



# Small Producer Organization (SPO) Development, Strengthening and Resilience

## LITERATURE REVIEW

**Ellen Magnus and Ingrid Flink**

Royal Tropical Institute (KIT)



**KIT** Royal  
Tropical  
Institute

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# 1. Introduction

The Royal Tropical Institute (KIT) was asked by Fairtrade International to undertake research on understanding whether and how Fairtrade certified small producer organizations (SPO) have developed and strengthened over time, and how these processes have benefitted the members of the organizations.

Fairtrade aims to support empowerment among small producers and workers by helping them build independent, democratic organizations; improving their negotiation position with buyers; achieving economic stability; making joint investments and increasing their collective influence. Fairtrade understands empowerment as “the expansion of assets and capabilities of people to participate in, negotiate with, influence, control and hold accountable the institutions that affect their lives.”

Fairtrade defines small producers as those who rely on family members for farm work and do not hire permanent workers ([www.fairtrade.net](http://www.fairtrade.net)).

Moreover, Fairtrade understands that “a strong SPO is a sustainable organization with a balanced governance structure, in which democratic principles are practiced and the business is effectively managed based on the collective needs of the members. The above requires for an SPO to have good governance and business management capacities in place, serving a common purpose that is owned and internalized by its members.”

The formation, viability and resilience of small farmer organizations sits at the heart of Fairtrade's Theory of Change (2013). Fairtrade certifies all type of producer organizations, including cooperatives and associations ([www.fairtrade.net](http://www.fairtrade.net)). Fairtrade believes that when small scale farmers engage in collective action, they can achieve economies of scale, more power in markets, innovations in products and processes, and improved access to services and inputs on better terms. The cooperative organization must be set up in a transparent way and not discriminate against any particular member or social group, such as women (FLO, 2011).

Fairtrade acknowledges that internal and external factors contribute to (or obstruct) the performance of SPOs, and the basic conditions for their development to be successful. This literature review should identify those factors which support or block organizational progress, and generate

recommendations for future programmes focusing on organizational development. The main objective of this literature review is to inform the field research plan and analysis by building on the current literature.

## 1.1 METHODOLOGY

In cooperation with colleagues with expertise in researching and working with farmer organizations and informed by existing literature reviews on SPO functioning, we devised Figure 1 below, identifying all the internal and external factors of possible influence on the performance of SPOs.

Subsequently literature was searched through Google Scholar and reference lists of academic articles and scientific literature. Articles on Fairtrade organizations and audit reports per selected country were also reviewed in preparation for this work, but were not included in the literature review as such.

This literature review provides an overview of secondary literature found on the dynamics of internal and external governance of SPOs. Section 2 gives an overview of the different approaches and methods to research producer organizations that are cited in the literature review. Section 3 presents all the major insights gained with regard to internal factors that influence SPO performance. Section 4 summarizes the findings in the literature on external factors that impact the functioning of an SPO.

### *Defining producer organizations*

Different names are used for the same or similar types of farmer organization. Just to list a few examples encountered in the literature: farmer organization (Stockbridge et al., 2003), rural producer organization (Bosc et al., 2001), agricultural producer organization (Rondot and Collion., 2001), agricultural cooperative (Hussi et al., 1993), farmer association (Shen et al., 2005), producer group (Banaszak, 2008), and producer association (Fulton, 2005). All of them refer to groupings of two or more people who collaborate to achieve a certain purpose; they are rooted in rural areas; they are member-based organizations; they have a democratic structure that allows members to control the operation of their organization

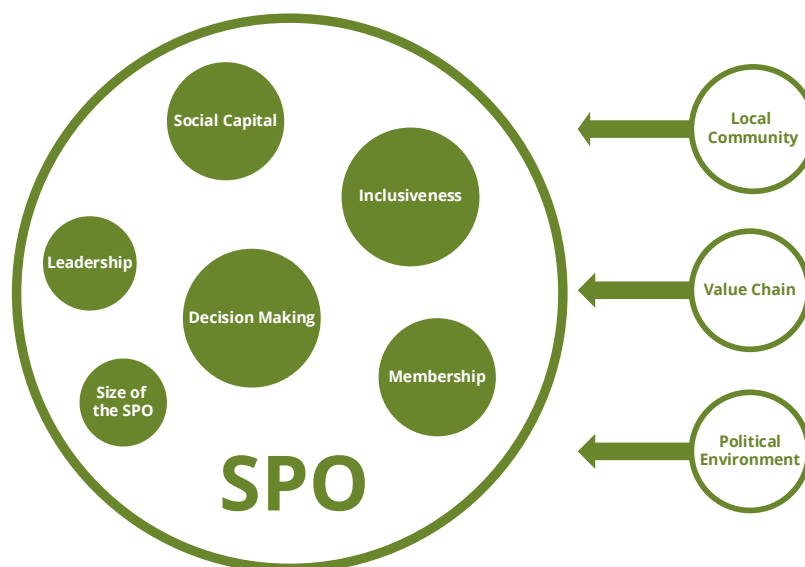


Figure 1: Internal and external factors of possible influence on performance of SPOs

(Bijman, 2007; Wennink et al., 2007) and they have an economic function (when functioning as part of the value chain) (Mangnus and de Steenhuijsen Piters, 2010). Throughout this literature review, the term SPOs will be used, referring to farmer organizations, associations and rural producer organizations.

