Global Cooperative linkages ? –
The Challenge To Harmonize local with global economies

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Abstract

This paper focuses on how cooperatives participate in globally integrated value chains. In the first section a brief literature review will shed light on some contemporary arguments in favor of and against cooperative internationalization. A brief discussion of the mechanisms by which coops manage to link local and global agents follows. Current examples of real life coops of the western world and those in developing countries which act on an international level show that linking up regional membership organizations with globally integrated value chains may attenuate cooperative principles and create incentives to change an organization by laws up to a point where most cooperative principles are given up. A different story occurs if commodities traded are subject to certain values for which consumers are willing to pay a price premium. Organic farming or fair trading constitutes examples discussed. It follows that the type of commodity, the proper working of markets and probably most relevant, the consumer attitude towards a particular product and the way it is produced and shipped play decisive roles. The latter bares consequences for the design and implementation of policy interventions in favor of cooperatives linking local to global value added chains.

1. The background – various drivers of change

During the past decades, the world`s agricultural economy has changed. Especially in the areas of international trade and industrial organization globalization of production and trade, and the vertical disintegration of transnational corporations, have stimulated the growth of industrial capabilities in food retail sectors and agricultural value added chains (Gereffi et al. 2005). Global retailers such as Tesco, Carrefour and Wal-Mart are fighting for market share within China, India, South America and the privatizing economies of Russia and Eastern Europe. Projections from 2007 suggest that these emerging economies will grow three to five times faster than Europe, North America and Japan (Hogeland 2009).

Cooperatives in developing countries as well as their western counterparts have developed strategies to accommodate with this situation. The way they react differs because they often operate from different ends of the value added chain and at differing levels of professionalization: In developing countries cooperatives are often viewed as instruments to group producers, to enable access to markets and make markets work for the poor. As such they have become increasingly interesting not only for their members but also for political entrepreneurs and international traders looking for reliable supply with votes and commodities, respectively. In more developed market economies, cooperatives realize globalization through increasing competition by large scale international investor-owned firms (IOFs). Size and cost-leadership have become decisive issues of international competitiveness and it remains important to consider whether the organizational structures of these cooperatives that have evolved in the past are likely to remain appropriate for their increasing international activities in the future.

The theoretical framework to fully understand complex developments of cooperatives vis-à-vis globally integrating markets on both sides of the globe is yet to be established. Theories from supply chain management and those of the diverse strands of the theory of collective action are to be combined with elements of New Institutional Economics (Porter 1985, Olson 1965, Kollock 1998, Ostrom 2005). Contemporary scholars from different disciplines have described developments and generated anecdotal and case study based knowledge about important drivers and developments (Seipel and Heffernan 1997, Humphrey 2005, Bijman 2002, Chaddad and Cook 2004, Ruben 2007). The main drivers and (phenomena) of observed changes are:

1. The rapid worldwide industrialization of the food retail sector (international investors, supermarkets).
2. The growth, concentration and consumption promises of megacity-development (bulk-retail).
3. The cheaper and easier dissemination of knowledge about production circumstances (internet, TV).
4. The change of lifestyles (convenience products, freshness, latte-generation).
5. Consumer preferences demanding track and trace technologies as quality standards.
6. The rise of ethic food movements like fair trade and other.

2. Cooperative strategies

Increasing competition with national and global players pushes regionally based cooperatives to develop innovative strategies in order to become part of a wider value added chain. Especially in developing countries, a cooperative`s ability to continuously upgrade functions, processes and products becomes a matter not only of innovativeness but ultimately one of survival (Table 1).

Upgrading strategies of agricultural cooperatives			
Area of change	Products	Processes	Functions
Mechanisms	Developing more pretentious product categories	Organizational, technical and logistical streamlining	Adopting new functions in the chain process (own brand, design)

Table 1: Upgrading agricultural cooperatives (own table based on Humphrey and Schmitz 2000)

Humphrey and Schmitz (2000) distinguish three alternatives for upgrading. Product upgrading (1) which is a movement into more pretentious products, the more efficient streamlining of production processes (2) and/or the uptake of new functions (3).

The distinction of three different areas of change is artificial. In reality, these three areas of change take place simultaneously. For example: the introduction of new product categories may afford processes to be carried out more efficiently or even new branding activities. Subscribing to particular modes of production and ethical values may be viewed as a labelling strategy towards upgrading functions of a cooperative (fair trade, organic farming, etc.). At the same time product innovation and process upgrading are involved.
Upgrading as such is definitely not new to agricultural cooperatives. Looking at the past one comes to realize that the history of agricultural cooperatives is one of successful adaptation to increasing upgrading needs. However, the way in which the world economy has changed over the last two decades cannot be compared to the adaptation processes in the past. The rate by which the drivers (1-6) change the business environment of producers, middlemen and suppliers clearly exceeds structural change rates of the past.

