Conditions, attitudes and structures of successful POs and cooperatives

Potential role in supporting a competitive farming sector in England and Wales

January 2014
# Contents

1. Executive summary 1  
   1.1 Conclusions and recommendations 5  

2. Aim of the project 7  

3. Background 8  

4. Structure of report 11  

5. Producer organisations vs agricultural cooperatives 12  
   5.1 Introduction 14  
   5.2 The differences between a PO and a cooperative 15  
   5.3 Organisational objectives 16  
   5.4 The implications of competition law 17  
   5.5 The legal structure of PO’s vs. Cooperatives 18  

6. Literature review summary 19  

7. Measurement & ingredients of success 23  
   7.1 Difficulties in measuring Success 26  
   7.2 Key Ingredients of Success 30  
   7.3 Impact on the Competiveness of the Sector 32  
   7.4 Examples of Successful Cooperatives 37  
   7.5 Management and Leadership 38  
   7.6 Further Considerations on External Efficiencies 42  

8. Barriers to the development of POs/Cooperatives in the UK 44  
   8.1 Structure and Scale 47  
   8.1 Internal Influences 48  
   8.2 External Influences 48  
   8.3 Attitudes of Farmers 50  
   8.4 Vertical collaboration 52
9. The willingness to join and member commitment 54
  9.1 Developing Social Capital 56
  9.2 Why farmers don’t join or commit to POs/cooperatives 58
  9.3 Member Commitment 58

10. The economic case for cooperation 61
  10.1 Competitiveness and Competitive Advantage 66
  10.2 Contributions to Efficiency 68
  10.3 Innovation, Competitiveness and Growth 71
  10.4 Challenges 75

11. Transferability of fruit and vegetable POs to other sectors 79
  11.1 Dairy and livestock 81
  11.2 Cereals 82
  11.3 Other issues 82

12. Potential downsides of POs/Cooperatives 84
  12.1 Capital Constraints 85

13. Appendices 87
  13.1 Literature review 87
  13.2 Survey 124
  13.3 Interviews 145
  13.4 Workshop 146

Contact:
Siôn Roberts       Duncan Rawson
EFFP LLP           EFFP LLP
sion.roberts@effp.com  duncan.rawson@effp.com
1. Executive summary

The aim of this report, which combines a review of the academic literature with the results of an industry survey and workshop undertaken for the project, is to provide socio-economic evidence as to the condition, attitudes and structures that characterise successful cooperatives and Producer Organisations (POs) and to make recommendations as to how government could potentially support the introduction and development of cooperatives and POs in the future. Please note that the views expressed in the report do not necessarily reflect those of Defra.

Cooperation and collaborative ventures have long been recognised as having many benefits within the agricultural sector, bringing farm businesses together to achieve greater efficiencies in areas such as purchasing, production and marketing. In the UK POs, as defined under the Common Market Organisation (CMO), have existed in the fruit and vegetable sector in their current form since 1996 and can be characterised as essentially marketing cooperatives that are also responsible for the coordination of production, storage and packing of their members’ crops. Although traditionally associated with the fruit and vegetable sector, the EU is now intent on making provisions for Member States to recognise POs across the majority of agricultural sectors; indeed, the legal and practical framework for the introduction of POs in the dairy sector has already been implemented. However, it is not intended that POs introduced into other agricultural sectors will be able to apply for financial assistance as is the case under the Fruit and Vegetable Regime.

In terms of the attributes that underpin successful farmer collaboration there would appear to be very little difference between a PO and a marketing cooperative organisation; hence, we consider both as one in the same throughout the report. There would appear to be little that the introduction of POs in the dairy and other sectors can offer that cannot already be delivered by an agricultural cooperative and indeed the industry interviews and in particular the output from the industry forum, confirm this view. This point is explored in some detail in section (5) and where differences may exist between POs and cooperatives these are highlighted.

Measuring the success of POs and Cooperatives

In recent decades we have seen significant changes in both the organisation of transactions and the growing intensity of competition within the food chain which has led to a fundamental shift from a production orientated focus to a market orientated focus. This has resulted in a corresponding shift in the behaviour and structure of POs and cooperatives who have had to extend their activities beyond better marketing their members output, to investing into the fixed assets and capabilities required to add value to their members production; whether this is by processing or packing, raising efficiency of production, procurement and processing or encouraging and supporting innovation at both the farm and product level.

A fundamental point to understand when trying to measure the success of POs and cooperatives is that the objective of most is to enhance the performance of their members’ businesses thus making the performance of the PO/cooperative itself subordinate. It follows that attempting to compare the performance of a cooperative and an investor owned firm (IOF) is particularly challenging. The key business goal for an IOF is shareholder value which is driven by growth and profit maximisation. Not only do cooperatives not have a stock market valuation but also the value they create is captured in the growth and profitability of their members’ businesses.
Moreover, a PO/cooperative will often be established to achieve an objective or range of objectives that are wider than an IOF with a focus not just on financial performance but also on the development of social capital and member satisfaction.

Traditionally many POs and cooperatives were established to address a market failure; for example, to provide a route to market that didn’t exist or to rebalance power in the supply chain. From this perspective the PO/cooperative offered members the prospect of higher returns by securing market access and/or the ability to negotiate on more equal terms with buyers. More recently many have adopted vertically integrated strategies involving investment in added value activities rather than addressing a market failure per se. This in itself adds another challenge, particularly if attempting to measure performance by price as it does not take into account the impact on price that any investment into value adding activities may have in the short-term – an issue that the large UK dairy cooperatives have had to battle with in recent years.

Although a cooperative cannot be judged on its financial performance alone, to be successful it must be in a financial position to meet its members’ aims and objectives and to enable it to develop in response to changes in the external business environment. To that end, it is appropriate to consider the health of a cooperative by using some of the conventional financial ratios – but these should not be used alone to measure success.

**Sector competitiveness**

As a nation we seek three unambiguous outcomes from our businesses; efficiency, competitiveness and sustainable growth. This trinity of economic outcomes is generally, but not necessarily, mutually inclusive and competitiveness is seen as the key goal. Competitiveness and competitive advantage are discussed in more detail in section (10). Cooperatives offer smaller scale farms three sources of efficiency that they would struggle to achieve by themselves: economies of scale; vertical integration; and coordination. Scale economies lower unit costs by sharing. Vertical integration enables members to add value, including participating in the introduction of new products and/or marketing innovations. Coordination facilitates the dissemination of knowledge across members.

It follows that as members of a cooperative, smaller scale businesses can collectively participate in a wider set of attributes that contribute to competitiveness, including innovation, while enabling individual members to focus on the more traditional approach of comparative advantage, i.e. efficiency in production. While scientists and entrepreneurs initiate the process of innovation, when it comes to commercialisation there is a critical role for the transfer of knowledge, the application of expertise and funding. It is at this stage that cooperatives offer a major advantage, allowing smaller scale businesses to be mutually aligned in the process of innovation and thereby potentially reinforcing the industry’s competitive advantage. Cooperatives have a commitment to competitiveness as a sustainable source of growth and thereby a direct link to members’ satisfaction via the profitability and growth of their businesses. A well-managed cooperative can expand market share and/or enter new markets by engaging in value adding production stages and developing innovative products. In an open trading environment it is these sources of competitiveness that drive industry growth.

As marketing cooperatives have been a feature of most farm sectors this suggests that these positive social benefits are not sector specific. That said, supply and demand characteristics vary from sector to sector and the behaviour and focus of cooperatives should adjust accordingly. In some sectors short term volatility will
demand an emphasis on minimising the impact on members’ returns whereas sectors with a more controllable supply are likely to put more emphasis on convenience, variety and quality. Another, characteristic that varies across sectors is the bargaining power of buyers and in these situations countervailing power is a relevant consideration which calls for larger scale cooperatives. Yet another characteristic that varies across sectors is the scope for downstream processing. Thus, a cooperative’s strategic focus should vary according to the sector’s prevailing conditions of supply and demand.

Achieving competitive advantage, particularly when it involves processing or new product development requires investment in fixed assets and capabilities. A major issue in judging the potential economic success of cooperatives is their ability to raise capital. Many have faced funding constraints if the investment involved places significant demands on members. To overcome these constraints many larger scale cooperatives have experimented with new organisational forms in order to facilitate external funding thus raising the question as to how these new organisational types adhere to the concept and principles of cooperatives. This suggests, smaller scale cooperatives with a supportive membership and low credit risk may be less constrained and reinforces the point that cooperatives do not need to be large to be successful.

These positive social benefits are potentially threatened if a cooperative achieves a dominant position. As market share increases so a cooperative’s ability to influence the market price by engaging in agreements with rivals or restricting supply increases. It follows that in encouraging the setting up of marketing cooperatives care should be taken to preserve competition. Another potential concern is vertical collaborations between a cooperative and a downstream customer e.g. a food processor; where the agreement gives the buyer or seller a large market share, or prevents the buyer purchasing from an alternative supplier.

**Success factors**

The success of a PO/cooperative is dependent on a number of factors but central to this is the quality of management and leadership. It falls to senior management, being the board and executive, to determine with the support of the membership, the objectives of the cooperative and the organisational architecture and strategies that have the highest probability of achieving them. The organisational architecture includes the structures and practices that ensure democratic governance. The challenge for a PO or cooperative is the need for a leadership team that not only has the ability to meet the demands of the market place – the skills deemed necessary in an IOF – but also meets the demands of and has empathy with the members.

Moreover the skills required of senior management teams are changing. In a traditional marketing PO or cooperative, the skills required involved the ability to control costs and oversee efficient democratic structures. As cooperatives have become more market orientated and engaged in vertically integrated activities within the supply chain the attributes demanded of their senior managers have grown to include entrepreneurial skills; namely, the ability to identify opportunities others have neglected, the skills to attract others to embrace the vision associated with the opportunities and the tenacity to pursue them. Indeed, ambition in the management team and in the board is becoming an important requisite in cooperative businesses. This leads to questions around the capability of farmer elected directors and their ability to understand and govern the types of organisations some POs and cooperatives have or are becoming.
The survey of POs and cooperatives found that ambition is an important factor leading to success for such businesses. But ambition can be a double edged sword, quickly becoming a dangerous attribute if the senior management team – board and/or executive – is not aligned to the objectives and demands of its members. Experienced managers and their board of directors will know the importance of an ambition to grow the business and build a reputation but they will also be aware that the cooperative can only pursue such goals to the extent that its members are themselves progressive and entrepreneurial. For an ambitious manager this democratic control can be a frustrating and potentially demotivating issue.

Managers will be motivated by factors such as pay, power and prestige. These motivations must be provided by POs and cooperatives if they are to attract experienced, high quality managers. Rewards such as stock options and leveraged buyouts are not available to traditional cooperatives, so in order to match the competition from IOFs in attracting the best managers, they have to rely on salary. This poses a problem for smaller-scale and even some larger scale cooperatives. Paying salaries and rewards for senior managers that are comparable to IOFs sometimes confronts a mind-set amongst farmers who find this challenging.