Instead of looking at names, it is more useful to distinguish organizations based on their form.

Small producer organizations differ with regard to:

- Origin: some groups emerged from community collaboration, others have been instigated by external actors.
- Size: there are small producer groups of five people and umbrella organizations uniting 200 people.
- Gender balance.
- Legal status: most countries distinguish between formal organizations (in law often referred to as cooperatives) and informal organizations (in law often referred to as associations).

Most developing countries took at the ILO recommendations for cooperative law and recognize a cooperative as: an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.

The cooperative principles are guidelines by which cooperatives put their values into practice:

1. Voluntary and Open Membership.
2. Democratic Member Control.
3. Member Economic Participation.
4. Autonomy and Independence.
5. Education, Training and Information.
6. Co-operation among Cooperatives.
7. Concern for Community.
8. Membership Base.

- Functions: some organizations are involved in marketing only, others also in value addition, storing of produce, financing, lobbying, knowledge dissemination, etc.

- Purposes: farmers can organize for economic purposes, but also for social reasons, knowledge sharing or lobbying.

- Services provided: some SPOs function as brokers between farmers and service providers, other SPOs provide services themselves.

- Scale: Number of members.

• Level of operations: SPOs often operate at local level. However, often they are members of so-called second-tier organizations or umbrella organizations that operate at district or regional level.

While frequently rooted at the local (micro) level, they may also operate at the meso and macro levels through the economic and representative functions they perform (Bosc et al, 2002; Vermeulen et al, 2008). Each organization is socially embedded and

has a unique history of development (Coe et al., 2008). All producer organizations share some joint characteristics: they are rooted in rural areas, they are member-based organizations and they have a democratic structure that allows members to control the operation of their organization (Bijman, 2007; Wennink et al., 2007) and, when functioning as part of the value chain, they have an economic function (Mangnus and de Steenhuijsen Piters, 2010).

## 2. Methods to assess farmer organizations

This chapter gives an overview of examples of different types of research studies encountered in the literature to assess SPOs.

<i>Article</i>	<i>Aim of research</i>	<i>Method</i>	<i>Criteria/Indicators</i>	<i>Sample size</i>
Barham, J. and C. Chitemi, (2009). Collective action initiatives to improve marketing performance: Lessons from farmer groups in Tanzania. Food Policy 34: 53–59.	Identify the underlying factors that enable smallholder producer groups to improve their market situation.	Survey	Infrastructure: physical access to markets, agro-ecological factors, farming systems (distance to markets, road conditions, staple food crops, land, and reliable water source). Social structure: group assets, group composition and characteristics, and group heterogeneity. Partner agency intervention: the partner agency with which the farmer groups worked and whether or not the groups were actively linked to other market chain actors in an effort to improve their market situation.	34 groups with a mean group size of 35 members.

<i>Article</i>	<i>Aim of research</i>	<i>Method</i>	<i>Criteria/Indicators</i>	<i>Sample size</i>
Kalogeras et al., (2009). Understanding Heterogeneous Preferences of Cooperative Members. Agribusiness, Vol. 25 (1) 90–111	Identifying the organizational attributes of co-ops and the factors influencing heterogeneity in member preference structures.	Focus groups, individual member interviews	<p>Intra-organizational attributes: based on the definition of co-op as user-owned and user-controlled business that distributes benefits on the basis of use (USDA, 1995).</p> <p>Strategic attributes: strategic market choices made by co-ops.</p> <p>Factors influencing heterogeneity:</p> <p>-variance in the business size of members</p> <p>- risk attitude</p>	120 cooperative members
Bernard, T. and D.J. Spielman, (2009). Reaching the rural poor through rural producer organizations? A study of agricultural marketing cooperatives in Ethiopia. Food Policy 34, 60–69	Understanding the notion of inclusiveness in rural producer organizations (RPOs) and the extent to which such RPOs can be used to reach the rural poor in sub-Saharan Africa.	Two surveys (2005 & 2006)	<p>Inclusiveness and membership</p> <p>Inclusiveness and benefits</p> <p>Activities friendly to non-members</p> <p>Activities neutral to non-members</p> <p>Activities unfriendly to non-members</p> <p>Inclusiveness and governance</p> <p>Inclusiveness and performance</p>	<p>7,186 households randomly drawn from 293 kebeles</p> <p>205 cooperatives in 54 woredas (district)</p>

Article	Aim of research	Method	Criteria/Indicators	Sample size
Storbakk, A.E., (2013). Social capital and Rural Producer Organizations: An assessment of the relevancy of social capital in the functioning of Rural Producer Organizations in Bolivia. MSc Thesis, University of Agder	Examines the relevancy of social capital in the functioning of Rural Producer Organizations (RPOs).	Semi-structured interviews, observation, secondary analysis, and statistics	Members' expectations of the RPO and if the activities are in accordance with their needs	15 members of APROCMI, 17 members in AMAS, and 10 comuneros.
Vedeld, T., (2000)., Village politics: heterogeneity, leadership and collective action, Journal of Development Studies, 36:5, 105-134	The main aim of this paper is to explore the conventionally-held thesis that "the smaller and more homogeneous the group, the stronger its ability to perform collectively" <sup>1</sup> .	Household survey	<p>Group size and collective action</p> <p>Heterogeneity and capability for collective action</p> <ul style="list-style-type: none"> <li>- political heterogeneity</li> <li>- heterogeneity in endowments</li> <li>- heterogeneity in entitlements</li> <li>- heterogeneity in economic interests</li> <li>- heterogeneity in culture (level of education, values, life orientation)</li> </ul>	N=191