3. Challenges of linking up cooperatives to globally integrated value chains

As a result of change, a shift of bargaining powers and risk has taken place. Emerging markets offer growth, but also significant risk because the sources of demand and supply are not clear. Uncertainty has led to concentration and massive vertical integration of businesses along value chains and ultimately to a few very large multinational players with consequences for new market entrants and current participants. In the emerging architecture of a globalized agricultural economy, the risks and returns that suppliers obtain from participation in value chains will depend upon the incidence and extent of monopoly or oligopoly powers.[1] Large sellers are able to exert pressure on small buyers, and large buyers are able to exert pressure on small suppliers (Humphrey 2005: 26). Often do the bulk of appropriable profits occur at the consumer nearest end of the value added chain. This has given rise to supermarket chain development and powerful multinational food processing industries and all sorts of strong to weak models of vertical integration among them. The result of such trends has been a shift of the food market away from a producer and processor oriented market towards a more and more consumer-oriented or demand driven market in which investments in branding, marketing and the constant redefinition of products are highly profitable. Increasingly it is industrialized country companies who are capturing value added on developing country products through branding and re-exportation (Vorley and Fox 2004).
In this business environment upgrading must be understood as a strategy of those coming from a more producer oriented side of the value chain to organize production in a way that allows to capture higher shares of value. For each cooperative the appropriate mix of upgrading mechanisms will depend on its current and desired position within a globally integrated value chain. At the same time the success of upgrading strategies will depend on the internal institutional structure (the allocation of property rights) within the cooperative.
Two opposing examples of strategic choice exemplify typical trade offs for management decisions of cooperatives in developed and in less developed countries, respectively and mark a continuum of alternative pathways for cooperatives who intend to take advantage of internationally integrated value chains.

1. <u>Size or control</u>: Consider a cooperative has attained market power over a value chain that is internationally integrating and is already rather close to the consumer end of the value chain. In this case the cooperative has control over a decisive share of the added

[1] In 1998, the two largest international coffee traders, Neusmann and Volcafé, controlled 29 % of the market, and the top six companies 50 % (Ponte 2001). The coffee roasting market is even more concentrated than that of the traders. The two largest groups, Nestlé and Philip Morris, control 49 % of the world market for roasted and instant coffees (Ponte 2001), Nestlé alone controlling 56 % of the market for soluble coffees.

value and influence on prices as long as it is able to cost wise control similarly sizeable competitors. Concentration trends on the market will challenge its position and force the cooperative to constantly cut costs and to design innovative products and processes. Being a sizeable player among others complementary product categories (think of yoghurt or ice-cream for a large dairy cooperative) may only be realized by strategic mergers and acquisitions on an international level exposing member investors to the involved risks of putting money into longer term international operations. Further de-regionalization and management professionalization (investment-orientation) create known problems of governance and liquidity. For example, horizon problems may restrict cooperative management to venture new projects (and capital). Depending on the appropriable monopoly rent, firm size is restricted by the increasing cost of monitoring and controlling a growing number of actors in the value chain.

2. <u>Innovation by members or outsiders</u>: Consider a cooperative has established a position on a market rather close to the producer end of the value chain. In this case a different spectrum of risks and opportunities applies. At the lower end of the value chain cooperative is likely to be a price taker not a price setter. Upgrading affords agreed upon decisions in which direction producers should collectively invest. As soon as the cooperative gives up its regional markets orientation and specializes in internationally tradable products, asset specificity of investments in an adequate production structure puts member investments at risk. The bargaining position of the cooperative vis-à-vis larger national and international retailers/traders affords it that investments in quality and homogeneity of products have already been done and are borne by members. If not, larger traders and not the members may invest in the upgrading processes within the cooperative. If so, external innovators not members may want to safeguard their efforts by attaining influence on the cooperative's decision making therewith changing the internal structure of property rights in the cooperative.[2]

4. A framework

Figure 1 is an attempt to conceptualize different stages and the ways in which cooperatives integrate into global value added chains in agribusiness. Drivers of change like the concentration of consumers in megacities, technical progress and raised consumer awareness due to democratization processes and increasing media coverage determine new opportunities for groups of producers to attain larger tranches of product value. Depending on the position of coops at the higher or lower end of the value chain, alternative upgrading strategies may be followed. Members may have to produce higher quality, larger amounts or more homogeneous products. Likewise members may have to invest in new activities like branding and marketing or in costly merger and acquisition projects. In any case investments have to be made and new risks have to be taken and distributed. Problems of collective action among member-owners will have to be solved because either members have to find new rules for self-financing these investment (think of investor members) or attract external investors` capital. Institutional changes will alter the property rights regime of the cooperative. Depending on asset specificity of investments (Williamson 1985) and the monopoly power of larger retailers and traders in the value chain, safeguarding those investments may be difficult.