**Barriers to cooperation**

It is sometimes argued that the structure of UK agriculture and the dominance of the retail sector have presented insurmountable barriers to the development of POs and cooperatives across England and Wales, but this is not the case. In fact retailers as well as food companies in the UK have become increasingly involved in recent years in formulating new forms of supply chain collaboration. While it is clear that the structure of UK supply chains and in particular the dominance of the multiple retailers could have an impact on PO/cooperative development, retail concentration is also a characteristic of other EU countries yet many successful, large scale cooperatives operate in these environments. One difference between the UK and its EU partners that may be pertinent is timing – many successful European cooperatives developed long before the retail sector became so concentrated.

Taking the agricultural industry as a whole, a greater proportion of production is concentrated on larger farms in the UK than is the case across the EU, but many large scale farmers are found in some of the most successful US, EU and UK POs/cooperatives. Arguably it is the attitude of farmers and in particular their attitude to risk and/or perceived lack of control that is a more relevant factor. Farmers in general tend to be risk averse and the heightened risk – perceived or actual - associated with investing capital and/or committing product to a cooperative can be a barrier to collaborative activity. However, there has to come a point when the benefits offered by a cooperative overcome the barriers. Indeed the survey results show that farmers in the UK are today far more willing to join a cooperative than they were five years ago.

Of key importance is the development of social capital; the development of networks involving relationships, reciprocity and trust which facilitates the building of a community within the PO or cooperative structure. The creation of social capital can give rise to a virtuous circle encouraging more relationship building, reciprocity and trust and in the process bring about a situation where cooperation is a widely accepted social norm. This emphasises the importance of member communication, internal governance structures and procedures, the capability of the management team and the alignment of objectives between members and their PO/cooperative. It also highlights from an external point of view the role that government and other organisations, such as the National Farmers Union (NFU), have to support and promote the benefits of cooperation.
1.1 Conclusions and recommendations

- Across the globe there is a long history of successful agricultural cooperation originating in a desire to correct market failure and exert market power but which over the past century has shifted from a production orientated focus to a more market orientated one based on quality and product innovation (see literature review summary – section 6).

- Based on the research undertaken for this report, there is a strong case that greater cooperation both horizontally and vertically in the food and farming sector, could improve efficiency, drive competitiveness and lead to faster economic growth (section 7.3, 10, industry workshop 13.4).

- A consensus emerged across those contacted through the survey, interviews and workshop discussions that increased cooperation across the UK food and farming industry was going to be of critical importance to competitiveness over the next few years (industry interviews, industry workshop 13.4).

- There was over-riding agreement that PO/cooperative businesses had to have clear commercial aims and objectives and be carefully structured to ensure that they delivered against them (section 7.1)

- It was widely felt that good governance and professional management are key to the success of POs and cooperatives (section 7.5, 8.2, 9.3, industry survey).

- It is important to note that new and different forms of collaboration are currently developing in the UK food chain; some traditional cooperatives are proving successful and playing a key role in areas such as input purchasing and farm product marketing (section 7). However new forms of supply chain groupings are also emerging, often led by retailers and food companies. These tend to be focused around specific supply chains and customers, unlike traditional cooperatives that often sell into a number of markets (section 8.5).

- From all the evidence gathered, it is not clear that POs offer much to farmers that they cannot achieve anyway under existing cooperative legislation. On balance though, the views encountered in researching this report supported the position that the introduction of POs could help promote the competitiveness of agriculture by providing 'momentum' towards greater collaborative activity across the industry; lead to the formalisation of some loose farmer groupings and; help ensure that UK farmers were not disadvantaged in the future if support or other benefits were linked to PO status (section 5).

- It is recognised that the likely uptake from different sectors would vary. The dairy sector has two cooperatives of significant scale and a number of producer groupings which may see benefit in developing more formal structures. For the red meat sector, whilst the view was that there needed to be a more collaborative approach, producers have resisted formal structures to their marketing (industry workshop 13.4d, section 11.1). Cereal producers do cooperate in production, storage, primary processing and marketing but the view in the workshop was that there there was scope for greater collaboration at both horizontal and vertical levels (industry workshop 13.4d).
• Survey respondents and workshop attendees felt that government could play an important role in encouraging and supporting PO/cooperative businesses through education and training, business support in the early stages of development and via capital grants *(section 7)*. However the level of government support up to now was not considered to have been a major factor in influencing whether farmers joined cooperatives or POs.

• There would of course be an administrative cost involved in the introduction of POs into new sectors of agriculture beyond just dairy and this would have to be weighed against any potential benefits that may accrue when making decisions on the way forward.
2. Aim of the project

This report is the outcome of a research project designed to provide socio-economic evidence as to the conditions, attitudes and structures that characterise successful cooperatives and in particular Producer Organisations (POs).

It further explores their current and potential role in supporting a competitive farming sector in England and Wales.

The key issues researched are:

- The objectives of POs/cooperatives including why they were set up;
- The functional scope of POs/cooperatives and their various business models;
- The types of activities they undertake as well as their current and potential role in supporting a competitive farming sector;
- The methods that might be employed to measure the success of a PO/cooperative;
- The elements that contribute to a successful PO/cooperative;
- The issues, including market failures, that are barriers to the development of POs/cooperatives;
- The willingness of producers to join these organisations and their reasons for doing so;
- The experience of European POs to test the transferability of other sectors;
- Possible downsides of POs/cooperatives for the different sectors including resource requirements; and
- Policy implications and recommendations
3. Background

Section summary

- Cooperation and collaboration have long been recognised as having many benefits within the agricultural sector. POs might correctly be characterised as marketing cooperatives and as such have played a fundamental role in the European Union’s (EU) fruit and vegetable sector.

- The EU is making provision to recognise POs across the majority of agricultural sectors. The initiative is a response to the imbalance in bargaining power between farmers and the concentrated processing and retail sector.

- The UK already has a number of marketing cooperatives operating in other sectors e.g. dairy and cereals, and these perform the type of roles being envisaged by the EU for POs.

- Given the heightened interest in POs, the developing policy framework and the potential benefits for producers as well as others in the food supply chain, there is a need for research into the relatively unexplored subject of POs. There is a need to gather evidence as to what makes a successful farming cooperative and PO as well as assessing the likely contribution to the competitiveness of farming and the food chain in general.

- This research also addresses the farmer characteristics associated with collaboration and the scope such organisations might provide for innovation in the area of efficiency including knowledge transfer, risk management and the promotion of new product research.

- In gathering the evidence to produce this report a detailed literature review has been undertaken followed by a survey to seek the views of a wide cross section of Chairmen and CEOs of cooperatives and POs as well as other industry stakeholders such as the NFU and Agricultural and Horticultural Development Board (AHDB). This has been augmented by one-to-one interviews with several CEOs of leading UK PO/cooperatives and an industry forum. In addition EFFP has drawn on its long experiences with cooperatives (and those of SAOS operating in Scotland).

Cooperation and collaboration has long been recognised as having many benefits within the agricultural sector. A farming cooperative is a collectively owned firm, established to further the economic well-being of its farmer members. Within this horizontal structure, farm businesses work closely together to achieve greater efficiencies in areas such as purchasing, producing and marketing; for example by sharing machinery, buying inputs in bulk or jointly marketing produce. In addition vertical collaborations are an increasing feature of agricultural cooperatives where
the cooperative works closely with its supply chain customers (processors-manufacturers) to generate greater efficiencies and hence value. POs might correctly be characterised as essentially marketing cooperatives and as such have played a fundamental role in the European Union’s (EU) fruit and vegetable sector since 1972, i.e. Article 13 of Regulation (EC) No. 1035/72 which established the Common Market Organization (CMO).

Since then, the CMO has undergone various reforms. The 1996 revision as laid down in the Council regulation (EC) No 2200/96 was followed by further refinement in 2003 which has now been consolidated into the Council regulation (EC) 1234/2007 in 2007. In response to these reforms there have been changes in the activities of POs. The original objective was the management of supply (withdrawals, entry price schemes and export subsidies) to bring about greater stability in producer prices and income and little attention was paid to specific marketing issues. This changed with the 1996 reform where thinking, in response to the increasing concentration of the retail sector, had moved to viewing grower cooperation as a means of providing countervailing marketing power. However, with the inclusion of the CMO in the single payment scheme in the 2007 reform, the focus shifted to the improvement of the market orientation and competitiveness of producers.

Many fruit and vegetable POs were set up in the UK following the revisions of the CMO in 1996. To achieve recognition by a Member State Competent Authority a PO had to meet a number of criteria but in practice some of the POs formed in the UK were only concerned to meet the requirements of the scheme in order to be eligible to receive grant aid. They were not necessarily engaged with the primary objective which was to support and promote the consolidation of produce marketing. Indeed EU Auditors who visited nine UK POs in 2005 reported that in their view five had been created artificially (in some cases by their marketing agents) as vehicles to enable growers to access grant aid without meeting the recognition criteria or engaging with the objectives of the scheme. Far from finding POs had been formed on the initiative of their grower members with the objective of working together to market their produce, the EU auditors found POs formed with no real business in place, but rather a mechanism for accessing grant aid. Over recent years the impact of EU audits has led to a reduction in the overall level of production supported as growers and POs struggle to meet the requirements of the scheme. Consequently the number of recognised POs is 34 today compared to a high of 73 in 2005.

Although traditionally associated with the fruit and vegetable sector, the EU is now intent on making provision for Member States to recognise POs across the majority of agricultural sectors. The UK already has a number of marketing cooperatives operating in other sectors e.g. dairy and cereals, and these perform the type of roles being envisaged by the EU for POs. The EU’s initiative is a response to the recognition that the concentration of supply from farmers is much lower than the concentration at the processing or retail level which results in an imbalance in bargaining power between these levels. However, we would argue that the changes are more complex than this, driven by a fundamental shift within the food chain from a production-orientation to a market-orientation involving a number of related changes. In practice this includes changes such as: the substitution of spot market transactions by contractual arrangements; increased information exchange amongst producers and their buyers; introduction of quality assurance programmes; as well as much greater emphasis on product innovation. All this has taken place against a background of structural change in which processors and traders have increased their scales of operation and an external competitive business environment which is increasingly international.

Many of the changes that have been made in response to the shift to a market orientation can be grouped under the heading of increased vertical co-ordination involving cooperation between farmers and their downstream customers. The collectively owned activities of a typical, modern marketing cooperative now extend
beyond finding markets for its members’ perishable products to include a number of value adding activities. Many cooperatives add value by processing and/or packaging their members’ produce whilst others encourage and support innovation at both the farm and product level. But describing what marketing cooperatives do, and recognising their long history, does not in itself provide evidence that their existence raises the efficiency and competitiveness of individual farm businesses or particular food chains.

Given the heightened interest in POs, the developing policy framework and the potential benefits for not only producers but also others in the food supply chain including consumers, there is a need for research into the relatively unexplored issue of POs. Following from the questions posed above there is a need to gather evidence drawing on the experience of England and Wales as to what makes a successful farming cooperative and PO as well as assessing the likely contribution to the competitiveness of farming and the food chain in general. The research contained in this report not only addresses these matters but also the farm and farmer characteristics associated with collaboration and the scope such organisations might provide for innovation in the area of efficiency including knowledge transfer, risk management and the promotion of new product research.