<sup>1</sup> In Ethiopia, kebeles or peasant associations (PAs) are the smallest administrative unit below the woreda (district) level. For purposes of comparison, kebeles correspond to a cluster of villages in many other sub-Saharan African countries

### 3. Internal Governance

Empirical data proves that SPOs are complex organizations. They exist because farmers share an economic objective and as such should be considered as firms. At the same time they are small communities. They are collectives of autonomous members that are owners, users and social actors at the same time. The interests of the members are not always aligned (Nilsson and Hendrikse, 2010). Collective decision-making enables SPOs to coordinate actions among members. However, such decision-making structures also make them susceptible to a wide range of “incentives problems” arising from conflicts between collective and individual goals (Borgen, 2004). In this section we discuss the internal factors which may influence the functioning and marketing performance of SPOs: size, decision-making procedures, leadership, membership, and the role of social capital in SPOs.

#### 3.1 SIZE

Group size is often referred to as an important denominator in the performance of SPOs. Nevertheless studies present contradictory findings.

Coulter et al., (1999) mention that small group size provides for strong internal cohesion and makes it easier to know and monitor other members. Markelova et al., (2009) confirms this; small groups do have more internal cohesion. According to them this is because members know each other and grassroots groups are often rooted in local communities.

Nevertheless, Markelova et al. (2009) also state that larger groups allow for enhancing economies of scale and are able to reach more farmers. Achieving economies of scale is one of the key mechanisms through which farmers' groups can improve the collective bargaining power of small scale producers (Muriadan, 2013). The scale of operations is a key source of counteracting power in farmers' groups, vis-à-vis other agents in the value chain, and is among the key ‘*raison d'être*’ of cooperatives (Valentinov, 2007). From this point of view, increasing the group's size is important for an SPO in order to perform well in marketing.

The pitfall of merely increasing size is that the cost of coordinating actions among members also increases. In addition, larger groups require a higher level of delegation of management tasks to the board of directors or the managers, increasing

the probability of principal-agent problems (Levi and Davis, 2008).

Evidence shows that when SPOs professionalize and establish a management responsible for the day-to-day running and marketing performance of the SPO, there is a risk that incentives motivating the persons in charge of managing the firm will not align to those of the members. For example, from a management perspective, it might be wise to target high value markets and only buy quality produce from the members. Members, on the other hand, joined the cooperative to be able to have a better market for all their produce. The chances of these types of problems are higher if there is a considerable educational gap between managers and the members, as it is often the case in cooperatives operating in poor rural areas in developing countries. This explains why, in some circumstances, smaller groups function better, as compared to larger ones, despite having lower bargaining power (Chagwiza et al., 2013).

The trade-off between these two variables (economies of scale and coordination costs) suggests that probably there is an ‘optimal’ group size. Such optimal size would depend on a variety of factors, such as the level of members' heterogeneity, the products concerned, the decision-making structure and the level of social capital among members. Place et al. (2004) have found evidence supporting the hypothesis that optimal size depends on a variety of factors. They show that middle-sized groups of Kenyan farmers showed a higher level of performance compared to both the smallest and the largest groups.

Larger groups often also require tighter rules for membership since it is more difficult to rely on more informal, community-based rules. This may lead to more barriers for accessing the group and hence lead to the exclusion of the poorer, less resource-endowed smallholder farmers (Markelova et al., 2009). Inclusion and exclusion dynamics in SPOs will be elaborated on further in Section 3.4. Then, larger groups also require implementing rules to promote common interests and action, and to prevent ‘free riding’ of membership services. Agreeing and implementing these rules to meet the collective needs of all members is generally more difficult with larger and more heterogeneous SPOs and where the benefits of collective action are uncertain, not clearly limited to or identified with categories of members (Chirwa et al., 2005).

*Key learning points for the fieldwork:*

- Success in marketing depends on group size. SPOs with a large number of members benefit from economies of scale. However, they also risk having coordination and decision-making problems.
- Size also influences internal functioning: smaller groups have stronger social cohesion.
- The optimal size depends on the level of members' heterogeneity, the products concerned, the decision-making structure and the level of social capital among members.

**3.2 DECISION-MAKING**

A characteristic of SPOs is collective decision-making, which encourages member commitment and a feeling of ownership. An organization usually performs better when its members are involved in decision-making, as they are often closest to the information needed to make decisions. Also, by participating they will feel involved and be motivated to take responsibility for their actions. Decisions based on group consensus usually produce better results than decisions that are taken by a sole leader (Mangnus and de Steenhuijsen Piters, 2010).

However, a collective decision-making structure also makes SPOs susceptible to a wide range of 'incentives problems' arising from conflicts between collective and individual goals (Borgen, 2004).

Democracy gives each member at least one vote, but in a large organization this vote can be of almost zero influence. Moreover, democratic decision-making in SPOs means that the majority rules (or even that decisions are taken by consensus). The majority, however, is usually rather conservative, that is, opposing change.

The literature shows that, on the one hand, decision-making structures should be based on the recognition of members' rights and influence. However, on the other hand, decision-making procedures should also take into account the external environment. In the case of a marketing cooperative, for example, it is important that the cooperative is able to respond to market demand and standards, and this might mean decisions that are not favored by the members.