[2] Chaddad and Cook (2004) argue that alternative cooperative models differ in the way ownership rights are defined and assigned to the economic agents tied contractually to the firm – in particular, members, patrons, and investors. Based on multiple examples, they propose a typology of discrete organizational models, in which the traditional cooperative structure and the investor oriented firm (IOF) are characterized as polar forms.

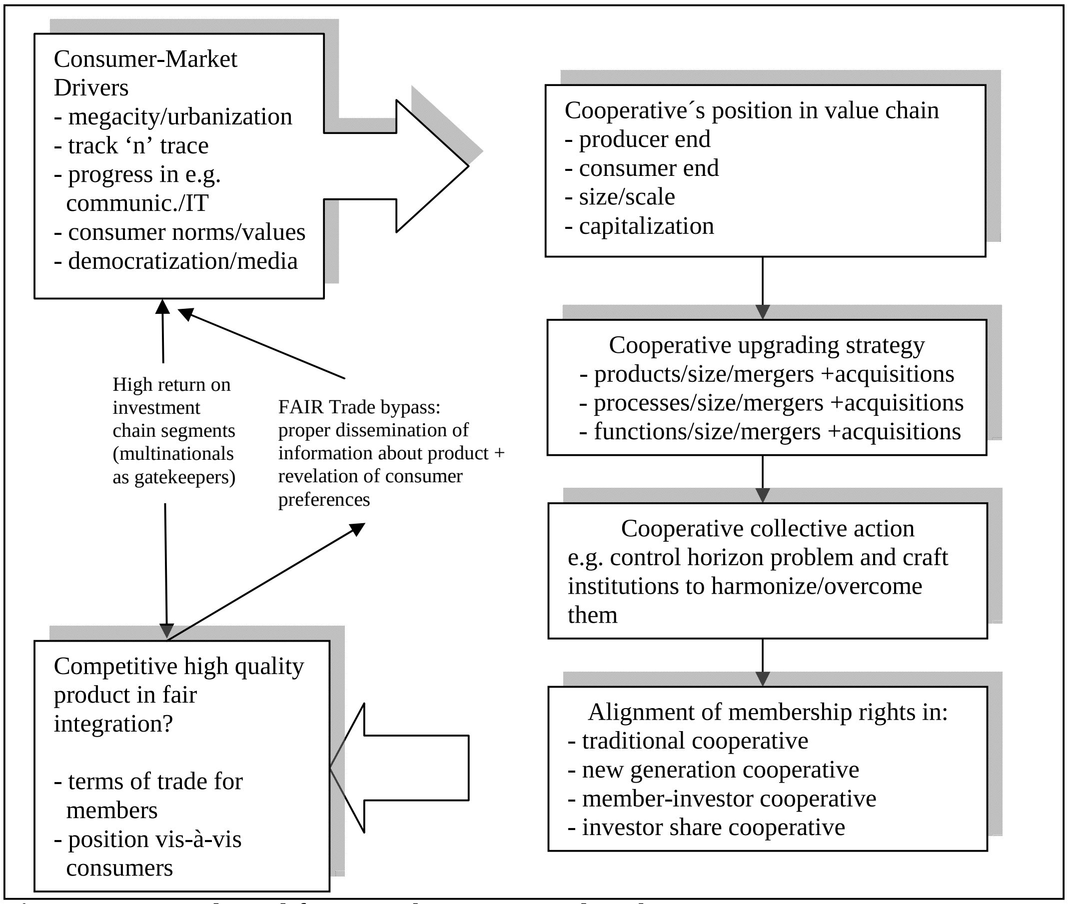

Figure 1: An analytical framework: coops in value chains

Larger retailers and traders may charge monopoly rents from market entrants. Alternative efforts to directly link producer groups with consumers might yield more accurate information about circumstances of production for consumers and as a follow yield higher prices and returns to investment for producer groups.
Multinationals can be viewed as gatekeepers to attractive markets for upgrading cooperatives. They may want to avoid new markets of fair trade to be established by creating own labels of ethical food production and retail. Those new labels could either lead to new globally accepted standards of fairness and pricing or contribute to the problem of asymmetric information between consumers and retailers by confusing the criteria and standards established by traditional fair traders. Likewise multinationals may accept fair-trade niches and absorb part of fair trade products.