Specifically this report explores formal collaborative arrangements amongst farmers, both in the UK and abroad. That is, the study is confined to cooperatives/POs that have an established documented corporate-type structure and an experience to draw on. It is our view that in terms of the attributes that underpin successful farmer collaboration there is very little difference between a PO and a marketing cooperative organisation; hence we can reasonably consider both as one of the same throughout the report. Where differences do exist they are highlighted in section (5).

Multiple sources of information have been used to gather the evidence required in order to produce this report. In addition to carrying out a literature review (see the appendices) we have conducted a survey of a wide cross section of Chairmen and CEOs of cooperatives and POs as well as other industry stakeholders such as the NFU and Agricultural and Horticultural Development Board (AHDB). This has been augmented by one-to-one interviews with several CEOs of leading UK PO/cooperatives. The study concluded with an industry workshop. In addition EFFP has drawn on its experiences with cooperatives (and those of SAOS operating in Scotland) from helping to set them up to advising on their development and efficiency.

The detailed responses from the survey are shown in the appendices and where appropriate the results have been used throughout the report to evidence the arguments put forward. All figures in the report (unless otherwise stated) are sourced from the industry survey.

A list of face to face and telephone interviews is also shown in the appendices and these form the basis of the small boxed case-studies used throughout the report.

Please note that through the report the graphs and figures are based on the results of the industry survey. All graphs are shown in the appendix along with comments from the survey while a proportion is shown again at the appropriate point in the text to support specific points and arguments.

The key to the graphs is as follows:
- Blue = POs/Coops
- Green = POs
- Red = Industry Stakeholders
4. Structure of report

The report has been informed by a combination of qualitative and quantitative research, including surveys of senior PO/cooperative managers and industry stakeholders, an industry forum and where appropriate, case studies.

In response to feedback from Defra:

- Section (5) has been added which considers the difference between a PO and a co-operative
- Section (10) on competitiveness has been extended to try and answer a range of pertinent issues that have been raised and can be read either as a standalone piece or in the flow of the document where included.

Thus, after a discussion about the similarities and differences between POs and cooperatives in section (5), the structure of the report broadly follows the ten key research issues as set out in the aims section on page 6.

The first three issues can be summarised as relating to the objectives, functional scope, business models and types of activities undertaken by PO/marketing cooperatives as well as their current and potential role in supporting a competitive farming sector. These are dealt with in the literature review. This is set out in full in Appendix 13.1 and is summarised in section (6). The literature review attempts to capture the current position in both the UK and abroad and where possible specifically covers POs in the fruit and vegetable sector. It also seeks to identify key lessons and gaps in evidence.

Section (7) explores the methods that might be employed to measure the success of a PO/cooperative as well as the elements that evidence suggests contribute to a successful PO/cooperative. The next section (8) records the barriers that POs/cooperatives in the UK face in developing and growing their businesses including the business environment, the attitudes of external stakeholders and the ambition or goals of PO/cooperative managers and Boards. Section (9) studies the willingness of producers to join these organisations; in particular their reasons for doing so and the factors that influence their commitment.

Section (10) then sets out the economic case for cooperation in the farming sector and summarises the potential contribution to efficiency, competitiveness and growth. Recognising that Europe has a stronger tradition of farming cooperatives and much greater experience of POs in the fruit and vegetable sector, Section (11) considers the transferability of this experience to E&W producers and also to other sectors. The penultimate Section (12) outlines the potential/possible downsides of POs/cooperatives. The final Section (13) sets out a list of policy implications and policy recommendations.
5. Producer organisations vs agricultural cooperatives

Section summary

The rationale for the introduction of POs into dairy and a number of other sectors is to ensure a fair standard of living for producers by providing the mechanism by which their bargaining power vis-à-vis downstream operators can be strengthened, thereby resulting in a fairer distribution of value added along the supply chain. To enable this, POs should be able to negotiate, subject to quantitative limits, the terms of delivery contracts including price for some or all of their members' production.

The question is whether POs offer anything a cooperative cannot already do. To help answer this three issues must be considered: a) what the objectives of each organisational model are seeking to achieve; b) the implications of competition law for each; and c) the legal structure of each model.

a) Organisational objectives

- At first sight, the objectives of a PO, as set out in EU Regulations and Member State guidance notes appear more limited than those of an agricultural cooperative; concentrating supply and marketing the produce of members, adapting production to the requirements of the market, improving the product and rationalising the mechanisation of production. Further instructions from the RPA refer to a requirement to achieve one or more of the following; planning production, improvement of quality, boosting the value of products, promotion of products, environmental management and crisis prevention.

- In essence therefore to achieve the above POs do have substantial freedom to pursue activity that is not just horizontal in nature, but also to vertically integrate to add value to products via processing, packing, etc. As with a cooperative there is nothing material within either current or proposed legislation that would prevent a PO from investing downstream in the supply chain to create and capture greater value.

b) Competition law

- For POs collective negotiation comes with certain conditions, principally quantitative limits, In the dairy sector the limits upon which a PO may negotiate is 33 per cent of member state production or 3.5 per cent of EU milk production, whichever is the greater; in the cereal and beef sectors it is 15% of the total national production of any member state.

- However, even where the thresholds are not exceeded, the competition authority may decide that a negotiation should be examined if it considers competition has been excluded or there is a risk of damage to SME processors of raw milk in its territory.

- In comparison, the Office of Fair Trading in the UK takes the view that a cooperative may decide on sales volumes and prices without falling foul of competition law. That is on the proviso that such decisions are indispensable
for the implementation of their marketing functions and their ability to generate efficiencies. It also assumes the cooperative does not hold significant market power – which is deemed unlikely if its market share does not exceed 20 per cent in the relevant market. Above such thresholds there is no presumption of illegality, but the potential restrictive effects will have to be assessed on a case to case basis.

Thus there is more clarity around this area for POs but it does come at the cost of more scrutiny with regular reporting to the RPA and potentially subject to OFT review.

c) Legal structure of POs vs cooperatives

- An agricultural cooperative is a legal entity, either constituted as an Industrial and Provident Society under the Industrial and Provident Society Act or as a company limited by shares or guarantee and registered under the Companies Act. It is important to recognise that a cooperative can be legally constituted under either legislative framework.

- POs must be formed as a legal entity or a clearly defined part of a legal entity on the initiative of farmers. The framework under which a PO might be established is not specified as long as the statute is consistent with its objectives, for example, a set of Rules if constituted as an Industrial and Provident Society or Articles of Association if formed as a company. Therefore in terms of the legal structure of a PO or cooperative there is no difference in how they can, or should, be formed.

Overall there would appear to be little that the introduction of POs in the dairy and other agricultural sectors can offer that cannot already be delivered by an agricultural cooperative. The industry interviews and workshop, in the most part supported this view.

Whilst the differences between a cooperative and a PO were not obvious or material there was a consensus at the workshop that the government should encourage the introduction of POs into other sectors for the following reasons:

- For some, particularly in the dairy sector, the clarity in market share thresholds provided by the PO framework in relation to competition law could provide assurance that their role has a legal basis.

- It was felt that the introduction of POs across other sectors could stimulate interest and activity providing a catalyst for the formation of cooperatives in the future.

- It was thought conceivable that future EU policy may offer specific benefits to those recognised as a PO, leading to the risk that UK farmers would miss out on such opportunities if the UK remains outside the scheme.
5.1 Introduction

On the face of it there would appear to be little that the introduction of POs in the dairy and other agricultural sectors can offer that cannot already be delivered by an agricultural cooperative. Indeed, the industry interviews and in particular the output from the industry workshop, in the most part supported this view.

In the workshop, which was attended by a wide range of industry stakeholders (full details are included in Appendix 13.14), a number of perceptions were revealed by participants suggesting that:

- POs were concerned with marketing whereas cooperatives increasingly involve investment into processing;
- POs would generally act as agent rather than principal in product marketing;
- The role of POs is likely to focus on price negotiation whereas cooperatives have a wider role;
- POs may be able to enforce regional standards by imposing rules and conditions on all producers for designated product from a geographical area.

In discussion, however, it was concluded that whilst the first three points may appear to be valid perceptions, participants could identify clear exceptions to each. On the fourth point regarding the wider enforcement of PO standards, Defra confirmed that the reform proposals leave discretion in applying this option to member states and it is unlikely to be pursued in the UK.

Overall it was concluded that the differences between a cooperative and a PO were not obvious or material and in reality the proposed new regulation might not bring anything that could not in theory be undertaken already. Nonetheless, there was a consensus at the workshop that the government should encourage the introduction of POs into other sectors for the following reasons:

- For some, particularly in the dairy sector, the clarity in market share thresholds provided by the PO framework in relation to competition law could provide assurance that their role has a legal basis within the supply chains they operate; in other sectors the thresholds are to be set at a lower level and thus it could be argued, present less of an advantage.

- When POs were introduced into the dairy sector last year they generated considerable interest in greater farmer collaboration, albeit their introduction coincided with a period of political instability around milk prices. Therefore, it was felt that the introduction of POs across other sectors could stimulate interest and activity providing a catalyst for the formation of cooperatives in the future.

- Importantly, much political capital has been spent by the EU to include POs in the CAP reform package. It was therefore thought conceivable that future policy may offer specific benefits to those recognised as a PO, leading to the risk that UK farmers would miss out on such opportunities if the UK remains outside the scheme.
5.2 The differences between a PO and a cooperative

A producer organisation is a form of cooperation between farmers and more generally producers of certain agricultural products which is defined in Article 122 of Council Regulation (EC) 1234/2007 (also known as the Single CMO Regulation). In order to be recognised as a PO, the legal entities concerned must meet certain requirements set out in Article 125b of the Single CMO Regulation, such as, for example, having a minimum number of members and cover a minimum volume or value of marketable production to be laid down by the Member State.

In the Fruit and Vegetables sector, there are specific criteria attached under the EC Fruit and Vegetable Regime that allows POs to apply for financial assistance under an Operation Programme. However, it is not envisaged that such assistance will be made available to POs in other agricultural sectors under the latest reformation of the CAP. Indeed the introduction of POs in the dairy sector as adopted in the Dairy Regulation 2011 does not provide for financial assistance.

The rationale for the introduction of POs across both the dairy sector and now as proposed into other agricultural sectors is to ensure a fair standard of living for producers by providing the mechanism by which their bargaining power vis-à-vis downstream operators can be strengthened, thereby resulting in a fairer distribution of value added along the supply chain. To achieve this objective it is deemed that recognised POs should be able to negotiate, subject to quantitative limits, the terms of delivery contracts including price for some or all of their members' production. The proviso is that those organisations pursue one or more of the objectives of concentrating supply, the placing on the market of the products produced by its members and the optimising of production costs. The pursuit of these objectives should lead to the integration of activities to generate significant efficiencies.