In their paper on inclusiveness in rural producer organizations (RPOs) in Ethiopia, Bernard et al., (2009) use various indicators to measure participation in decision-making processes in Ethiopian farmer cooperatives based on a series of questions meant to identify who the decision-makers are for a series of commonly-taken decisions. The decisions considered included: (a) the inclusion of new members, (b) the expulsion of existing members, (c) the start of a new activity within the cooperative, (d) collaboration with a new partner, (e) the amount of dividends to be distributed, (f) investment in new materials or infrastructure, (g) the amount of output to buy, (h) the amount of output to sell, (i) the amount of output to store, (j) the amount of input to buy, (k) the amount of input to sell, (l) the time to sell, (m) the price given to members for their outputs, (n) the person or organization to buy input from, (o) the person or organization to sell output to, and (p) the market on which to sell.

The results from the research in Ethiopia, showed that an average of 19 percent of all decisions were open to all members. As for the general decisions, the average reaches 38 percent, and only eight percent for the technical decisions.

According to Bernard et al. (2009), there is no clear consensus in the literature on the extent to which performance outcomes are directly related to democratic decision-making procedures in SPOs.

*Key learning points for the fieldwork:*

- Democratic voting structures do not mean that farmers express their real needs. Often they adhere to community norms, in which certain power structures are legitimized.
- So far, no causal relation has been found between democratic decision-making and success in marketing. Contracting of professional managers from outside the community can contribute to management and coordination. However, as they are detached from the community and focused on profit and the running of the business they risk neglecting the needs and motivations of the members and lose member commitment.

### 3.3 LEADERSHIP

Leadership plays an important role in mobilizing members and, at the same time, guiding the SPO in response to requirements of the external environment. However, SPOs need to find the right balance between leadership continuity, ensuring effective management, and leadership rotation – an important function of accountability and grassroots control and creating space for new ideas. As a consequence of lack of availability and competence issues among members in rural communities, leaders often stay several years in position. Most SPOs require leadership rotation by limiting the number of years that leaders can hold their position. However, it is not uncommon for leaders to remain in their position for much longer. A more effective approach can be to invest in leadership training for potential new leaders, while encouraging leaders to recognize the benefits of leadership rotation by organizing exchange visits with other SPOs where this is common practice (Penrose-Buckley, 2007).

In order, to avoid fixed leadership, a sound voting system should be in place. Penrose-Buckley (2007) mentions that in many SPOs, voting is conducted by a show of hands, which can constrain the ability of women and other marginalized members to vote freely. Introducing a secret voting system could change this.

Rubin et al. (2009) found that leadership of SPOs is often gender-biased. Perceptions about men's and women's leadership qualities, as well as structural constraints on time and mobility, tend to channel men into senior leadership and restrict women to clerical positions. This certainly has a consequence for performance of the group as a whole: women members will be more loyal to the organization and benefit more broadly from association membership when they have equal opportunity to participate in group leadership and to set association priorities and policies.

Another way of encouraging more representative leadership within SPOs is to introduce a formal quota, which makes it a requirement for each level of the organization to involve a minimum number of women leaders for example (Penrose-Buckley, 2007).

Above all, what is important is that leaders should be trusted, able to motivate the members and should possess business and networking skills. (Mangnus and de Steenhuijsen Piters, 2010). Cracogna and Garzon (2003) consider that a leader must be honest, competent, visionary and inspirational.

According to a number of authors, strong leadership with centralized decision-making processes leads to better outcomes, while too much participation by inexperienced members may limit the capacity of the group to pursue profitable strategies (Tendler, 1983; Staatz, 1987; Bianchi, 2002). The distribution of tasks and responsibilities between the members, the (elected) board and the (appointed) management may give rise to competence issues in the sense that not all individuals have the capacity to perform certain tasks or responsibilities. (Bijman and Ruben, 2005). Others argue that participatory governance is a means of enhancing the sustainability and effectiveness of the organization by adjusting decisions to local conditions and customs, and constitutes a desirable outcome in itself (e.g., Attwood and Baviskar, 1987).

#### *Key learning points for the fieldwork:*

- Leadership that does not rotate does not mean decision-making is not democratic. It might also be an indicator of lack of capable leadership among the SPOs members.
- There is a trade-off between member participation in leadership and the marketing performance of the SPO. Professional leaders might be able to make better business decisions.

### 3.4 INCLUSIVE OR EXCLUSIVE MEMBERSHIP?

SPOs are representing a multitude of farmers: large, small, marginal, men and women, young and old, subsistence and/or market-oriented. The needs, interests and ambitions of these farmers vary greatly. Many organizations struggle to truly represent this diversity. Who are the members? Whose agendas dominate? Is the organization inclusive? Can it be really inclusive? Are women's interests sufficiently addressed? And what structures and systems are in place to allow for this?

Bernard et al. (2009) found that although the majority of cooperatives declare that their membership is open to all individuals, all of them condition membership on the fulfillment of particular criteria. Often, the condition is of a financial nature. Farmers with the smallest land sizes tend to be excluded from agricultural cooperatives, since they face difficulties in meeting membership requirements and the costs of collective action probably offset its benefits among this type of farmers. The amount they sell is often little and the costs of membership contribution and

time required to spend in meetings might be too high. (Bernard et al, 2009).

