



Briefing on the Agribusiness Enabling Environment



# AgCLIR LESSONS FROM THE FIELD: CLOSING A BUSINESS



This publication was produced for review by the United States Agency for International Development (USAID), as part of the Agribusiness Commercial Legal and Institutional Reform (AgCLIR) diagnostic.

The business of agriculture occupies a critical space in most economies. Distinct and special among industries, agriculture is the dominant source of employment for a large share, even a majority, of the population in developing nations.

Accordingly, governments treat the regulation of agriculture and food differently than any other sector. Unlike the output of other sectors, many agricultural products are basic necessities: agriculture provides the food, fiber, fuel, and construction materials necessary to sustain human existence. Governments everywhere assume responsibility for assuring that the distribution of agricultural commodities is great enough and equitable enough to provide a reasonable quality of life for its citizens.

*Agriculture and Agribusiness: Closing a Business* is a briefer that mirrors the analytical framework used by the World Bank Group's "Doing Business" series ([www.doingbusiness.com](http://www.doingbusiness.com)) and adopted by USAID's Commercial Legal and Institutional Reform framework. Divided into four sections (Legal Framework, Implementing Institutions, Supporting Institutions, and Social Dynamics), this briefer highlights the specific issues that must be addressed in local legal, regulatory, and institutional environments if agribusiness is to be economically productive, contribute to environmental sustainability, and assure a safe and reliable food supply.

## CLOSING A BUSINESS: KEY CONCEPTS

A farmer deciding, after two rejected shipments, that the risks of producing green onions for the global market are too great and that the production of sweet potatoes for the local market would be better is effectively "closing the business" of green onion cultivation and starting another. The losses from the green onion business have already been absorbed by the household enterprise and sweet potato planting materials can be readily acquired. Such easy entry and exit characterize many agricultural enterprises in the developing world. Few legal barriers exist to prevent closure of one business and start-up of a new one.

As agribusinesses grow in scale and increase their levels of capitalization, however, entry and exit become more complicated. Significant amounts of credit, substantial investments in fixed assets, and contracts with employees need to be taken into account. Then, the option of bankruptcy becomes highly relevant to the process of closing one business and starting another. Bankruptcy law provides a "pre-determined set of rules concerned with the legal definition of insolvency, the liquidation of reorganization of the insolvent business, and the allocation of the financial consequences between stakeholders... This allows for efficient reallocation of the debtor's resources, which itself leads to greater public confidence in the security of their investments."<sup>1</sup>

Governments often bear some responsibility for the closure of agribusinesses in developing countries. There are two kinds of situations in the agribusiness sector that seem to

<sup>1</sup> USAID and Booz Allen Hamilton (BAH), *Commercial Law & Microeconomic Reform: A Practical Guide to Program Implementation* (March 2007). This publication can be found at [www.bizlawreform.com/CLIRTechPub-r2b.pdf](http://www.bizlawreform.com/CLIRTechPub-r2b.pdf).

engage governments and to prevent the use of normal bankruptcy procedures:

- Where the company in question holds a monopoly position (or is part of a small oligopoly) and failure would jeopardize consumers' or producers' interests; and
- Where the company in question has been grossly negligent and has raised issues of public and/or environmental health.

For various reasons, some developing country governments have awarded monopolies or quasi-monopolies to specific agribusinesses or have allowed limited numbers of firms in a particular area, thus creating oligopolies. In some cases, they are considered to be state trading enterprises or parastatal firms. In other cases, they are privately owned and managed but operating under special conditions. Fertilizer importers are a common example of this type of firm. State-run dairy industries or grain mills are another. Although in principle these firms are to operate along commercial lines and be profitable, in practice many of them have become insolvent. Rather than risk that there will be no fertilizer imports, however, governments intervene directly to prevent bankruptcy and the closing of the business.

The second situation could arise when a firm's action has created a liability of such public importance that special work-out procedures are required. Companies importing day-old chicks known to be infected with avian influenza, for example, could be prevented from simply closing when the fact of infection became known. The public health liability incurred would require government assessment of damages as part of the bankruptcy proceedings.

The liquidation or restructuring of an agricultural cooperative may present a special case of bankruptcy. Where the cooperative has been constituted as a legal entity and has sound corporate governance, closing it may be relatively straightforward. It will be important to ensure that processes that assure a fair and equitable outcome for all shareholders are established and followed.

