that has a broad view of the different farming systems, and their knowledge is covering. On bases of their available information, they are able to choose the governance structure that suited best their farming needs. Nevertheless, there is a large group of farmers that has only a limited knowledge of the different possibilities and consequences of alternative business governance structures in agriculture and horticulture. Out of ignorance, they continue farming in sole ownership.

## 5.2 Limitation of transition to alternative business governance structures

Alternative business governance structures can be considered for fiscal, family and property reasons (see chapter 3). The perception of characteristics for both sole ownership and partnership, will reveal the significant differences in perception between different juridical forms (Table 3).

**TABLE 3 Perception of Farming Characteristics by Sole Ownership Farmers**

	-3 ← 0 → 3	average		paired sampled T-test
		sole ownership	partner-ship	
limited administration	extensive administration	1,29	1,68	-3,298 **
management less important	management important	1,44	1,49	-0,361
non flexible form of farming	flexible form of farming	1,08	0,47	3,702 **
legally complex	legally not complex	0,76	-0,11	4,436 **
not tax profitable	tax profitable	0,29	0,74	-2,702 **
capital intensive	capital extensive	0,14	0,10	-0,218
high capital risk	low capital risk	-0,18	0,40	-2,921 **

(\*\*: significance < 0,01)

According to farmers working in sole ownership, there is no difference in the importance of management between sole ownership and forms of partnership. Management is important in every juridical form. In average there is no explicit need for capital in the different governance structures. Extra capital in alternative business governance structures is not necessary in the perception of farmers under sole ownership.

Explanations of the limited transition to alternative business governance structures can be found in a higher administration, the legal complexity and the less flexible form of farming. In the perception of farmers, forms of partnership are more tax profitable and have a lower capital risk.

The fiscal and property reasons to adapt alternative governance structures are acknowledged by farmers working in sole ownership, but the complexity of these forms, both

in administration and legislation, limit the transition to alternative business governance structures.

### 5.3 Motivation of own governance structure

The knowledge and the perception of farmers towards the different governance structures can be set against the own juridical form of the farm. This reveals the reason way farmers are working in their current governance structure, with respect to the opportunities and threats of this form.

The farms that work under the sole ownership configuration, continue this form because they were used to do so. Also the government support for investments is an incentive to continue the current management. On the other side, alternative business governance structures are on average more adapted for the fiscal advantages and the limitation of risk, although limitation of administration seems to be not at all suitable. For alternative business governance structures in agriculture and horticulture, the farm transfer can occur in theory in a more fluent way than in sole ownership, but in comparison with partnership, more farmers in sole ownership indicate that a fluent transfer of the farm is an incentive to stay in this structure (Table 4).

**TABLE 4 Reason of Adaptation of Own Juridical Structure<sup>#</sup>**

	sole ownership	partnership	F-value
governance structure already existing	1,44	0,40	4,262 *
easy to receive government support	1,16	- 0,07	6,501 *
limited administration	0,29	- 0,87	3,947 *
fiscal advantages	0,39	0,73	0,723
fluent transfer of the farm	0,70	0,47	0,662
limitation of risk	- 0,13	0,80	3,471 *

(<sup>#</sup> score: -3: not at all applicable; 0: neutral; 3: totally applicable - \*: significance < 0,05)

An important aspect of the motivation of the own governance structure is also the intensity of information collection about alternative business governance structures. Significant more farmers with an alternative business governance structure attend workshops about other governance structures ( $P\chi^2 < 0,05$ ) and they discuss this subject more with extension officers.

Although the change of governance structure is not always obvious, 29,9% of the farmers has already considered to a smaller or larger extent the possibility of adopting another governance structure. Especially the farmers who have considered it to a larger extent, are not working under the current governance structure because of the easiness of receiving government support. They are also not continuing in sole ownership because this governance structure already exists.

### 5.4 Discriminant analysis

The underlying reasons of choosing for a particular juridical form, can be analysed by means of a discriminant analysis. This analysis gives the explanation why farms are choosing for sole ownership or partnership, based on the objective knowledge and the subjective perception of the different juridical forms.

Based on the motivation of the own governance structure, and the knowledge of the different juridical forms, 4 variables are restrained for further analysis:

- objective knowledge of the governance characteristics of the agricultural company
- limitation of risk as reason for adaptation of own juridical form
- limitation of administration as reason for adaptation of own juridical form
- governance structure already existing as reason for adaptation of own juridical form
- easy to receive government support as reason for adaptation of own juridical form

The restrained discriminant function (1) has an eigenvalue of 0,221, a  $\chi^2$ - value of 37,61 ( $P\chi^2 < 0,01$ ) and 42,5% of the variation is explained by the model. The individual possibility of choosing a governance structure does not allow a higher explanation percentage.

$$(1) \quad Z = -0,551 + 0,211 X_1 + 0,367 X_2 - 0,281 X_3 - 0,137 X_4 - 0,094 X_5$$

- with:  $X_1$  : knowledge of governance characteristics of agricultural company  
 $X_2$  : importance of limitation of risk  
 $X_3$  : importance of limitation of administration  
 $X_4$  : importance of governance structure already existing  
 $X_5$  : importance of easiness to receive government support

**TABLE 5 Standardized Canonical Discriminant Function Coefficients**

	Coefficients
$X_1$ : knowledge of governance characteristics of agricultural company	0,650
$X_2$ : importance of limitation of risk	0,632
$X_3$ : importance of limitation of administration	-0,534
$X_4$ : importance of governance structure already existing	-0,293
$X_5$ : importance of easiness to receive government support	-0,172

Alternative business governance structures will be adapted by farmers who have a higher knowledge of alternative business governance structures, such as the agricultural company. The limitation of risk is also important and they recognize that the characteristics of partnership can lower the risk for both the farmer and the farm family. On the other hand, the limitation of administration is less important than for farmers in sole ownership. The higher administration is compensated by a lower risk. The fact that the governance structure is already existing within the farm is important for sole ownership. They also attach importance to the government support.

Farmers working in partnership are not stuck by their juridical form: the partnership is a structure in which they are able to farm, but if other governance structures appear to have better characteristics for their farming situation, they will change it for the well-being of their farm and farming family.

## 6 CONCLUSIONS

Alternative business governance structures play a marginal role in the Flemish agriculture and horticulture. Only 7 % of the agricultural and horticultural farms in Flanders is managed through different forms of partnership. These juridical forms have opportunities for farms on fiscal, family and property grounds, but the attitude towards these juridical forms limits the transition from sole ownership to alternative business governance structures.

A survey among Flemish farmers reveals that the knowledge of governance structures is limited. There is only a limited group of farmers that has a broad view of the different

farming systems, and their knowledge is covering. They are able to choose the governance structure that suited best their farming needs. Nevertheless, there is a large group of farmers that has only a limited knowledge of the different possibilities and consequences of alternative business governance structures in agriculture and horticulture. Out of ignorance, they continue farming in sole ownership.

The fiscal and property reasons to adapt alternative governance structures are acknowledged by farmers working in sole ownership, but the complexity of these forms, both in administration and legislation, limit the transition to alternative business governance structures. Farmers already working in partnership are not stuck by their juridical form: the partnership is a structure in which they are able to farm, but if other governance structures appear to have better characteristics for their farming situation, they will change it for the well-being of their farm and farming family. Alternative business governance structures will be adapted by farmers who have a higher knowledge of alternative business governance structures and accept that the higher administration is compensated by a lower risk.

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