An agricultural cooperative on the other hand is a voluntary association of persons established in order to pursue certain commercial objectives which, unlike a PO, does not need to meet any specific requirements laid down in legislation or to be officially recognised in order to operate as such. The rationale for the formation of an agricultural cooperative are numerous, but the literature review points to the historic development of cooperatives as a way for producers to offset market failures caused by inequalities in size between producers and those they transacted with, in other words to exert market power. A rationale that is very similar, if not identical to that underpinning the introduction of POs under the Single CMO regulations. In more recent decades, agricultural cooperatives have increasingly modified their organisational structures in an attempt to become more entrepreneurial, investing capital into value adding activities such as processing, innovation and branding in an attempt to achieve competitive advantage and thereby increase returns to members. The development of new entrepreneurial forms does not appear to be a consideration in either the existing or proposed legislation for POs, albeit as highlighted below, in practice across the fruit and vegetable sector there are examples of POs which have pursued this route.

In order to draw out the key differences between a PO and a cooperative we have identified the following three issues each of which are considered in more detail below. The three issues are: a) what the objectives of each organisational model are seeking to achieve; b) the implications of competition law on the activities they undertake; and c) the legal structure of each model. We then consider the benefits a PO could potentially deliver that a cooperative cannot already achieve.
5.3 Organisational objectives

As set out above, an agricultural cooperative is in the most part able to pursue a wide range of commercial objectives on behalf of its members which includes the collaborative purchasing of inputs, collective bargaining, activities to share resources, collaborative processing and vertical integration and collective marketing. Indeed the research highlighted that the objectives of a cooperative are mixed, but achieving benefits for members was the common goal, however that was achieved.

At first sight, the objectives of a PO, as set out in EU Regulations and Member State guidance notes appear more limited than those of an agricultural cooperative. Article 122 of Council Regulation (EC) No 1234/2007 states that Member States shall recognise POs which pursue a specific aim, which may in particular relate to:

- Concentrating supply and marketing the produce of the members
- Adapting production jointly to the requirements of the market and improving the product
- Promoting the rationalisation of mechanisation of production

The guidance notes for the Fruit and Vegetable Aid Scheme as issued by the Rural Payments Agency (RPA) stated that to be recognised under the Fruit and Vegetable Regime a PO has to have one or more of the following objectives:

- Planning of production
- Improvement of product quality
- Boosting the commercial value of products
- Promotion of the products, whether in fresh or processed form
- Environmental measures and methods of production respecting the environment, including organic farming
- Crisis prevention and management

Moreover the recent publication by the RPA of the recognition criteria for Dairy POs (DPOs) confirmed that a DPO must pursue a specific aim and provides examples which include:

- To be able to negotiate contracts on behalf of members for the delivery of raw milk
- Making sure that production is planned and adjusted to demand, particularly in terms of quality and quantity
- Concentration of supply and the placing on the market of raw milk produced by members
- Optimising production costs and stabilising producer prices

Whilst at first sight these objectives appear more limiting than those of an agricultural cooperative, in essence they do provide substantial freedom to pursue activity that is not just horizontal in nature, such as the coming together of farmers to collectively bargain or improve planning of production, etc., but also to vertically integrate activity to add value to products via processing, packing, etc.
Drawing examples from the fruit and vegetable sector to support this claim can be challenging given the short supply chains that characterise produce moving direct from field to retail. That said, POs such as Freshgro, Berry Gardens and G’s all show entrepreneurial flair investing heavily into research and development, cutting edge processes and vertical integration. In the dairy sector we have yet to see the registration of a PO, but in theory there is nothing written into the recognition criteria that precludes added value activity and vertical supply chain integration, be that through investment or partnership.

In conclusion, whilst the *raison d’être* for the introduction of POs to other sectors is to improve farmers’ negotiating position by making provision to collectively negotiate contracts for the supply of crops or livestock, there is nothing material within either current or proposed legislation that would prevent a PO from investing downstream in the supply chain to create and capture greater value. Indeed, it has been argued by some of those involved in the interviews and industry workshop that collective negotiation can only take the industry so far. Given that the price for most agricultural commodities is ultimately dictated by global supply and demand dynamics, the ability to innovate and add value is arguably more crucial for the long-term sustainability of farmers than simply achieving a better negotiating position in the short-term.

5.4 The implications of competition law

Under the recent agreement on the reform of the CAP it was announced that the rules relating to the recognition of POs will be introduced across other sectors including beef and cereals to allow farmers to collectively negotiate contracts under certain conditions and safeguards; namely, that recognised POs should be able to negotiate, subject to quantitative limits, the terms of delivery contracts including prices, for some or all of their members production. In the dairy sector the quantitative limits have been set at 33 per cent of member state production or 3.5 per cent of EU milk production, whichever is the greater; in the cereal and beef sectors it is 15% of the total national production of any member state.

However, to be eligible for these exemptions, dairy POs, and therefore it is expected other POs, will be required to regularly report to the RPA the nature of any negotiations that take place and be submitted to routine OFT assessment. Moreover, it should be pointed out that whilst the regulations provide clarity over the scale of negotiations which dairy POs may cover, even where the thresholds are not exceeded, the competition authority may decide that a negotiation should be reopened or not take place at all if it considers that this is necessary in order to prevent competition being excluded or in order to avoid seriously damaging SME processors of raw milk in its territory.

The situation with regard to agricultural cooperatives is not as clear but in general terms EU and UK competition laws already allow many forms of cooperation between farmers and tend to see them as beneficial, contributing to the modernisation of and rationalisation in the agricultural sector thereby improving efficiency, to the ultimate benefit of the consumer.

In written evidence submitted by the Office of Fair Trading to the Environment, Food and Rural Affairs Committee as part of a review of the EU proposals for the dairy
industry in June 2011\(^1\) it was stated that under EU competition rules, a cooperative may decide on sales volumes and prices without falling foul of competition law, provided that such decisions are indispensable for the implementation of their marketing functions and their ability to generate efficiencies; and also as long as the cooperative does not hold significant market power – which is deemed unlikely if its market share does not exceed 20 per cent in the relevant market. Above such thresholds there is no presumption of illegality, but the potential restrictive and efficiency enhancing effects will have to be assessed on a case to case basis.

In the UK the Competition Act 1998 provides an exclusion from competition law for agricultural products that mirrors the exemption in the Single CMO regulation. This is an exclusion from the application of the Chapter I prohibition (which prohibits agreements and concerted practices which prevent, restrict or distort competition), to the extent they relate to production of, or trade in, an agricultural product, and:

- form an integral part of a national market organisation;
- are necessary for the attainment of the objectives set out in Article 39 of the TFEU, or;

are agreements of farmers or farmers’ associations belonging to a single Member State which concern: (i) the production or sale of agricultural products, or (ii) the use of joint facilities for the storage, treatment or processing of agricultural products and under which there is no obligation to charge identical prices.

It appears from the evidence above that whilst an agricultural cooperative can control a significant market share of any relevant market, the criteria as to what is acceptable or unacceptable in the eyes of the competition authorities is not precisely defined but depends on prevailing circumstances including defining the ‘relevant market’. This is the case for dairy POs and thus likely to be the case for POs introduced in other sectors. However, the clarity afforded by a PO potentially comes at a cost. The requirement to regularly report to the RPA the nature of any negotiations that take place and be subject to regular OFT review could create a burden that some don’t wish to incur.

### 5.5 The legal structure of PO’s vs. Cooperatives

In the UK an agricultural cooperative is a legal entity that is either constituted as an Industrial and Provident Society under the Industrial and Provident Society Act or as a company limited by shares or guarantee and registered under the Companies Act. It is important to recognise that a cooperative can be legally constituted under either legislative framework.

According to the EU Council Regulation No 1234/2007, POs in either the fruit and vegetable or dairy sectors shall be formed as a legal entity or a clearly defined part of a legal entity on the initiative of farmers. The framework does not specify under which legal framework a PO might be established. In the recent UK publication ‘Guidance on Recognition as a Dairy Producer Organisation (DPO)’ it states that a DPO should have a statute that is consistent with its objectives, for example, a set of Rules if constituted as an Industrial and Provident Society or Articles of Association if formed as a company. Therefore, we can conclude that in terms of the legal structure of a PO or cooperative there is no difference in how they can, or should, be formed.

\(^1\) [http://www.publications.parliament.uk/pa/cm201012/cmselect/cmenvfru/952/952vw12.htm](http://www.publications.parliament.uk/pa/cm201012/cmselect/cmenvfru/952/952vw12.htm)
6. Literature review summary

This section summarises the literature review set out in Appendix 13.1 with full references shown at the end of the section. This reveals that the academic literature on agricultural cooperatives is extensive and shows that there is no archetypical cooperative (Hind, 1997). The modern cooperative originated in Europe and one development regarded as having a major impact was the formation in 1844 of a consumer cooperative, the Rochdale Society of Equitable Pioneers, Ltd (CfC, 2012). The first agricultural cooperative in Britain was formed some twenty years later to supply seeds and fertilizers to members. In 1895 the International Cooperative Alliance (ICA) was established and in the ensuing years its membership has grown to 227 organisations in 98 countries representing over one billion individuals (ICA, 2012a).

The ICA defines 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 (ICA, 2012b). The United States Department of Agriculture (USDA) succinctly defines the principles underpinning a cooperative as: user ownership; user control; and user benefit. The foregoing raises the issue of property rights which are held in common in a cooperative i.e. who has control over, and who receives income from the cooperative. This common property rights structure is manifested in three characteristics (LeVay, 1983; Staatz, 1987b, Barton, 1989): the owners are the users of the cooperative’s services; the benefits accrue to the owners through and in proportion to their use of these services; and control over the cooperative lies with all users together based on decisions that are taken democratically. An important contrast between the traditional cooperative and the IOF is that the cooperative’s investors are not residual claimants; their return becomes a prior charge (LeVay, op cit).

The purpose of this summary is to provide an overview of the development of theory and research applying to agricultural cooperatives but with particular emphasis on marketing cooperatives. As explained above a PO is essentially a marketing cooperative and therefore this review can be viewed as a prelude to an analysis of the potential offered by the wider adoption of POs in the UK. Academic studies of agricultural cooperatives can be traced back to the 1920s and to two influential Americans: Edwin Nourse; and Aaron Sapiro. Sensitive to the inequalities in size between producers and those they transacted with, Nourse saw cooperatives offsetting market failure by offering producers more equal opportunities (Knapp, 1980, Hogeland, 2006). In contrast Sapiro’s cooperative model was based on the principles of bilateral monopoly, matching the market power of the seller to that of the buyer. He argued that the prime purpose of farmer cooperatives was to unify farmers on a commodity basis in order to exert market power (Staatz, 1989).

In a seminal paper, Edwin Nourse (1922) set out the three ‘fundamentals’ for cooperation, namely … increased efficiency or reduced costs ….. popular distribution of savings or profits …[and] … democratic control, each member voting as an individual (op cit, p578). For Nourse cooperatives did not exist to influence the ‘true’ market price but rather to … reflect these markets conditions back most promptly and fully to producers (Nourse, 1942 [1992]). The Nourse’ school contended that cooperatives should function as ‘competitive yardsticks’ to enhance efficiency and competition (Cotterill, 1992). Sapiro’s approach was very different based on the imperative that the cooperative’s scale of operation must go beyond a geographic locality to dominate sales of a commodity (Sapiro, 1923 [1993]) garnering 90 per
cent plus of growers for a particular crop and concentrating on orderly marketing (Hogeland, 2006).