## LEGAL FRAMEWORK

Bankruptcy law is relatively straightforward. Bankruptcy law generally provides two options for firms facing insolvency: liquidation or rehabilitation. Either option can be entered into voluntarily by the company owners (the debtors) or initiated by creditors (shareholders). It establishes the priority of creditors' interests, as well as other types of expenses or debts. It shares certain fundamental necessities with other commercial laws, such as the ability to execute judgments, the need for competently administered registries for real and movable property, and the existence of sound implementing and supporting institutions such as courts, administrators, and valuation professionals.

USAID recommends that, rather than incorporating procedures to address insolvency issues in civil or commercial codes, countries enact a single bankruptcy law to cover all enterprises or corporate entities other than financial institutions and insurance companies. The law should cover the following: commencement of process; creditors' involvement and treatment; the role of the court; corporate reorganization; corporate liquidation; and criminal provisions.

As noted above, to take into account specific situations in the agricultural sector, some attention to managing or remedying public health or environmental liabilities and to maintaining

operation during a period of reorganization due to the essential nature of the product or service provided may be necessary.

Further, given the continued existence of many parastatal entities in the agricultural sector, some consideration directed to addressing the insolvency and reorganization of this category of entities in particular is warranted.

## IMPLEMENTING INSTITUTIONS

Judicial institutions, financial institutions (creditors), and specialized organizations and consultants dealing with business work-out and reorganization play roles in implementing the process of closing or reorganizing a business under rules governing bankruptcies.

In addition, bankruptcies may involve a special insolvency agency rather than a court. At the company level, the appointment of administrators or trustees and liquidators is common. The administrators or trustees are designated to handle either the rehabilitation or the liquidation of the enterprise and are accountable to the court or agency with jurisdiction over insolvency cases. The disposition of the property and distribution of the assets may be designated to another individual or entity, known as the liquidator.

## SUPPORTING INSTITUTIONS

Court officers, such as bailiffs, and lawyers are an essential part of the judicial processes involved in bankruptcy. Professional associations are also useful for addressing the needs of bankruptcy constituencies and promoting the effectiveness of the bankruptcy system as a whole.

Because of the strong public interest in food and agriculture, extension services provide education and information that can help agribusinesses understand and initiate bankruptcy proceedings as needed.

Business advisors or consultants can provide the company and its appointed administrators with the advice needed to determine whether liquidation or reorganization is the best way to close the business. While international business consulting firms (such as McKinsey and Company and Bain Consultants) are sought for their advice in some cases, non-governmental organizations such as ACDI/VOCA, CNFA, and Technoserve are available to provide advisory services to smaller agribusinesses in many developing countries.

## SOCIAL DYNAMICS

Financial institutions wishing to expand agribusiness lending portfolios are perhaps most aware of the need for bankruptcy law and regulation as it underlies their abilities to recover assets in lieu of credit repayment.

The failure of state trading enterprises, parastatal production units, or state-managed "cooperative" apex organizations has probably had a larger impact on the majority of agricultural enterprises, however. Governments have often intervened to forestall an orderly process of liquidation or reorganization of such entities in the interests of consumers, corrupt but well-connected political figures, or an inability to agree on the appropriate state role regarding the function in question (Kenya Cooperative Creameries, and the Ethiopian cotton industry, for example).

Keeping publicly owned but failing agribusinesses going takes a toll on taxpayers and establishes a climate of uncertainty that

keeps new businesses from taking over the functions of the failed enterprises. Reorganization as private companies seems to be the bankruptcy remedy most often proposed by donors, but unilateral liquidation on the part of the government seems to be more effective (e.g., the Uganda Coffee Cooperative, the National Food Authority of Tanzania).

### About AgCLR:

AgCLR, or the Agribusiness Commercial Legal & Institutional Reform diagnostic is a unique tool for agribusiness enabling environment analysis that identifies the root causes of an inefficient or underperforming agricultural sector. AgCLR is a sector-specific adaptation of the United States Agency for International Development (USAID) CLR approach, which aims to improve the business enabling environments through sound analysis and strategic interventions. This series, Briefings on the Agribusiness Enabling Environment is intended to shed light on some of the most important, and least understood, components at the intersection of agribusiness and commercial law and institutional reform. All issues are available at <http://egateg.usaidallnet.gov/EAT>

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