Support for Farmers' Cooperatives

Executive Summary

European Commission

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Purpose and organisation of the study

The imbalances in bargaining power between the contracting parties in the food supply chain have drawn much scholarly attention but have also been closely examined by policy makers. The European Commission is committed to facilitate the restructuring of the agricultural sector by encouraging the creation of voluntary agricultural producer organisations. DG Agriculture and Rural Development has launched a large study, "Support for Farmers' Cooperatives" (hereafter: SFC), to provide background knowledge that will help farmers organise themselves in cooperatives as a means to consolidate their market orientation and so generate a solid market income. The specific objectives of the study are the following:

1. To provide a comprehensive description of the current level of development of cooperatives in the European Union. This description will pay special attention to the following drivers and constraints for the development of cooperatives:
    a. Economic and fiscal incentives or disincentives and other public support measures at the regional and national levels;
    b. Legal aspects, including those related to competition law and tax law;
    c. Historical, cultural and sociologically relevant aspects;
    d. The relationship between cooperatives and the other actors of the food chain;
    e. Internal governance of the cooperatives.
2. To identify laws and regulations that enable or constrain cooperative development.
3. To identify specific support measures and initiatives which have proved to be effective and efficient for promoting cooperatives and other forms of producer organisations in the agricultural sector in the European Union.

This Executive Summary provides the main findings of the study. But before presenting these results, a brief description will be given of organization of the project, the theoretical framework used, and the research methods applied.

The study was carried out during 2011 and 2012, by a European research consortium consisting of the following institutes:

- LEI Wageningen UR, The Netherlands: Krijn J. Poppe
- Wageningen University, The Netherlands: Jos Bijman
- Pellervo Economic Research PTT, Finland: Perttu Pyykkönen
- University of Helsinki, Finland: Petri Ollila
- Agricultural Economics Research Institute, Greece: Constantine Iliopoulos
- Justus Liebig University Giessen, Germany: Rainer Kühl
- Humboldt University Berlin, Germany: Konrad Hagedorn, Markus Hanisch and Renate Judis
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- Rotterdam School of Management, Erasmus University, The Netherlands: George Hendrikse and Tony Hak

In addition to the work of these consortium members, important contributions were made by national cooperative experts in all of the 27 Member States of the EU (see Appendix 1 of the Final Report for the names of all national experts). The data gathered in all 27 Member States has been presented and analysed in individual country reports. The data collected was also used in preparing eight sector reports, focusing on the role of cooperatives in the following sectors: dairy, wine, fruit & vegetables, olives and olive oil, cereals, pig meat, sugar and sheep meat. In addition, cross-cutting themes were studied at the EU level, leading to six EU synthesis and comparative analysis reports on the following themes: internal governance; policy measures;

position in the food chain; social, historical and cultural aspects; legal aspects; and transnational cooperatives.

In the second phase of the project, 33 cases studies have been carried out, and the situation in selected non-EU OECD countries has been investigated. The 33 case studies were divided into 15 transnational case studies and 18 national or sector case studies. Some of the case studies focused on individual cooperatives, others studied all cooperatives in a particular country or sector.

All of these background reports on the state of development in countries and sectors, these case studies, the EU-wide analyses, and the overview of experiences in other OECD countries, provide farmers, cooperatives and policy makers with useful insights regarding the market position and organisation of cooperatives and producer organisations as well as on the potential supporting and restraining role different regulations and policy measures may have on the development of those cooperatives and producer organisations.

Theoretical framework

The starting point of this study is the assumption that there are at least three main factors that determine the success of cooperatives in food chains. These factors relate to (a) position in the food supply chain, (b) internal governance, and (c) the institutional environment. These three factors constitute the three building blocks of the analytical framework adopted in this study in order to explain the performance of cooperatives (Figure A).