There remains limited quantitative evidence on SPOs' capacity to effectively reach poorer households, particularly in sub-Saharan Africa. Within cooperatives, decision-making tends to be concentrated in management committees that are less inclusive of the poorest members of the organization. Significant differences in wealth are found between leaders and members, and how these differences may be related to the level of participation in the cooperative (Bernard et al., 2009). Results from a survey among grain marketing cooperatives in Ethiopia confirm these exclusivity dynamics: the poorest smallholders are often excluded. This may be a choice of the smallholders not to join the group (e.g. low expected financial returns) or the reluctance of the organization (e.g., high financial contribution required (Bernard et al., 2008). Exclusion of some members can induce lower levels of trust between the members and the managers and therefore lower levels of members' commitment and sense of group identification, which would affect the SPO's performance negatively (Nilsson et al., 2012; Hernandez-Espallardo et al., 2013).

From a gender perspective, membership criteria sometimes discourage women's active participation by insisting on a single membership for an entire family or by requiring demonstration of legal land ownership, as is the case in Tanzania (Tovo, 2010). In patriarchal societies, the head of the household (often the man) will be appointed to become a member, instead of the woman. A positive example from the producer organization Fedecares in the Dominican Republic, however, showed that they intended to make membership more inclusive by extending membership to spouses. This would enable women to participate more actively as well (Penrose-Buckley, 2007).

#### *Key learning points for the fieldwork:*

- There is a trade-off between being a social 'inclusive' SPO and performing well in marketing.
- The influence of women in gender-mixed SPOs is often minor.

### **3.5 MEMBERSHIP HETEROGENEITY**

Farmers differ in age, location, size, their investment portfolio, amount of capital investment, social background, attitude towards risk, and being

an active or retired SPO member. Membership becomes more heterogeneous as farmers move from being producers of generic commodities for local markets towards producers of specialized products targeted at high quality markets. As mentioned earlier in Section 3.2, as SPOs become larger and more heterogeneous, agreeing on rules and decisions becomes generally more difficult.

Decision-making may become more laborious (Hansmann, 1996), coordination between members and the SPO may become more difficult (Hendrikse and Bijman, 2002), member willingness to provide equity capital may be reduced (Van Bekkum, 2001), and member commitment may decrease (Fulton and Giannakas, 2001) with heterogeneity. Commitment can, for example, reduce as a consequence of a perceived lack of connection between members' efforts and cooperative success (Bijman and Ruben, 2005).

In sum, membership heterogeneity could affect the efficiency of the cooperative organization. The number of activities increases, sub-group pressure is likely to emerge resulting in control issues and rising influence costs. In addition, free rider problems can be intensified and the risk is that membership commitment declines (Bijman and Ruben, 2005).

Members' homogeneity is expected to facilitate communication and the alignment of incentives, thus reducing coordination costs. However, homogeneous groups may encounter disadvantages in creating connections with other parties in the market, which are usually crucial for developing marketing functions properly (Muriadan, 2013).

In a case study of two village-based common property regimes in Mali, controlled by Fulani agro-pastoralists, and used to inform a discussion of the effect of heterogeneity on the capability of groups for collective action, Vedeld (2000) found that homogeneity among elite groups does enhance capacity for collective action. Collective action was enhanced when political elites and leaders were better endowed and wealthier than the average community members, but only as long as the level of their assets was not antithetical to the economic interests and sense of fairness of other social groups.

Barham and Chitemi (2009) report that gender composition also influences the performance of farmers' marketing groups. Having males within the group affects marketing performance positively. This may be explained by the structure of male

networks, which normally involve more external ties (outside the group).

The interests of women and men also differ. A study from Northern Nigeria shows that men are more likely to join production-oriented groups, which tend to be linked to land ownership, while women tend to join more civic groups. Men also tend to participate more in collective action for community development because of their public orientation and relative power roles within communities, e.g., building schools and roads. In turn, women tend to engage more in informal networks, e.g., running schools, childcare (Wennink, 2010). Women negotiate within the established social structure for better conditions (Abdulwahid, 2005). Studies undertaken in Ghana, Ethiopia and India found that women were less likely to join farm-based organizations (Quisumbing and Pandolfelli, 2010).

#### *Key learning points for the fieldwork:*

- Membership homogeneity contributes to efficient internal governance but might limit an SPO's capacity to link with external actors.

### **3.6 THE ROLE OF SOCIAL CAPITAL IN SPOS**

Coordination costs and transactional risks can be reduced by informal mechanisms such as social relations. Social structure can restrain agents from opportunistic behaviour and facilitate information exchange (Platteau, 2000). Embeddedness of transactions in a social context can reduce the cost of safeguarding against opportunism by diffusing information about reputations and by facilitating collective sanctions. Governance based on social and informal interaction, often called 'community governance' (Bowles and Gintis, 2002; Hayarni, 2009), relies on the set of shared norms that regulates how transactions will be carried out repeatedly over time, how commitments will be monitored and what sanctions will be imposed in case of non-performance.

Since it is highly likely that members of a community who interact today will interact in the future there is a strong incentive to act in socially beneficial ways now to avoid retaliation in the future. Communities often are capable of enforcing norms and overcoming member free rider problems by directly punishing 'antisocial' actions, even without the punisher expecting to be personally repaid for this (Bowles and Gintis, 2002; Hayami, 2009).