Formal modelling of agricultural cooperatives did not begin until the 1940s (Cook, et al, 2004) and in the ensuing years economists came to view the cooperative in one of three ways: as a form of vertical integration; as an independent firm; and as a coalition of firms (Staatz, 1987a, 1989). The vertical integration approach was advanced by Phillips (1953) who argued that a cooperative was an extension of the members’ farms; that is, a multi-plant, vertically integrated firm. Critics of Phillips’ model pointed out it involved a very diffuse decision making process and was strongly challenged by Savage (1954) who argued that the economic nature of cooperatives cannot be adequately explained as an extension of the standard neo-classical theory of the firm, as although farmers own their cooperative they …do not make all or most of the entrepreneurial decisions (op cit, p531) concerning the cooperative.

For Savage the revocable delegation of day-to-day decision-making authority elevated the cooperative to an independent organisation (Staatz, 1987b) and Helmberger and Hoos (1962) argued that decision making resided with the cooperative’s senior managers who would attempt to maximise member benefits by maximising the average member’s rebated surplus. In practice decision making lies somewhere between this extreme and the decentralised model proposed by Phillips. That is, in order to analyse how decisions are actually made in cooperatives it is necessary to analyse the internal organisation of a cooperative and this area increasingly attracted the attention of academics during the 1990s.

In parallel, academics (see for example Boehlje, et al, 1995) viewed the internationalisation of food markets, the proliferation of technology, the deregulation of markets, and heterogeneity in consumer behaviour as combining to mark a major economic shift from production to market-oriented competition. This raised a question (see Van Dijk, 1999) as to whether the traditional democratic system of decision-making within cooperatives was equipped for a more market-driven economy. As the marketing emphasis turned from homogeneous commodities to differentiated products (Hendrikse and Veerman, 2001) so the basis of competitiveness shifted towards quality and product innovation, areas in which IOFs were believed to have an advantage. However, Saitone and Sexton (2009) argued that cooperatives can compete effectively with IOFs in quality-differentiated markets as revenue pooling confers two strategic advantages; it attenuates the incentive of competitive farmers to overproduce a high-quality product and it insures risk-averse farmers against adverse realisations of quality.

Yet another area of research opened up during the 1990s. This arose from academic dissatisfaction with a cooperative model that played down the likelihood of differences in members’ relative efficiencies and objectives giving rise to the study of a cooperative as a coalition (see Hind, 1999). This approach turned to game theory (Staatz, 1983, Sexton, 1986), principal-agency theory (Vitaliano, 1983) and in general the theories of ‘new institutional economics’ (NIE) to analyse the organisational complexities of cooperatives. Applying NIE theories and concepts resulted in significant advances in the understanding of cooperatives; in particular, organisational design and capital constraints. Particularly influential was a paper by Cook (1995) which identified the five cooperative types as set out in Table 1: a Nourse I type provides a missing service or economies of scale; a Nourse II type may integrate forward or backward with the objective of operating more efficiently at these stages than the alternatives; a Sapiro I type has the scale and bargaining power to beneficially influence the term-of-trade; a Sapiro II type is a marketing cooperative taking the form of producer vertical integration; and a Sapiro III, is the ‘New Generation Cooperative’ (NGC) model that emerged during the 1990s.
Table 1: Residual Claimant and Decision Control Problems

<table>
<thead>
<tr>
<th>Cooperative Type</th>
<th>Nourse I (1)</th>
<th>Nourse II (2)</th>
<th>Sapiro I (3)</th>
<th>Sapiro II (4)</th>
<th>Sapiro III (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Free rider problem</td>
<td>major</td>
<td>minor</td>
<td>major</td>
<td>minor</td>
<td>Minimal</td>
</tr>
<tr>
<td>Horizon problem</td>
<td>major</td>
<td>major</td>
<td>none</td>
<td>minor</td>
<td>Minimal</td>
</tr>
<tr>
<td>Portfolio problem</td>
<td>minor</td>
<td>major</td>
<td>none</td>
<td>major</td>
<td>Minimal</td>
</tr>
<tr>
<td>Control Problem</td>
<td>minor</td>
<td>major</td>
<td>minor</td>
<td>major</td>
<td>Minor</td>
</tr>
<tr>
<td>Influence costs problem</td>
<td>major</td>
<td>major</td>
<td>minimal</td>
<td>minor</td>
<td>Minor</td>
</tr>
</tbody>
</table>

Source: Cook 1995

Cook examines these types against five property rights constraints. The ‘free rider’ problem where non-members capture the benefits of membership; the ‘horizon’ and ‘portfolio’ problems that arise from restrictions on the transferability of residual claimant rights and create a disincentive for members to invest in growth opportunities; the ‘control problem’ inherent in preventing a divergence of interests between cooperative members (principals) and their hired senior managers (agents); and the ‘influence costs’ when constituent groups in pursuit of their selfish interests attempt to influence the decision to their benefit (Milgrom and Roberts, 1990). Cook’s contribution was not to suggest that cooperative models would gravitate towards the NGC but rather he provided an important bridge between the business behaviour of cooperatives and contemporary research on the organisational structures of firms. For Nilsson (1998) it was clear that in order to survive cooperatives would increasingly be forced to seek …

….. new organizational structures in their attempt to be competitive on the increasingly internationalized, deregulated and demanding markets. There are good reasons to believe that this trend will become even more pronounced in the following years as internationalization will proceed and competition will become even harder (op cit, p8).

Iliopoulos (2002) examined the relevance of these issues for agricultural cooperatives in the EU and concluded that the model being gradually adopted for long-term financing methods possessed one or more of the characteristics found in successful American NGCs. Nilsson (1998), however, points out that empiricism shows that in many countries cooperatives are thriving businesses and he predicted a diversity of cooperative models according to strategic considerations, a conclusion supported by an empirical study of agricultural cooperatives in fifteen EU member states (Van Bekkum and Van Dijk, 1997). This gave rise to what Nilsson (1999) describes as ‘entrepreneurial models’. The common element in entrepreneurial cooperative models is allowance for external sources of investment capital. However in the view of Van Bekkum (2001), focusing primarily on organisational structures risks ignoring how these compliment or conflict with desired business strategies. This concern lead Van Bekkum to define four ‘basic’ models: the village; niche; commodity; and value added cooperative (op cit, p49). The commodity model focuses on a low cost strategy whereas the niche model is dedicated to differentiation. The value-added model is a weighting of these two strategies while the village model does not have a clearly defined strategy. Van Bekkum completes his taxonomy by defining two organisational structures: collective; and individualised. The former would adhere to the traditional model whereas the latter is the management response to increasing complexity in terms of market strategy and operations including restricted membership, proportional voting and differential pricing (op cit, p38).
The development of new organisational forms does not appear to have spread to POs or indeed to be a consideration in the legislation. The concentration of production is the primary objective assigned to POs if they are to access EU support (Camanzi, et al, 2009). This reflects the thinking of a traditional Sapiro model and in terms of Van Bekkum’s taxonomy the POs would fall between the commodity and value-added models. The CMO for fruit and vegetables allows for an operational fund, within the limit of 4.1 per cent of the value of marketed production (VMP), co-financed by both producers and Member States to pay for POs’ marketing activity. However, a study of POs in France, Italy and Spain noted that this limit had not been reached which may … signify a low level of commitment by producers (Camanzi, et al, 2009, p13).

Notwithstanding the fact that the objectives set by members for their cooperative are likely to vary from those of IOFs, considerable attention within the academic literature has been devoted to attempting to compare the performance of agricultural cooperatives with IOFs (see for example, Staatz, 1987b; Hendrikse and Veerman, 1997). The academic literature comparing the performance of cooperatives with IOFs can be divided into two main approaches: the first deals with their respective influence on their functioning in the marketplace (see for example, Fulton and Giannakas, 2001; Notta and Vlachvei, 2007); and the second compares financial ratios for cooperatives and IOFs (e.g. Gentzoglouis, 1997; Harris and Fulton, 1996). A major issue for the first group is a cooperative’s ability to raise capital and to engage in alliances, mergers and acquisitions strategies. As noted above, new models have emerged to attract outside equity (Chaddad and Cook, 2004; van Bekkum and Bijman, 2006) and a study by Van Der Krogt et al, (2007), of the EU’s 15 largest dairy processing firms (comprising seven cooperatives and eight IOFs), did not find a significant difference in terms of alliances, mergers and acquisitions. Turning to the second group, studies often emphasize the superiority, in terms of financial performance, of the IOF-like models though see Royer (1991) for an alternative viewpoint and given the very different objectives set by members for their cooperatives, the value of such studies is far from clear.

Attempting to measure the economic importance of cooperatives to communities is daunting. Several studies have used input-output analysis (see for example Coon and Leistritz, 2001, Folsom 2003) but according to Zeuli and Deller (2007) such studies are handicapped by issues such as the geographic scope, the appropriate multiplier, the treatment of patronage refunds and spending patterns. That said there have been a number of US studies (see for example USDA, 2003) that demonstrate a wider benefit for the local community in terms of incomes and jobs. Turning to the wider issue of the impact of marketing cooperatives on the overall competitiveness of the farming sector we are unaware of any academic study that explicitly addresses this question.

Explicit analysis, within the academic literature, of the performance of POs is very limited but this is neither surprising nor a matter of concern. In essence POs are marketing cooperatives and therefore the research that has been published regarding the development of the latter organisation is directly relevant. An area that does not appear to have attracted much attention in the literature is the influence of variables beyond organisation and culture that might influence market orientation and performance, for example, the degree of product differentiation (Gruber, et al, 2000) and demand conditions. Another concern not deeply researched in the literature is the observation that member commitment to the traditional form of cooperative appears to be waning (Fulton, 1999). This loss of commitment is coming at a time when cooperatives are facing some significant challenges from outside competition requiring the development of marketing systems in which product quality and differentiation are essential. In light of this development research into policies that will foster member commitment would be of significant value.
Measurement & ingredients of success

Section summary

Measuring performance – a different approach needed for cooperatives

- Measuring performance of a cooperative business is challenging as the standard approaches used in an IOF are less applicable. Financial measures such as return on equity and net margin on sales do not account for the cost of using members’ equity in financing a cooperative’s operations nor the fact that the objectives of many cooperatives involve maximising returns to members, thus minimising net margin to the coop. Furthermore a cooperative does not have the measure of a stock market valuation.

- Whilst it is logical to assume that the profits of members’ businesses would be enhanced by marketing products or purchasing inputs through a cooperative; in practice this is almost impossible to measure due to the difficulty in finding a comparable group of farm businesses not trading through a cooperative, as well as identifying this benefit from the many other factors that impact on profitability of individual farms.

- Most participants of the survey considered member satisfaction and the price achieved for members (either input or output price) the most important measures of success, however the latter can be difficult to accurately quantify due to the difficulty in achieving a like for like comparison with alternative supply routes.

- Performance of cooperatives particularly in marketing activity can be influenced by the risk averse nature of farmer members who will compare the opportunity cost of investing in their own business coupled with the fact that the cooperative may be obliged to take delivery of all its members’ supplies which may be above the optimum level for the marketplace.