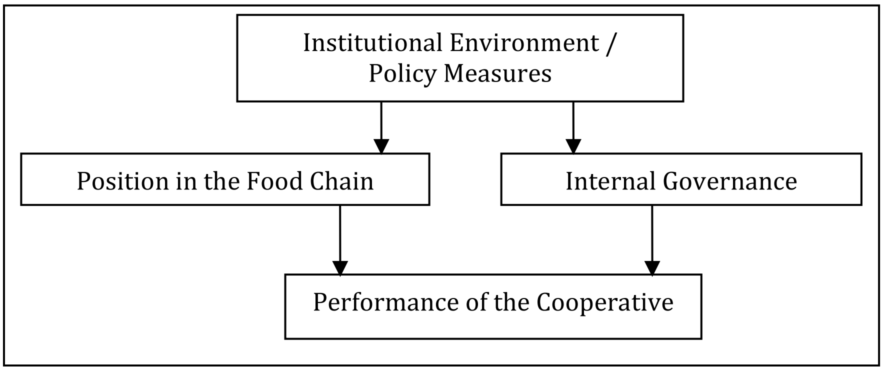

Figure A. The core concepts of the study and their interrelatedness

The position of cooperatives in the food supply chain refers to the competitiveness of cooperatives vis-à-vis its partners, such as processors, wholesalers and retailers. It also refers to the strategy that the cooperative follows in choosing a particular position in the food chain. Internal governance refers to the decision-making processes adopted, the role of the different governing bodies, and the allocation of control rights to members and professional management. Further, the internal governance refers to issues such as the organisational structure of the cooperative enterprise (e.g. the formation of holding and daughter companies). The institutional environment refers to the social, cultural, political and legal context in which cooperative operates, and which may have a supporting or constraining effect on the cooperatives' performance. History is an important ingredient of the institutional environment. For example, positive past experiences of cooperative development usually have resulted in the generation of trust and has boosted social capital – both necessary for efficient operation of the cooperative as well as for establishing new cooperatives. Legal aspects of the institutional environment, such as taxation and competition laws, are equally crucial in fostering or deterring cooperative development.

In defining cooperatives and producer organisations we have applied the three basic principles developed by Dunn (1988):

1. The User-Owner Principle: Those who own and finance the cooperative are those who use the cooperative.
2. The User-Control Principle: Those who control the cooperative are those who use the cooperative.
3. The User-Benefits Principle: The cooperative's sole purpose is to provide and distribute benefits to its users on the basis of their use.

These are simple and flexible principles, still encompassing a latitude of practices such as open or defined membership and one-member-one-vote or proportional voting. These basic cooperative principles can be found in the following organisational practices. Users typically control cooperatives by democratic decision-making structures. Capitalization of cooperatives is created by direct investments, retained patronage refunds, and per-unit capital retains. Benefits are realized by returning net income (or surplus) to patrons in proportion to use, by receiving/paying fair prices, and by gaining access to markets, supplies, and services. In sum, a cooperative has been defined as a "user-owned and controlled business from which benefits are derived and distributed on the basis of use" (Dunn, 1988: 85). While many different types of agricultural cooperatives exist in the EU Member States, our study focused on marketing cooperatives.

Main findings

Farmers' cooperatives play an important role in helping farmers to capture a higher share of the value added in the food supply chain in all Member States. The key functions of all marketing cooperatives are improving the bargaining power of their members and letting members benefit from economies of scale. In addition, cooperatives are reducing market risks, reducing transaction costs, providing access to resources, and strengthening their competitive position through product innovation and guaranteeing food quality and safety. A large number of cooperatives have expanded their activities in downstream stages of the food chain, thus strengthening their customer and consumer orientation by enhancing efforts in marketing (including branding), product innovation, and customization.

As agrifood supply chains are generally characterised by bargaining imbalances between farmers and their upstream and downstream partners, cooperatives play a key role in strengthening bargaining power and thus maximizing their members' share of the value added. However, generally the countervailing power of cooperatives vis-à-vis their retail customers is limited. The need for further strengthening bargaining power will most likely lead to more (international) mergers among cooperatives, while such mergers are also induced by seeking economies of scope in R&D and branding. To support farmers in this trend, legal definitions of producer organisations and support measures should not discriminate against large cooperatives. As this (international) growth process is often accompanied by changes in the internal governance, it holds the risk of a loss of member control over the cooperative firm.

We found that a large market share for cooperatives in a particular sector and country can increase the price level and reduce the price volatility, as is currently the case in the dairy sector. Also non-member farmers in this sector and country benefit from the large market share of the cooperatives. These non-member farmers may even benefit more, as IOF competitors generally pay higher prices. These findings are in line with the competitive yardstick theory. Cooperatives also continue to be important for reducing market risks for farmers, notably the risk of receiving payment for the deliveries.