The set of social relations that helps to reduce

transaction costs has often been studied under the heading of social capital. Social capital can be defined as "social networks, the reciprocities that arise from them and the value of these for achieving mutual goals" (Schuller et al, 2000). It is about the moral norms that one shares with people with whom one has common feelings of identity (Coleman, 1988). Moral norms are informal rules that facilitate, motivate and govern joint action of members of close-knit groups and reduce incentives for opportunistic behaviour (Ostrom, 1999; Platteau, 2000). Borgen (2001) argues that identification with the collective organization conditions members' trust in the benevolence/intentions of the management, and this, in turn, influences members' commitment. Along these same lines, in Swedish cooperatives, Osterberg and Nilsson (2009) found members' perceptions of their participation in the governance of the organization to be key determinants of trust. Here, the role of voice (Hirschman, 1970) seems to be important in the process of trust-building.

Then there is also so-called 'bridging' social capital, which involves connections across explicit or institutionalized power gradients in society to people in influential positions (Szreter and Woolcock, 2004).

Fafchamps (2006) argues that social capital supports trust and reduces the cost of information exchange. Social capital reduces coordination costs and by increasing the likelihood of contract compliance it reduces transaction risks. Trust and norms are linked to the social capital of smallholder farmer groups and organizations. Trust can be defined as confidence and is based on norms which define what actions are considered acceptable or unacceptable (Lyon, 2000).

A cooperative with strong social cohesion may have a comparative advantage in coordinating members' activities through interpersonal and organizational trust (thus reducing monitoring and sanctioning costs). In a context of high coordination requirements along the value chain, internal social capital may be insufficient to enhance the cooperative's performance, since reinforcing bonding social capital may take place at the expense of investments in bridging social capital. In cooperatives with a high level of internal social capital, members risk being 'locked in' a low innovative or inefficient situation. Cooperative members may also be subject to the 'paradox of embeddedness' (Uzzi, 1997), which means that an organization has difficulty accessing new information and learning new routines and skills because it is too embedded in one network.

While internal social capital works well for horizontal coordination, particularly in small and homogeneous groups, it may be less suitable for value chain participation (Muradian, 2013).

#### *Key learning points for the fieldwork:*

- Trust relations support effective internal coordination.
- Strong internal social relations might point to the absence of external linkages, which are important for succeeding in marketing and innovation.

## 4. External Governance

The objective of this chapter is to systematize the evidence found in literature about the relationship of (members of) SPOs towards other actors along the value chain, the government sector, civil society, the local community (non-members), neighboring communities and other associations or institutions. Staal et al. (1997) say that SPOs co-ordinate actions both horizontally (among members) and vertically (with value chain agents).

### 4.1 EXTERNAL SUPPORT VS AUTONOMY

In many development interventions it is assumed that it is best to build on 'existing' collective action structures rather than take a top-down intervention approach. Farmers often have a history of collaborating and it is most effective to respect these existing cooperation structures. As Levi and Davis (2008) conclude: the existence of internally crafted rules has been singled out as a key factor determining the success of collective action in general, and agricultural cooperatives in particular. However, the findings in the literature do not always support this idea. Existing ways of working together do not always help new groups to succeed in marketing (Shiferaw et al., 2011).

Literature also presents contradictory findings with regard to the sustainability of farmer organizations set up by actors from outside the community. Some studies find that farmer organizations set up by companies or NGOs often dissolve after the programme/financial support is no longer there (Markelova et al. 2009). However, after reviewing collective arrangements for integrating small scale farmers into agricultural markets in Eastern and Southern Africa, Poole and de Frece (2010) conclude that "most successful cases of collective enterprise creation have depended on a substantial degree of intervention from NGOs and international donors." External agents can facilitate the acquisition of managerial and technological skills, as well as

cover the initial high transaction costs involved in the creation of farmer groups. Such high set-up costs are a major barrier for the establishment of cooperatives.

In many countries in Africa and Eastern Europe cooperatives have a negative connotation because in the past they were initiated and managed by the state. Producers were forced to become members and were obliged to sell their products through the cooperative marketing organization. The distribution of farm inputs was also carried out by state-run organizations called cooperatives. In many countries, these organizations were used by the elite as vehicles for individual or partisan political enterprises. The state domination, low efficiency and even fraud that accompanied many of these organizations has led to a deep distrust among producers of any collective organization. External interference (particularly by the state) has been identified as one of the key reasons behind the failure of cooperatives (Lalvani, 2008). Too much control by external stakeholders can lead to problems, such as a weak sense of ownership among members, which leads to low member commitment, and weak accountability by the board and management.

The recent boom in agricultural cooperatives in China shows that a favourable policy environment might be very effective in promoting cooperative development (Deng et al., 2010). The challenge is then to find the right and delicate balance between external support and enough autonomy in cooperative development.

The literature also shows that SPOs are attracting other sources of funding. In research prepared by Boonman et al. (2011) on behalf of the Dutch Association of World Shops (DAWS), results showed that in Latin America, five out of seven producer organizations indicate that they make use of external funding (71 percent), while the remaining

two out of seven (29 percent) indicate they do not use external funding. In Africa, 60 (54 percent) out of 111 organizations used external funding, while 51 (46 percent) did not. In Asia, the figures were 26 (51 percent) out of 51 which did and 25 (49 percent) which did not. The organizations that make use of external funding were asked to report from which sources they obtained their funding. There were six options: churches, community funding projects, international donor societies, banks, customers and a residual category 'other'. The sources of funding that are used most often by Fairtrade producers are churches and banks.