The exemplified pathways represent extreme ends in a much larger decision tree concerning the upgrading decisions of cooperative management (Chaddad and Cook 2004). In reality cooperatives will sometimes invent new strategies to overcome the problems of control and weakening property rights of members vis-à-vis investors (Fahlbeck 2007). Contract farming or co-ownership between member organizations on the ground and larger retailers are examples of intermediate positions. Chaddad and Cook (2004) distinguish different types of cooperatives by the way in which members and investors share rents from the realization of stronger or weaker rights. This model delivers organizational change predictions and hypotheses about the relevance of "size or control"/"member/non-member innovation"-trade-offs in respective decisions of cooperative management. The more money is needed in the process of integrating into value chains (upgrading, Mergers & Acquisitions), the more risks are involved and the closer the cooperative is predicted to approximate the property rights structure of an investor-owned firm.

5. Empirical cases

Empirical knowledge about processes and successes and failures is anecdotal and cannot serve to draw general conclusions. However examples highlight the relevance of the link between market position, investment structure and decision making rules for cooperative pathways (Seipel and Heffernan 1997, Ruben 2007, Cook and Iliopoulos 1999, Hanisch 2006).

Ruben (2007) compares six cases of cooperatives in developing countries in Brazil, China, Rwanda, India, Ethiopia and South Africa with respect to different pathways for horizontal smallholder cooperation that are emerging in specific development settings in response to increasing demands from vertical supply chain integration. Examples fit well into the discussed analytical framework and the way cooperatives have upgraded products, processes and functions can be better understood by taking a closer look at investment needs and resulting property rights structures.
As potential pathways he identifies several alternatives of how cooperatives adapt internal decision making rules in order to better take advantage of globally integrating value added chains. The direction of institutional change follows the logic of the ownership rights typology in figure 2:

1. Joint asset management; smallholder cooperatives investing in joint collection facilities and logistics in order to improve scale and to enable compliance with quality grades and standards to reach a better bargaining position and add value to the product (Brazil case);

2. Contract-farming; smallholder cooperatives that emerge from self-investment and produce specified output for downstream processors while sharing input costs (India case);

3. Preferred supplier regimes; smallholder cooperatives that reduce their uncertainty regarding market outlet choice through contractual arrangements with brokers operating on behalf of agro-industrial or retail firms (China case);

4. Multi-purpose cooperatives; diversified smallholder groups that simultaneously operate at various (input and output) markets and to diversify (short-term) risks through multi-market management (Rwanda case);

5. Mixed cooperatives; smallholder cooperatives operating on the commodity exchange in order to reduce long-term price risks through future operations (Ethiopia case);

6. Co-ownership cooperatives; smallholder groups that are directly shareholder in downstream commercial operations (e.g. processing, trade) and therefore reduce their information failure regarding prices and quality demands (South Africa case).

Seipel and Heffernan (1997), Hanisch (2006), and Cook and Iliopoulos (1999) analyze examples of how cooperatives in more developed countries react on globally integrating value added chains in the US, Poland and Germany. Seipel and Heffernan find that the investment strategies of US cooperatives often lead to paradoxical and contradictionary business objectives. For example in the case of LandoLake investing in Polish milling operations a vivid discussion about granting full membership rights to Polish partners led to a change in LandoLake´s by-laws.

In the other cases it seems to be that management uses international investment strategies as a means to bypass member-owners control on their decision making. Hanisch makes a similar observation for the case of the Nordmilch cooperative. Management of the Nordmilch cooperative explained its members that investments in Chinese milk processing industries would afford to transfer the core of the business of the Nordmilch into a joint stock company for reasons of compatibility with international business law (Hanisch 2006). Two of the analyzed cases, Dakota pasta growers company and Nordmilch AG, international investment plans of cooperatives have led to a change in the allocation of property rights and decision making powers. In the cases of the Nordmilch Cooperative and the Dakota Pasta Growers cooperative, international involvement has ultimately led to a change of the juridical form from a cooperative towards an investor-owned company (Hanisch 2006, Cook and Iliopoulos 1999). Like in the previously analyzed examples the direction of institutional change follows the logic of the ownership rights typology in figure 2:

5. Alternative pathways – The Fair Trade by pass

Other challenges for upgrading cooperatives at either side of the globe are that top positions in the value chains are usually held by giant multinationals like for example Tesco, Carrefour and Wal-Mart. To capture part of their monopoly-rents means to directly compete with them.
But over the last decades terms of trade are such that the five largest retailers earn returns on investment above the 25% mark whereas returns on investment for producers remained between 2-4%. For the case of the coffee market, Margaret Levi and April Linton (2003: 411) argue that it is the roaster-distributors that have the largest value added in the coffee commodity chain, making three to five dollars a pound compared to the 20 to 40 cents a pound earned by the small-scale producer, or even the 70 cents a pound of the large landowner.
Fair trade in the realms of the above discussed concept can be interpreted as an effort of small producers´ associations in the South and consumers in the North to directly contract terms of production and price. This outcome can only be understood if an asymmetric dissemination of information about the exploitive circumstances under which normal products are produced (child labour, environmental damages, and minimum wages) persists and if those at the top end of the chain use their monopoly power to successfully reap the benefits of that situation by withholding that information vis-à-vis consumers. In this case fair trade appears to be a problem of asymmetric information and unrevealed consumer preference.

The idea of Fair Trade originated in the 1960s as a response to the dissatisfaction of developing countries with their terms of trade. Alternative Trading Organizations (ATOs) started selling the products of people from developing countries to consumers in the North, and thus created new types of markets in which the rules were different. Producers were paid above market price. At the beginning, these organizations operated the whole chain, and were responsible for the importing as well as the distribution and sale of the products, often in special ‘World shops’ (Milford 2004). Today, the Fair trade labelling system makes it possible for any commercial business company to purchase products from a selection of producers in the South, and to put a 'Fair Trade' label on it for consumers to recognize (Milford 2004). To bring this about, in 1997 the umbrella organization Fairtrade Labelling Organisation (FLO), was founded. The organization today has 17 members, which are so-called national initiatives operating in 17 different countries (14 European countries plus Canada, Japan and the USA). Fair Trade labelled coffee, sugar, oranges, cocoa, bananas, tea and honey are purchased from Latin America, Asia and Africa. In each of the consumer countries, the national initiatives work to increase the demand for these products. In order to reach small-scale coffee farmers, FLO works with democratically organized producer co-operatives that are seen as able to contribute to the social and economic development of their members and their communities (FLO 2009), and have therefore been accepted by the organization. Thus cooperatives and the idea of fair trade belong to the same family of ideas (Develtere and Pollet 2005). The producers do not pay for being registered with FLO, but the licensees pay for using the Fair Trade label. The fee is paid to the Fair Trade national initiative in the consumer country. Other than that, the main features of the Fair Trade labelling system are direct access to the market, a guaranteed minimum price, the certification system, the criteria and the monitoring.

Stylized facts: Impacts of fair trade

Over 4,000 small-scale producer groups in more than 50 developing countries participate in fair trade supply chains. More than five million people in Africa, Latin America, and Asia benefit from fair trade terms (Becchetti and Constantino 2008, Fair Trade Advocacy 2005). Fairtrade only accounts for less than 0,01% of all traded goods worldwide (Develtere and Pollet 2005). However, about one million families in developing countries directly depend on fair trade. Looking at single commodities fair trade is probably most important for products like coffee and cocoa (Havers 2008). For the case of Kenyan farmers Becchetti and Constantino (2008) found that Fair trade and Meru Herbs affiliates benefitted from membership: Member households had comparatively higher price satisfaction, higher food consumption expenditure, and dietary quality. Another interesting result was the remarkable difference between fair trade affiliated and control farmers in terms of income satisfaction. Other studies highlight the impact Fair Trade has on improving local infrastructure like schools, credit, roads and public health (Levi and Linton 2003, Moore 2004, Milford 2004, Goodman 2004, Hira and Ferrie 2006).