A special type of farmers' cooperative is the bargaining association. Bargaining associations promote farmers' interests and are also a valuable partner for food processors, wholesalers and retailers, as they coordinate the supply of large volumes of products of homogeneous quality. Unlike marketing cooperatives, bargaining associations do not own assets and, usually, do not assume ownership of their members' produce at any stage of production or marketing. These associations are mainly active in the dairy and fruit & vegetable sectors. In Germany, they are also active in selling cattle and pigs.

A number of cooperatives and producer organisations perceive legal uncertainty in competition law and report high legal costs. They see a lack of coherence between the agricultural policy that promotes bundling under the Common Market Organisation (CMO), and competition policy that seems to prohibit information sharing and other forms of collaboration. Some other OECD countries (e.g. USA) have more – albeit under strict conditions – exemptions for cooperatives in competition law to rebalance market power.

Farmers have multiple options in organising the internal governance of their cooperative. In many cooperatives, however, there is room for strengthening management and supervision capacities. Most national laws provide sufficient flexibility for cooperatives to choose an internal governance model that fits the strategy of the cooperative, although such flexibility may not always be accompanied with – the so much needed – guidance. In some countries cooperatives and national legislators need to pay more attention to the ability of farmer-members to effectively control both the board of directors and the professional management, for instance by strengthening the capacities of the supervisory board and by allowing non-member experts in boards of directors and supervisory boards.

More than 300 European, national and regional policy measures were identified. Cooperative legislation, competition rules, and financial inducements were among those observed most often. There exist considerable differences between Member States, in terms of policy measures adopted. There are no clearly established links between the (current) support measures for farmers' cooperatives and the market share of these organisations. Also in other OECD countries it is hard to find an unambiguous link between legislation and cooperative performance.

Many support measures could potentially benefit cooperatives. Cooperatives particularly benefit from a flexible cooperative law, single taxation, and clearly defined competition rules. In some sectors producer organisations and cooperatives have benefitted from the CAP and some of its reforms (such as in the wine and F&V industries). We recommend that governments at the national and EU levels develop policies and measures to support capacity building and technical (organisational) assistance, especially in for small and start-up cooperatives. This is particularly true for the New Member States, where self-organisation is hampered by a lack of social and human capital.

The links between cooperatives and rural development are manifold. Cooperatives are often important employers and contributors to the regional economy. They contribute to public policy objectives such as the development of human capital, the improvement of competitiveness, and environmental sustainability. Quite a number of cooperatives build their strategy on regional characteristics, like in developing and marketing regional specialties.

Additional findings

All Member States have a cooperative tradition, although its origin and intensity differs. In some countries, the cooperatives are directly linked to market failure in large agricultural transitions at the end of the 19th century (Denmark, the Netherlands), or a movement for independence (Finland), others have seen periods were cooperatives were not politically correct (Portugal), or where the cooperative was not based anymore on self-organisation principles but was used as a socialist planning tool instead (New Member States). Consequently, the label "cooperative" has different connotations in different regions.

The marginal role played by cooperatives in some countries (and especially in the New Member States) has an important social background: the low level of self-organisation and networking is not only a barrier to cooperative development but represents a persisting societal characteristic with far broader implications.

Cooperatives account for a large share of farm product market in some sectors but not in others. Figure B shows the EU average; substantial differences exist, however, per country. The differences among the sectors are mainly due to the characteristics of the product and the production process. In the dairy and fruit & vegetables sectors cooperatives have an important market share due to the perishability of the product and thus the high transaction costs in trading this product. Also in wine and olive oil, cooperatives have a substantial although sometimes minority market share. In sectors like cattle, pigs and sheep, the animals are often sold under contracts to traders or non-cooperative slaughterhouses, but in some countries cooperatives continue to have substantial market shares in these sectors.