#### *Key learning points for the fieldwork:*

- Political context (also history) is important. Many African countries have a history of state-imposed organizations: farmers were obliged to organise and collectively sell their produce to state enterprises. Many farmers have negative associations with SPOs.
- The history of an organization (composition, membership, functions) is key to understanding its sustainability.

## 4.2 SPOS AND THE LOCAL COMMUNITY

Although Fairtrade farmers gain direct benefits from being part of a Fairtrade SPO, the benefits do trickle down to the wider community as well. In any case, this is the intention: "Investment of the Fairtrade Premium by co-operatives in community development projects like improved health facilities and better access to education for children and adults is improving the quality of life of rural communities" (www.fairtrade.net).

In the literature, there are contradictory findings on the benefits to the wider community. Ronchi's (2002b) study of Kuapa Kokoo is one of the few assessments which explore how community members feel about the community investments that have been made, and what kinds of changes have resulted (e.g., with positive views expressed about improvements in school attendance, the quality of health and education provision, the development of a new entrepreneurial spirit, etc.). Similarly, Moberg (2005) also found clear evidence of positive changes: there was general agreement, both among Fairtrade and conventional growers, that the Fairtrade movement has materially benefitted farmers in the Windward Islands. These benefits accrue primarily from the Premium funds generated by Fairtrade bananas, which have funded

an array of community services otherwise beyond the reach of most rural residents (Moberg, 2005). A study on Fair Trade-Organic Coffee Cooperatives, Migration, and Secondary Schooling in Southern Mexico shows that collective marketing groups also include non-economic development effects, such as increasing the level of women's schooling among members' households (Gitter et al., 2012).

Next to social impacts at community level, environmental impacts have also been captured. The transition to organic cultivation of coffee (supported by Fairtrade) has encouraged some Fairtrade farmers (and non-Fairtrade farmers in the same community) to adopt organic practices in food production in the milpa (Jaffee, 2008). There are cases where local community members benefit from Fairtrade investment in community infrastructure rather than changes in the prices of their produce. Jaffee (2007) suggests this is particularly the case in close-knit, remote communities in Mexico, with a strong ethic of reciprocity. Farmers are learning from each other, with organic practices spreading to neighbours' food production (Jaffee, 2007). This demonstration effect was also found in the study of the Fairtrade VREL banana plantation (Blowfield and Gallat, 1999; Ruben et al., 2008). Fairtrade is supporting plantations which already have progressive labour relations, but Fairtrade is also helping them to improve practices on the estate and possibly having a demonstrative effect on labour conditions in neighbouring plantations.

Aguilar (2007) also mentions a range of impacts which reach beyond individual producers and their Fairtrade organization (e.g., transport and tourism services, higher export taxes for the treasury, creation of employment, etc.). Positive benefits may also accrue in less tangible, but no less important wider impacts such as promoting social cohesion in post-conflict situations. This effect was observed in a study of Fairtrade in Guatemala (Lyon, undated) in which the solidarity ethos of cooperatives is supported and civil spaces for participation created.

Not all studies state that there is a positive effect on the wellbeing of Fairtrade and non-Fairtrade producers. OPM/IIED (2000) states that the effects can be limited in scale. Because of the size of the overall Fairtrade Premium, there are instances in which benefits do not accrue at producer level – the Premium amounts are so small that instead they are used at cooperative level (OPM/IIED, 2000).

Furthermore, in a number of studies (e.g., Stonehill, 2006), producers have argued that the Fairtrade Premium should be divided up among individual producers to enable them to survive and to invest in

production. When economic conditions worsened this pushed members of the Ija'tz co-operative in Guatemala to divide up the cash dividends to supplement their meagre incomes, so there may clearly be situations in which the Premium is valued more as a means of survival for economically vulnerable producers, rather than as a source of funding for social initiatives.

Although some authors raised questions about whether negative regional externalities could arise (e.g. depressed demand for produce from non-Fairtrade farmers) there was limited empirical evidence to support this (Nelson et al., 2009). A small number of other studies show that non-Fairtrade farmers are benefitting from raised prices as a result of competition induced by Fairtrade (e.g., Jaffee, 2007; OPM/IIED, 2000).

#### 4.3 SPOS IN THE VALUE CHAIN

The internationalization and concentration of agricultural value chains have increased the need for vertical coordination in value chains. More vertical coordination means that the activities and investments of individual economic actors (such as producers, processors, traders and retailers) along the value chain become more closely aligned.

Vertical coordination in value chains implies that farmers are not merely suppliers, but have to adapt their supply to requirements of the parties they transact with. In order to be assured of a market, cooperatives, for example, have to invest in their reputation towards customers and perhaps a brand image. Muriadan et al. (2013) mentions that cooperatives can safeguard these investments, for instance, by introducing more hierarchical governance in member-cooperative transactions or even by excluding members who are unable to comply with the standards needed to protect the brand. Conflicts of interests may arise between individual members and the cooperative as a supplier to other agents of the value chain. For example, members are often interested in selling all of their produce to the cooperative, regardless of the quality; the cooperative, in order to meet buyers' requirements, must put in place a strict quality control system. If decisions about quality standards are taken democratically, there is a chance of the majority choosing to set low standards, which may lead to a collective action dilemma and a group failure (i.e., losing market opportunities). According to Guillermo Denaux Jr., from FLO International<sup>1</sup>, several Mexican cooperatives export their produce

jointly. This can significantly reduce the costs of exporting to consumer countries.