- Measurements are therefore likely to focus on efficiency, productivity and cost control. Economies of scale will be a major contributor but none of these drivers conflict with the desire to maximise the satisfaction of their members. The overriding objective is thus is to improve the margin on members’ farms; whether through a better price, reduced costs or greater efficiency of production.

- Efficiency gains can be achieved if the cooperative, through the provision of advice, information and coordination, helps improve the planning and alignment of members’ production; for instance through extending the season by delayed planting, lowering their unit costs of production (e.g. by bulk buying and advice) and supporting investments in quality improvements.

- Further efficiency can be achieved by reducing transaction costs for its members. Finding markets and negotiating contracts lower the cost to
individual members as well as countering the risks of opportunistic behaviour on the part of buyers. The collective scale of the cooperative also reduces the ‘agency’ cost of the transaction. The cooperative thus reduces risk and uncertainties; therefore opening up opportunities to members they may otherwise avoid.

**Increasing competitiveness**

- How cooperatives impact on competitiveness of the agricultural sector might ultimately be judged by the sustainability of its members’ businesses and its contribution to the economic and social life of a local community. The EU case for the further development of POs surrounds balancing or countering the exploitation of monopsonist or oligopsonist power by downstream buyers, mitigating market failure and in doing so improving the sustainability of individual farm businesses. To achieve this a PO, under the Regulation, will be able to negotiate contracts on behalf of its members, including the price – subject to some restrictions if the market share becomes very large.

- Pricing aside – and ultimately price is limited by what the market is prepared to pay – there are other external benefits arising from the ability to negotiate better contractual terms, for example, greater security in terms of future market outlets for members’ produce and hence more confidence in longer term investment.

- Further evidence for increased competitiveness by cooperatives and POs includes:
  - Planning and coordinating production across members’ farms reducing waste and raising productivity.
  - More efficiently in the areas of packaging and direct delivery to final customers – as in the case of fresh produce – reducing time between harvest and sale but also speeding up responsiveness to changing market conditions.
  - Investing in value adding activities can introduce a new source of competition to the food sector.
  - Innovation and technical advances including new crops, planting strategies, storage, processing and original marketing.
  - A more sustainable farming sector through providing a framework for environmental performance.

The full text provides examples and case studies of how cooperatives are using the criteria above to deliver increased competitiveness.

**Cooperative leadership and management is key**

- The industry survey highlights that Governance and Management Skills are deemed the most important attributes of a PO/cooperative after member commitment, albeit it is likely that member commitment follows the right governance and management skills. However, it is recognised from the literature that management and leadership quality does vary widely across
cooperatives and POs.

- One of the key responsibilities for senior managers is to ensure that the cooperative’s organisational architecture includes structures and practices that result in democratic governance.

- The size of a cooperative’s membership impacts on the resources that must be devoted to communication. As cooperatives grow into large memberships – and one of the aims of the PO Regulation is to encourage market concentration – so the share of management effort devoted to democratic decision making must increase. The need is for individuals who not only understand the market place but also are able to empathise with, relate to and communicate with members. This aspect scored highest in the survey when respondents were asked to rate key attributes in senior management.

- Senior managers running POs/cooperatives must take the role of member communications very seriously. This would suggest a need for managers in the very senior positions such as Chairman and CEO, with previous experience of cooperatives. However feedback from the surveys showed cooperative experience as one of the least important attributes required as long as senior managers are able to empathise with members and communicate well.

- Experienced senior managers and their Board of Directors will know the importance of an ambition to grow the business and build a reputation but they will also be aware that the PO/cooperative can only pursue such goals to the extent that its members are progressive and entrepreneurial. The cooperative will only develop at a speed that a majority of the membership will support. The alignment of management to members’ needs can be a very challenging aspect of cooperative governance; lack of alignment can lead the cooperative down a path that starts to alienate the membership.

- An efficiency gain that needs to be considered is the scope offered by POs/cooperatives to help farmers to adjust to a future environment as the real value of farm support under the CAP declines. Membership of a well-run PO or cooperative offers individual farmers methods of offsetting this adverse trend; firstly via economies of scale; and secondly through the value adding activities of professional marketing and/or vertical integration.

**The role of government**

- The PO scheme brings with it the force of official support for collaboration across the agricultural industry. A new drive, where both the government and the farmers’ unions are united in advancing the benefits of the PO scheme for individual farmers, could trigger widespread interest and sow the seeds of an industry wide momentum for collaboration.

- The survey highlighted grant funding targeted at vertical supply chain collaboration as the most important action to raise the performance of POs/cooperatives but that other industry wide, and government promoted initiatives, also featured highly.
One cannot sensibly measure the success of any organisation without reference to its aims and objectives. As noted in the previous section the academic literature has devoted considerable attention to comparing the performance of agricultural cooperatives with IOFs. It is however far from clear that such exercises have advanced the issue if growers form a PO/cooperative to achieve an objective that is not normally associated with an IOF or a range of objectives that are much wider. As a starting point the aim in setting up a PO or cooperative is to achieve a genuine community of interest among members based on something other than the amount of capital they have invested. This is likely to include not only economic objectives but also social and cultural aspirations. The basic characteristics that distinguish a cooperative from an IOF, namely that a cooperative is a business that is owned and controlled by the people it serves, rule out conventional measures. With this in mind, a cooperative can only be judged with respect to the benefits it delivers to its member-users, as opposed to an IOF which exists to serve capital investors through dividends and to share (stock) value appreciation.

### 7.1 Difficulties in measuring Success

The standard approach to measuring the financial performance of an IOF is therefore problematic in the case of a cooperative business. In particular many of the commonly used financial measures such as return on equity and net margin on sales do not account for the cost of using members' equity in financing a cooperative’s operations. A cooperative does not have a stock market valuation to provide a value measure going forward and thereby a reflection of its performance. As a result the ability of members, other stakeholders and wider society to judge a cooperative’s performance is more challenging. Membership satisfaction – whether measured by capital invested or some other measure of commitment – cannot be regarded as a sufficient measure of success if information available to members is incomplete. Moreover, if the success of a cooperative is to be judged on its ability to meet its objectives then these must be clearly set out alongside a delivery strategy.

If the objective of the cooperative is to maximise member’s returns through the price they receive for products sold or the cost of inputs purchased, the net profit of the cooperative will be minimised, to a level sufficient for reinvestment and contingency. It could be assumed that members benefit from increased profits at the farm level (as compared to a similar group of farm businesses that are marketing product or purchasing inputs through an IOF). In practice it is virtually impossible to isolate and measure empirically, as there are never two identical populations of businesses in type, location, physical performance etc. The literature review recognises this as an unresolved challenge.

Figure I is drawn from the industry survey (see Appendix 13.2) and shows that most participants believed that member satisfaction and the price achieved for members (whether input price or output price) were the most important measurements of success. However, both of these measures are difficult to quantify and benchmark against other IOFs or indeed other cooperatives.

When tackling the issue of the price achieved, a ‘like for like’ comparison does not necessarily take into account the impact that any investment into value adding activities might have on price in the short-term, an issue that the UK dairy cooperatives have had to deal with whilst investing into their portfolio of processing assets. Moreover, when comparing price achieved by the cooperative to an IOF consideration has to be given to the impact on the market price if the cooperative did not exist.
The performances of POs/cooperatives and IOFs are likely to differ for a number of reasons. As cooperatives are financed primarily by their members’ equity it is reasonable to expect them to be more risk averse than IOFs and subject to the opportunity cost of investing the capital in their own businesses. This suggests comparisons with IOFs based on new product performance are misleading if not irrelevant. In contrast to IOFs, cooperatives are often obliged to take delivery of all their members’ supplies which may at any time be beyond the optimal level, so again unit costs and price ratios are not as relevant as for an IOF that can more easily balance supply with demand.

**Figure I: Measurements of success in a Cooperative or PO**

Given that the *raison d'être* of cooperatives differs from IOFs it follows that a different approach to measuring performance must be adopted, one that takes account of the different objectives of cooperatives. A comparison of the performance of cooperatives with IOFs should take account of the interest of the owners of the cooperatives; ideally not only the current benefits for their farms but also their longer term objectives. This challenge is further complicated given that the objectives of one cooperative may differ from others. Figure II shows that whilst achieving a better price for members is the most common objective there remains a mix of other objectives reported in the survey highlighting that what might be important for one is less so for another. It is also interesting to note the difference in views of those representing cooperatives/POs as compared to industry stakeholders.

**SURVEY QUOTE**

“[the most important measure is the] improved profitability of members’ businesses as a result of marketing produce through the PO/Coop because without this members won’t realise the benefit of being committed to a PO/Coop”
As noted in the literature review the most frequently used measures of performance for agricultural cooperatives, sometimes used in combination, have been efficiency, productivity and cost control. Efficiency has two components: technical efficiency, essentially minimising the unit costs of the cooperative’s services and allocative efficiency which in the case of an agricultural cooperative would be the match between the volume and quality of members’ deliveries and demand. There is no conflict in principle between these two measures and the priority cooperatives must give to maximising the satisfaction of their members. All other factors remaining equal, economies of scale is a major contributor to efficiency. Matching supply and demand is more complicated and could involve a series of activities on the part of the cooperative from introducing systems and routines to lower members’ costs and raise quality to investing in packaging, processing and marketing.

Box 1: It is not all about profits

Wessex Grain is a regional grain marketing and storage business based in the South West. The business trades around 450,000 tonnes per annum of combinable crops through a variety of pooled and ex-farm contracts. Being a cooperative means that they can take a long-term view, not having to be driven by the need to maximise profits in the short-term. This means they can be very focused on the needs of the farmer, offering flexibility and offering a service that you wouldn’t necessarily get from an IOF.

(Sourced through business interview)

Figure II: Objectives of a Cooperatives or PO

Although a PO/cooperative cannot be judged on its financial performance alone to be successful it must be in a financial position to meet its members’ objectives and align its development with their aims as well as responding to changes in the external business environment. This does at least suggest a role for some
conventional financial ratios such as the current ratio. This measures the ability of a business to meet its current obligations as they come due and as such is the standard measure of liquidity, calculated by dividing total current assets by total current liabilities. In the experience of EFFP comparisons of the current ratio for cooperatives provide no evidence to support the hypothesis that cooperatives are generally financially weaker than IOFs in the sectors in which they operate. The use of other basic ratios, such as the gearing ratio (debt to equity) can be problematic in a cooperative as the legal structure often dictates that member investment is made in the form of debt finance rather than equity finance, albeit this can often be accounted for when looking at cooperative gearing.

A further complication is the way in which a PO or cooperative seeks to achieve its aims and objectives is likely to change over time. The evidence suggests that in part, changes are influenced by developments in the external environment and in particular changes in farm support policies and globalisation, the former frequently a response to the latter. For example EU legislation concerning the setting up of POs in the fruit and vegetable sector in 1972 came against the background of growing competition and the 1996 revision followed the MacSharry Reform of the Common Agricultural Policy (CAP) alongside the implementation of the Uruguay GATT Agreement which threatened to increase the competitive pressures on EU fruit and vegetables growers. Similarly the 2003 and 2007 reforms had the intention of bringing support for the sector into line with the CAP and the Single Payments Scheme. These policy reforms all had in common that they were introduced in response to farmer fears regarding the future value of farm support policies. The evidence from both Europe and the US is that as market conditions become or are perceived to become unfavourable so there is greater interest in the contribution that cooperation can make to providing members with access to markets and scope for adding value.