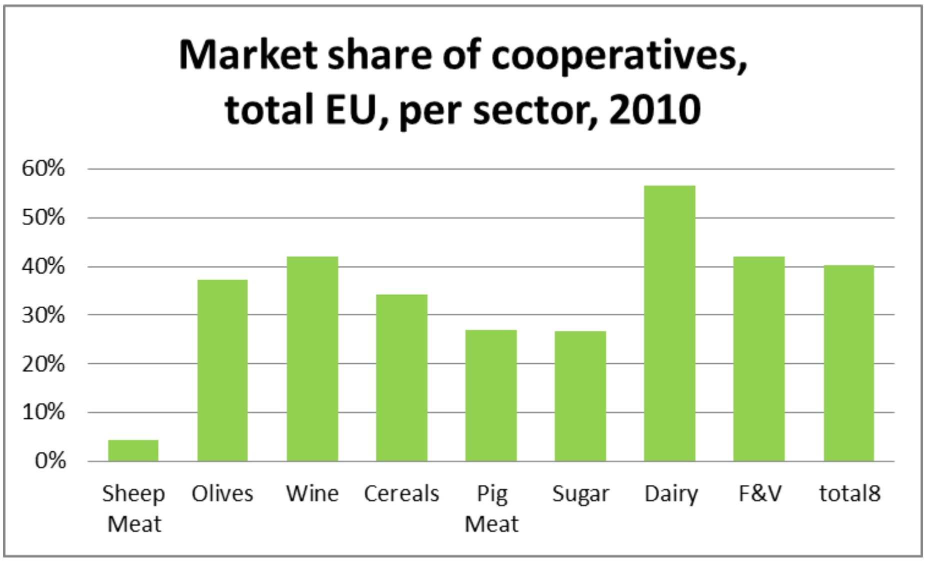

Figure B. Market share of cooperatives per sector, for EU as a whole.

Professional structures and policies regarding board composition and member participation affect the performance of cooperatives. Proportional voting rights, professional management, supervision by outsiders, and selection of directors on the basis of expertise or product representation and not regional origin, all have a positive effect on cooperative performance.

Branding activities performed by cooperatives differ by sector. Branded consumer products can be found in the dairy and wine sectors and, to a lesser extent, in the fruit & vegetables and olive oil sectors. They are, however, rare in the cereals, sugar, sheep and pig meat sectors.

Federated cooperatives are important in sectors and regions with many small cooperatives. They can obtain the economies of scale and bargaining power that local cooperatives cannot. However, as the long-run trend is that primary cooperatives become larger and more directly involved in marketing their products, the federated cooperative model may in the end disappear.

Several cooperatives have evolved into hybrid forms. This hybridization refers both to adopting organisational structures similar to those of investor-owned firms (IOFs) and to the development of non-user ownership structures. Cooperatives with hybrid ownership structures are still majority-owned by farmers, but not necessarily by farmers as users of the services of the cooperative but as members of a farmers' organisation. In these cases, one or more farmer organisations are among the owners of the cooperative. In addition, cooperatives with hybrid ownership structure may have allocated ownership rights to investors from outside the agricultural sector.

In addition there are many producer organisations that follow cooperative principles in their structure and operations but are not cooperatives as defined by national cooperative legislation. Whether farmers choose the cooperative (legal) form to strengthen their market position and bargaining power is usually driven by practical and not by ideological arguments, and depends very much on the institutional context, including legal, social and cultural aspects.

We found 46 transnational cooperatives (i.e., cooperatives with members in more than one Member State). They can be found mainly in the dairy and fruit & vegetables sectors in northwest Europe. They often have foreign subsidiaries that source from non-member suppliers, like the 45 international cooperatives that we also found. Most cooperatives prefer to internationalise by acquiring or setting up foreign IOFs, and not by merging with other cooperatives or inviting foreign farmers to become members. Avoiding the dilution of ownership (income and control rights) is cited as the main reason for this development. There are no dissuasive legal barriers in merging across borders.

The situation in the New Member States is diverse and contrasting due to differences in historical backgrounds, pre-collectivisation land reforms, post-collectivisation transformation laws, cooperative traditions and collective memories, policy streams and social and cultural contexts. However, all cases have in common that the impact of the communist legacy persists, as low trust is an obstacle to cooperative development. Building trust and coping with free rider problems, often in poor regions with vulnerable rural communities, reflect pioneer activities that resemble early stages of the cooperative movement in Western Europe. This calls for trustworthy and skilful leaderships.

The capitalisation of cooperatives is a major constraint in some regions, where risk capital and other forms of equity are not readily available or cooperatives fail to provide their members with adequate incentives. However, capitalisation is not the only or even the main barrier to cooperative development and often the (lack of a profitable) business model is a much more binding constraint.

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http://ec.europa.eu/agriculture/external-studies/index_en.htm

The project is managed by Wageningen UR (University & Research centre). Project managers: Krijn J. Poppe and Jos Bijman.

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