Depending on the level of asset specificity and uncertainty people leave governance either to the market or internalize it. On the scalar between market governance and hierarchy there are hybrid governance structures, of which the cooperative is one (Menard, 2007). According to Bijman et al. (2011), the cooperative form is particularly efficient among producers of perishable products, where asset specificity is high and products need to be processed quickly (as in the case of milk) or need to be distributed to consumers quickly (in the case of fresh vegetables).

Roy and Thorat (2008) studied an Indian cooperative in high value vegetables, Mahagrapes, and found that members earn a significantly higher income compared to non-members. They explain this by the fact that Mahagrapes succeeded in achieving scale economies in information procurement and processing for export markets. They find an important role for a group of lead farmers with greater skills in procuring information and disseminating it to smaller farmers. The cooperative is relatively big, which is important for cost bearing of branding.

Higher standards are, however, often achieved through more hierarchical decision-making structures at the expense of democratic decisions (Bijman et al., 2011). These dilemmas are specific to cooperatives (due to the fact that their owners and providers are the same people). Hence, meeting quality and other standards in highly coordinated value chains might constitute a significant management challenge for agricultural cooperatives. Indeed, Poulton et al. (2010) argue that the complexity of cooperatives' decision-making structures may be a burden when it comes to responding quickly to changes in buyers' requirements.

#### 4.4 INFLUENCE OF SPOS AT THE NATIONAL LEVEL

In principle, all Fairtrade organizations have a role in lobbying, either in actively trying to influence policy or by showcasing success stories of positive impact. Extracted from a comprehensive literature review completed by Nelson and Pound (2009), the box below presents a number of examples proving the influence of Fairtrade cooperatives at national level.

<sup>1</sup> Fairtrade Labelling Organization or FLO refers to Fairtrade International

**Organizational empowerment effects**

•Ronchi, (2002b): Kuapa Kokoo, Ghana: Following Fairtrade support, Kuapa Kokoo is now strongly representative at the national level in Ghana.

•Ronchi, (2002a): Coocafé, Costa Rica: Producer organization has also allowed Fairtrade farmers to voice their opinions collectively, thus increasing their power at national level. Members reported that their association with Fairtrade and FLO<sup>2</sup> as an international movement had supported them to voice their concerns in a local context that is not usually conducive for small producers (Ronchi cited by Nicholls and Opal, 2005, p.212). The cooperative initially began in a poor area with six poorly-run cooperatives. With strong leadership and Fairtrade support they have built capacity, improved their access to credit, found new markets and evolved into a successful group.

•Luetchford, (2006): Coocafé, Costa Rica: Initially the primary cooperatives had no influence on the national stage, but through their affiliation they now have links with and representatives in a wide range of government departments, cooperative organizations, financial institutions, export agencies, NGOs and campaign groups. One manager sits on the board of the national coffee institute (Icafé), which controls and regulates the industry.

•Milford, (2004): Mexican co-operative ISMAM (Indigenas de la Sierra Madre de Motozintla): Despite having a dispersed membership of 1,350 farmers across Chiapas, ISMAM has undertaken lobbying activities on a number of issues, including an issue that was of interest to farmers growing Robusta coffee (even though their members grow Arabica).

•Parrish et al, (2005), KNCU Fairtrade coffee, Tanzania: Fairtrade has successfully increased the influence of the KNCU coffee co-operative in Tanzania, while Fairtrade support enabled the KNCU to achieve indirect impacts on industry regulation (encouraging changes in the Tanzania Coffee Board rules allowing direct export contracts to bypass domestic auctions). A parallel model (support from Technoserve) supported coffee associations to have, arguably, an even higher impact at national level.

•Utting, (2008): Fairtrade in coffee, Jinotega, Nicaragua: Increased capacity to: network with other organizations; to engage in public policy debates; and positive influence on other local development organizations, including the local administration which had neglected coffee growing regions.

#### 4.5 EXTERNAL SHOCKS WHICH COULD INFLUENCE THE SURVIVAL/DOWNFALL OF SPOS

Fairtrade enables the survival of cooperatives in the face of shocks and stresses. Disadvantaged farmers are more able to hedge against swings in market prices with Fairtrade support (Berndt, 2007). The very survival of Coocafé in Costa Rica can be attributed to the benefits obtained by participation in Fairtrade. A considerable portion of its revenues come from Fairtrade sales (52 percent of volumes). Many other cooperatives failed

during the coffee crisis, but the Coocafé primary cooperatives survived and so all of the benefits flowing from their activities can, to some extent, be attributed to Fairtrade (Ronchi, 2002a). Members of the Tanzanian coffee producer Kagera Co-operative Union (KCU) felt that Fairtrade helped the KCU to survive following liberalization in 1992/93 (Suma in Farnworth and Goodman, 2008). Many other unions could not compete with the international buyers that entered the liberalized sector and members left.

<sup>2</sup> Fairtrade Labelling Organization or FLO refers to Fairtrade International

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**KIT Royal Tropical Institute**

Mauritskade 64  
1092 AD Amsterdam  
The Netherlands

Phone: +31 (0)20 568 87 11  
For enquires: [m.tyszler@kit.nl](mailto:m.tyszler@kit.nl)  
Web: <https://www.kit.nl/>



**KIT** Royal  
Tropical  
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