**Box 2: Changing priorities of Cooperatives and POs**

Freshgro is a producer organisation based in Nottinghamshire. It has a farming base of over 20,000 acres growing both conventional and organic vegetables together with 2 acres of factory space from which they serve all the country’s retailers. At its conception in 1998 the focus was purely on selling bulk carrots straight from the field into packers leaving the cooperative at the behest of its packer customers. An investment into their own washing facilities opened up the opportunity to sell direct to retail and subsequent investment into varietal research and development, production efficiencies, marketing and PR has resulted in Freshgro becoming the leading supplier of Chantenay carrots in the UK.

Camgrain is the largest central grain store in the UK with a strategy to continuously grow and develop the business for the benefit of its members. Whilst the fundamental purpose of Camgrain has remained the same since it was established, the scale now achieved means that its approach to market has had to develop. Not only is Camgrain now able to meet the demands of customers such as Sainsburys, but is arguable now setting a new agenda within cereal supply chains. Scale empowers farmers to be able to do this, but the business also has to have the ambition and vision to make it work.

*(Sourced through business interview)*

Although POs/cooperatives have a variety of objectives, and indeed so do their members, it is clear from our research that the over-riding objective for all farmer
members is to improve the margin achieved on their farms; whether through a better price, reduced costs or greater efficiency of production. This raises a conundrum as we can observe the farm business’ performance as a member of the cooperative but not at the same time how it would have performed outside. As the UK, indeed the EU, agricultural industry is characterised by a wide diversity of farm businesses, it is reasonable to suspect that membership of UK agricultural cooperatives is similarly diversified.

Farmers routinely face the considerable risk of production fluctuations hence a variable financial business performance. Particularly vulnerable are small scale, full-time farms with low production efficiency. Over recent decades this vulnerability is reflected in a steady decline in the numbers of such farms both in the UK and across the EU. Alongside this trend local patterns of production, distribution, and consumption of food have been increasingly replaced by national and even global operations. In such a business environment all farm businesses, but particularly smaller scale farms have limited access to markets and face a long term downward trend in the real prices they receive for their products after taking account of input price inflation. The pressures of this economic situation are compounded if the farm is limited in its purchasing power and access to financial resources. Over time this limits the ability to invest in the development and efficiency of the farm businesses. Despite the existence of the CAP the population of EU farm businesses continues to decline steadily. We can hypothesise that participation in a marketing cooperative offers a means of overcoming some of the limitations facing smaller scale farm businesses and hence in principle aiding the survivability and development of smaller scale farms.

Another measure of success would be the contribution to animal welfare and a more sustainable food chain. The CMO for the fruit and vegetable sector includes, alongside competitiveness, the sustainability of the sector among its most important goals. Put simply this objective sees an important role for POs in helping farmers to adopt sustainable growing, preserving, processing, and packaging technologies. In a Green Paper the EU Commission argued that consumers increasingly pay attention to the contribution made by farming to sustainability, biodiversity, climate change and animal welfare. The relationship between a company’s adoption of more friendly environmental practices and its economic performance constitutes one of the major lines of research within environmental management literature but so far agricultural businesses have received scant attention. In principle a PO/cooperative is in a better position than either an IOF or its individual members to promote and provide technical assistance to help its farmers lower the ratio of natural resources to output when measured in volume terms. Encouraging more sustainable production and marketing systems might enhance competitiveness and market value as processors and retailers become keen to differentiate their products, with sustainability being a characteristic that appears to be of increasing interest for consumers.

7.2 Key Ingredients of Success

The foregoing suggests that high levels of cooperative membership, particularly amongst smaller full time farms, within an agricultural sector might reasonably be regarded as a measure of success; however, this may not be sufficient. Although fruit and vegetable POs in countries such as France, Italy and Spain have large memberships, it is the market share accounted for by a PO that is arguably a better indicator of success. This follows because the goals set by the Commission under the CMO for fruit and vegetable POs include a better balance of supply and demand in terms of not only volumes but also quality so as to reduce withdrawals from the market. In a minority of member states, notably, France, Italy and Spain, POs account for very large market shares for fruit and vegetables; though the data also
show that the larger the PO the higher is the share of its Value of Marketable Production (VMP) destined for the fresh market. This may reflect sales direct to retail which are generally regarded as higher value compared to wholesale and processing markets. It may however, reflect a lack of interest in the added value processes of packaging and processing.

The EU had set a target for fruit and vegetable POs to achieve 60 per cent of VMP by 2013. The current average level of VMP marketed through POs across the EU is around 43 per cent which indicates that for many EU countries the majority of fruit and vegetable production is not supported by the scheme. In practice, concentration may be a necessary indicator of success for an individual cooperative but it does not appear to be sufficient if attention is turned to existing marketing cooperatives. We noted above that POs/cooperatives can be judged on the basis of technical and allocative efficiencies. These are internal efficiency gains but they are not exhaustive. In terms of judging success we must include some additional, but more difficult to measure, internal efficiency gains. We will then turn our attention to external efficiency gains which may or may not be influenced by membership numbers and market share; they relate to an overall improvement in the efficiency of the sector or indeed, the food chain which we can take to indicate improved competitiveness.

A clear internal efficiency gain arises if the cooperative, through the provision of advice and information, helps improve the planning and alignment of members’ production for instance through extending the season by delayed planting, lowering their unit costs of production e.g. by bulk buying and advice and supporting investments in quality improvements. Examples abound of internal efficiencies that can potentially be delivered by a well-managed cooperative which we define inter alia, as actively engaging its members. These include heightened on-farm efficiency by the sharing of best practice through the exchange of knowledge and benchmarking; the joint purchase of farm inputs including expert advice and better understanding of the external business environment through the provision of market information.

Box 3: Example of collaborative input buying – Anglia Farmers

Anglia Farmers is the largest agricultural purchasing group in the UK with a buying power in excess of £250 million, purchasing almost 1/10th of the UK’s key farm inputs. The group continues to grow, providing a highly professional procurement service for more than 3,500 shareholder members who are collectively farming over a million hectares of land in the UK. With more than 50 years of experience working with farmer-members, AF’s expert buyers secure savings across an extensive portfolio of products and services and offer an unparalleled level of member service and administrative support.

As the average size of farms has increased so Anglia has developed its service offer from purely undertaking aggregated purchasing on behalf of its members to an outsourcing of the backroom function of many farms. They believe that the trust and commitment of members is crucial to success this remains an on-going challenge as the cooperative grows larger. They say their ability to aggregate farmers demand for inputs such as fertiliser means that cooperation delivers real benefit to the competitiveness of UK agriculture plc when operating in a global market.

(Sourced through business interview)
Arguably it is easier for a well-run cooperative that has a longer term interest in its members’ performance to achieve these internal efficiency gains than for individual IOF buyers. We might further observe that a cooperative has an incentive in terms of its ability to maximise its members’ satisfaction in taking on the role of setting or supporting higher technical efficiencies on its members’ farms. Individual farms can turn to independent experts for advice e.g. agronomists, but not only is it likely that the cooperative would be able to secure similar services at lower cost per member but also address coordination problems that are beyond resolution by an individual expert.

Closely associated with the foregoing contributions to efficiency is a cooperative’s ability, through its regular operations to reduce transaction costs for its members. Providing a regular and comprehensive flow of information to its members while taking on the burden of finding markets and negotiating contracts lowers the cost to individual members of searching out information and seeking individually to counter the risks of opportunistic behaviour on the part of buyers. In this way the cooperative lowers both economic and technological uncertainties, therefore opening up opportunities to members that would otherwise be ‘held-up’ by uncertainties. The counterpart to transaction costs is agency costs which are associated with the separation of ownership and control in IOFs and in principle a cooperative avoids or greatly lowers these costs. We noted above that helping members to improve their farming operations and/or affording them the opportunity to capture more of the value they create is both an internal and an external efficiency gain. Efficient, competitive and sustainable farm businesses are a necessary condition for a competitive food sector.

Box 4: Example of providing effective interface in the supply chain

Dairy Crest Direct represents 1,175 dairy farmers in England and Wales supplying 1.6bn litres of milk to Dairy Crest, the largest branded milk processor in the UK. They work on behalf of their members to engage with Dairy Crest on a number of issues from pricing, to contracts to health issues. To achieve this they have built a trusted relationship with Dairy Crest from the board room to operations. Whilst the market will always drive price, this relationship has achieved incremental price changes and more importantly has influenced the timing of price changes for the benefit of farmers. Dairy Crest Direct also work closely with Dairy Crest developing the relationship with retail customers; an important role in the future to ensure a joined up and transparent supply chain.

(Sourced through business interview)

Our experience, supported by the survey and face-to-face interviews, is that the key measure of success for PO or cooperative members is the price achieved for their produce which, in the view of members depends on success in finding markets for the entire cooperative’s produce.

7.3 Impact on the Competitiveness of the Sector

We noted above that one of the measures of success would be the extent to which POs/cooperatives deliver external efficiency gains, which we can define as improving a sector’s competitiveness and its sustainability. In some cases, according to its objectives, a cooperative’s external efficiency might appropriately be judged on its contribution to the economic and social life of a local community. In measuring a cooperative’s success – subject to it objectives – we might ask a number of
questions. For example, how well is it adjusting to its changing business environment? What is its record in delivering new products and/or marketing channels? How well do its members adhere to quality assurance programmes and is there evidence that it has encouraged innovative practices amongst its members? Can it demonstrate improvements in the sustainability of individual members’ businesses and the cooperative’s operations? And is the cooperative capable of raising sufficient levels of capital to make the investments that will improve its contribution to the sector’s competitiveness and sustainability in the future?

One of the changes in the external business environment that has prompted EU legislation in the area of POs has been the growing concentration amongst farming’s downstream customers. To the extent that a PO/cooperative can balance or counteract the exploitation of monopsonist or oligopsonist power by downstream buyers so a market failure is mitigated, delivering an external efficiency. Monopsonist or oligopsonist power, if wielded, can depress prices for small scale, price taking enterprises, below where they would be if set in an unfettered market, forcing suppliers into contracts that prevent the level of return at the farm level necessary to invest in greater efficiency and innovation. A PO, under the Regulation, will be able to negotiate contracts on behalf of its members, including the price – subject to some restrictions if the market share becomes very large – whether or not ownership of the produce is transferred to the PO. Pricing aside – and ultimately price is limited by what the market is prepared to pay – there are other external benefits arising from the ability to negotiate better contractual terms, for example, greater security in terms of future market outlets for members’ produce and hence more confidence in longer term investment.

Within an imperfectly competitive environment POs and cooperatives provide countervailing power for their members, with access to reasonably secure markets and achieving prices above those that would be set by a buyer abusing its market power. To this extent they can be judged successful.