Reactions of large retailers

Compared to the total amount of traded goods the share of fair-traded goods is small if not negligible. Fair Trade cannot solve the many problems in global trade. As Vorley and Fox (2004: 26) put it*: "Case studies by companies, donors and NGOs can show success stories and 'best practice'. Consumers can feel vindicated by their purchases of a few fairly traded goods. But we must ensure that we are not deluding ourselves that we can niche-market our way out of a commodity crisis".*

But the impact of Fair Trade does not come with market shares alone but rather with the organizational structures (cooperatives and producer groups) that benefit and the strong value statement that is involved. Consumer awareness of the fair trade movement is large which is to say that the notions of monopoly powers in agribusiness and unfair treatment of producers in developing countries have reached the consumer. Retailers have long realized the loss of reputation they suffer which is connected to Fair Trade activities. They respond with information campaigns and countermobilizing activities: Fridell et al. (2008: 26f.) analyze the reaction of large retailers. They find that the largest four retailers in the global food market respond to claims of "unfairness" by promoting own labels of ethically sound production and pricing practices: "*the 'big four''s minimizing strategy also defends their interests as an industry bloc. It works as an effective countermobilizing social movement against threats posed by an increasingly visible and effective challenger, by undermining the 'unique' claim to ethical production and exchange that fair trade has labored to establish for its logo. The responses of the 'big four' function not only to protect brand value and increase market share, but to delegitimize fair trade as a valid tool for addressing poverty and to decrease the power and content of the fair trade logo*". In the long term this might pose a threat to the success of Fair Trade because the consumer is overburdened with various qualities of information about production and price practices.

Conclusions

Examples of real life cooperatives and hypotheses derived from institutional economics and the theory of collective action suggest that taking advantage from globally integrating value added chains is possible for cooperatives. In developing countries problems of small holders constraining supply and inhomogeneous product constrain international trade. Cooperatives may help smallholders to access the market and innovate processes and products. Cooperatives are attractive partners for multinational and global retailers. But with multinational retailers controlling large shares of the value chain, members` investments in upgrading may be at risk.

Cooperatives in the more developed world have often grown up to large competitive enterprises able to keep up with other actors in the chains. Cooperatives in developing countries and those in the developed world use upgrading strategies to capture larger shares of the respective value chains. For both, taking part in global agribusiness affords prior investments in quality and homogeneity of products and processes. Western cooperatives seem to combine merger and acquisition policies with upgrading objectives. In developing countries product and process upgrading play focal roles in adaptation strategies. Investment prerequisites may invite external investors to invest into the cooperative business in a way that calls into question traditional member rights and cooperative regionalism and one man one vote decision rules. The promise to attract external money may provoke managers to advise members to give up some of their property rights. The first cases have occurred in which this process has developed a dynamic on its own and ultimately led to highly dependent cooperatives or a transformation of a cooperative into an IOF. Best practice examples around the world indicate that between traditional types of agricultural cooperatives and IOFs are enough institutional and organizational alternatives to make property rights and residual claims fit and to find ways to harmonize local with global agricultural economies. However concentration of just a few large players together with undesirable outcomes of trade liberalization has led to market failure in the global value chain. Large retailers control market entrance and information flows. Policies in support of smallholders and upgrading cooperatives will have to honestly address this problem.

Crafting policies

Crafting policies is riddled by several bottlenecks (Vorley and Fox 2004: 26-29):

- imperfect markets defy standard economic analysis and provide a big challenge to advisors and regulators,
- power can be more a reflection of size than monopoly, and
- competition policy focuses primarily on consumer rather than producer welfare.

Following interventions may promote cooperative access to global value chains:

1. Monitoring multinationals at the UN level: Promoting fairness and sustainability of production should not alone be left to consumer-voters. Considering how much of agrifood trade, processing and retailing is in the hands of a small number of corporations, the case for monitoring multinationals at the UN level should be actively pursued and OECD guidelines for multinationals should incorporate clear and elaborate definitions about minimum standards of competition, sustainability and fairness.

2. Empowering consumers: Empowering consumers to make the right decision regarding the circumstances under which products are produced and processed means to inform consumers in developed countries. Lobby organizations are either not powerful enough to provide this information to all social strata of the population or not willing to do so. Governments can inform consumers in awareness campaigns and education programs.

3. Promoting cooperative principles of doing business: Whereas principles of a market economy like competition, private ownership, and cost efficiency are common knowledge the principles according to which cooperatives contribute to civil society development and fair business are far less known in many developed societies. Prior to realize cooperative advantages people have to know more about cooperatives in order to develop relevant capacities.

4. Laws of export: Harmonizing export laws to allow for direct trade with cooperatives as well as supporting access to inclusive finance: Ethiopia and Tanzania provide promising examples of successful policies.

5. Governments themselves can make a difference in buying only “fairness-certified products”.

6. In order to avoid confusion about critical issues of value chain ethics the development of ethical standards and best practice norms should be monitored on an international and national level respectively.

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