Box 5: Example of marketing cooperatives and POs – Berry Gardens

Founded over 40 years ago, Berry Gardens is the UK’s leading berry and stone fruit marketing business wholly owned by UK growers. Today they have a market share in excess of 30 per cent and a year round business supplying all of Britain’s leading retailers. Berry Gardens success stems from their ability to coordinate supply and demand between their growers and customers as well as using the PO scheme to drive investment into technology, new techniques and agronomy to improve the efficiency of production and reduce cropping risks. For instance, Berry Gardens was an early adopter of plastic tunnels. Looking to the future, Berry Gardens is very focused on delivering what the customers wants, recognising that growth and value will increasingly come from niche market areas.

(Sourced through business interview)

Even in a competitive market where there is no need of countervailing power, the economies of scale and the close working relationships with individual farmers offered by a cooperative can serve as competitive yardstick for IOFs operating in the sector. A large cooperative may be able to compete efficiently in the areas of packaging and via direct delivery to final customers – as in the case of fresh produce – reducing not only the time between harvest and sale but also speeding up responsiveness to changing market conditions. It can widen the opportunities for
existing customers’ by investing in group marketing; activities ranging from the provision of information, to branding or even the development of new markets.

Where a PO/cooperative invests in value adding activities, so it introduces a new source of competition to the food sector and thereby a contribution to the sector’s competitiveness. To the extent that POs/cooperatives can help drive a more competitive food sector so the likelihood is that the sector can meet more intense competition and the need for government support is lessened.

Another area where a PO/cooperative has the potential scope to improve the sector’s competitiveness is in the planning and coordinating of production across many farms. We identified such improvements, along with the provision of advice and support for on-farm improvements as an internal efficiency i.e. a contribution to more efficient and profitable farming operations. But to the extent that it lowers the costs of production – by reducing waste and raising productivity – so there is also a clear external efficiency gain. The more so if these improvements were otherwise not available, or only at higher costs, to farmers. In the case of services supplied by cooperatives which an IOF would find difficult to replicate or has no interest in supplying e.g. the provision of market price information, so the cooperative would be correcting a market failure and by definition making a contribution to the sector’s efficiency.

Potentially an even higher value external gain – albeit with increased risk – is available if the cooperative uses its resources to bring innovation and/or technological advances to bear. Successful innovation is always welfare enhancing. It is not only a significant source of competitive advantage for an individual farmer or cooperative but also has an external benefit by contributing to a more competitive agri-food sector as a whole. This is particularly the case in an environment where changes in consumer preferences and global competition demand constant attention to quality-enhancing innovations to satisfy market demands. Quality-enhancing innovations refer to a wide range of activities including; new crops and planting strategies; improved storage, packaging and processing facilities; as well as original marketing. Product innovation for cooperatives involves vertical integration and generally high levels of capital investment in an activity that carries considerable risk. The difficulties this raises for cooperatives is explored in sections (8), (10) and (12).

An important area where a PO/cooperative might be better than an IOF in delivering an external efficiency is the provision of a more sustainable farming sector. As noted above a cooperative provides a framework that can be used to improve both its and its members’ environmental performance. To the extent that the cooperative’s members reduce their use of, or use more efficiently, natural resources whilst protecting biodiversity and visual amenities so there is a positive spill over to both the food chain and wider society. In fact, environmental expenditure in some cooperatives is significant and the literature review revealed examples where cooperatives are persuading their members to adapt practices in line with environmental requirements.
Box 6: Example of Co-ops leading technical innovation – Camgrain

Camgrain is the largest central grain store in the UK with a strategy to continuously grow and develop the business for the benefit of its members. Scale offers major opportunities for the business allowing investment not only into supply chain relationships but also operational efficiencies and other innovations that add value to their member’s crops or improves the efficiency of crop production. Investment into a clean wheat plant has shifted Camgrain from being simply a commodity supplier to a supplier of food ingredients. Technical innovation into laboratory facilities means that Camgrain can deliver vendor assured grain direct to their customers taking significant cost out of the chain. They work with customers to explore varieties and their impact on the properties of the flour. They are currently involved in a cutting edge project with ADAS to measure the nitrogen content of the growing plant at critical growth points to allow greater efficiency of nitrogen application and better control of nitrogen levels in the harvested crop.

(Sourced through business interview)

The direct contact cooperatives afford with their members potentially allows environmental regulations to be better explained, environmental controls and certifications applied faster, and environmental practices to be widely adopted amongst members. High quality managers play an important initial role in establishing an improvement in environmental practices amongst members. However in the absence of official support to fund incentive programmes for the adoption of environmental quality practices there are limits to how much can be achieved.

Box 7: Example of Co-ops and POs delivering on sustainability agenda

Based in New Zealand, Fonterra is one of the largest dairy cooperatives in the world marketing over 22 billion litres of milk each year representing 95 per cent of New Zealand’s dairy farmers. Environmental sustainability is a core focus of the business strategy and as such they have invested into regional experts who provide hands on advice and support to help their members meet and exceed national and regional legislation. The aim is that Fonterra’s farmers lead the way in environmental practice.

First Milk is one of the largest dairy cooperatives operating in the UK supplying a range of dairy products and ingredients for both the national and international markets including soft cheeses, block cheese, raw milk, butter and skimmed milk powder. Their close working relationship with members means that they are able to influence and encourage practices on farm. This delivers economic and environmental outcomes benefiting their members and meeting their customers’ demands. They have been working alongside an Oxford-based organisation Food Animal Initiative (FAI) to develop and implement a bespoke programme of activity which focuses on both economic and environment on-farm improvements. In addition, they have made considerable investment in recent years to reduce the water and energy requirements of their processing plant.
Box 8: Evidence that cooperatives and/or collaborative activity improve the competitiveness of UK agriculture

“We have just secured the future of one particular large processing facility by committing significant additional volume which has given the processor the confidence to invest several millions on upgrading the facility which will include export approval to supply the broader market thus improving returns. This secures the future of the plant which secures a long-term customer for livestock in that region that had very few alternatives especially alternatives that didn’t add growing logistical costs”

“We have just secured the future of one particular large processing facility by committing significant additional volume which has given the processor the confidence to invest several millions on upgrading the facility which will include export approval to supply the broader market thus improving returns. This secures the future of the plant which secures a long-term customer for livestock in that region that had very few alternatives especially alternatives that didn’t add growing logistical costs”

“Top fruit growers working together in POs can pool resources to invest in grading and packing facilities to reduce costs. They can also employ marketing staff to further their position in the market place. Both of these things improve competitiveness”

“The JV between First Milk and Fonterra increased focus in GB on added value dairy ingredients. The First Milk sustainability programme has improved economic sustainability of farmers and sustainability of First Milk’s supply chain”

“OMSCo, First Milk and Milk Link Arla formed the alliance to market all organic milk through OMSCo. 65 per cent of the market supply through one organisation has resulted in £2 million successful generic campaign (return to market growth), 80 million litres of export, NPD and improved supply chain efficiency and flexibility. In summary it has resulted in maintaining a reasonable farm gate return during a period of extreme oversupply and a return to supply/demand balance much faster than would have been possible without cooperation”

“If you look at the [machinery] ring being potentially the largest contractor in a given area with great flexibility to undertake all types of job, thus potentially operating at reduced cost for the customer and this enabling them to be more competitive in the market place”

“In the grain sector the ability to segregate, blend, assemble and move large quantities of specific product creates an increase in value to the producer. Individual farms cannot achieve the same standards. The facilities offered by the coop, e.g. drying, storage, etc. reduce the need for investment and skilled labour at the peak harvest time on the farm”

“POs are able to supply quantity and continuity of supply which enables supermarkets to better plan supply and demand so supermarkets are more likely to work with POs than individuals”

(Sourced through industry survey)
7.4 Examples of Successful Cooperatives

It is possible to demonstrate some of the potential internal and external efficiencies being delivered by reference to acknowledged successful cooperatives. Arla Milk Link is a group of approximately 1,300 UK farmers who contribute 1.6 billion litres of milk a year to their cooperative. This amounts to about 12.5 per cent of UK production but arguably its market influence is enhanced by the fact that Arla Milk Link is part of Arla Foods, the world’s sixth largest dairy cooperative that is owned by 12,000 dairy farmers in the UK, Sweden, Denmark, Germany, Belgium and Luxembourg. However, much more important would appear to be vertical integration and brand development; indeed, size is important but successful brands appear to be central to its success. Arla Foods UK has some of the UK’s leading dairy brands including Cravendale, Lurpak, Tickler and Anchor; generating a turnover of some £2bn per year.

An example of a successful cooperative that cannot point to a set of consumer branded products is Australia’s Co-operative Bulk Handling (CBH) Group. This cooperative markets some 95 per cent of the Western Australia grain but its downstream activities are confined to the storage, first stage processing, and marketing. GBH can fairly claim to have been innovative with the development of its bulk-handling system involving wheat bags that reduced costs for farmers. Established in the 1930s, CBH is now Australia’s biggest co-operative with 4,500 grain farming members, a turnover of some £1.8 billion and net assets of £750 million. It has storage capacity for up to 20 million tonnes of grain – similar to the UK’s production in a normal year – at its sites, including four shipping terminals.

Returning to the UK Berry Gardens is an example of a successful cooperative in the fresh fruit sector that does not have a suite of consumer branded products. Operating for over 40 years its membership of 400 growers has a market share of 30 per cent and its customers include all the leading multiples. Whilst its market share is significant, Berry Gardens believes it success is largely based on its ability to supply its customers all year round, as well as its emphasis on quality and access to proprietary R&D. As a cooperative it has been able to organise its members’ production throughout the UK, so as to extend the cooperative’s season to six months and by establishing relationships with suppliers in other parts of the world it is able to achieve year round supply.

In contrast Ocean Spray, by any standards a successful cooperative, has grown by vertically integrating and creating its own range of branded consumer products encompassing juices, purees and dried fruit. Its size has also allowed it to form long term partnerships with PepsiCo and Coca-Cola and this year it is investing £90 million in a beverage manufacturing facility. Owned by some 700 North American growers it has a market share of more than 60 per cent and an annual turnover of £1.1 billion. Perhaps a clue to its continued success is its constant innovation resulting in a steady stream of new products. Its subsidiary, Ingredient Technology Group, has entered into a strategic partnership with Artemis International for the sale and marketing of products to nutraceutical manufacturers. Product innovation, despite the risks, would seem to be another important ingredient of success.

The importance of innovation as an ingredient of success is demonstrated by the Kerry Group though its story also points to a potential weakness identified in the literature review. Founded as a traditional milk cooperative in the early 1970s it vertically integrated into the production of downstream branded products in the 1980s. It also at this time embarked on strategy to raise the cooperative to the position of an international competitive company, financially strong and accounting for a significant share of any market in which it was a competitor. This policy was
founded on overseas acquisitions and R&D, both heavily dependent on access to capital. However, by the mid-1980s Kerry lacked the capital required to fund the level of growth commensurate with its strategy and ambitions. Rather than change strategy it decided it would change its corporate structure to create a public limited company – Kerry Group plc – acquire the operations, property and assets of the cooperative by issuing ordinary shares to members and make a public offering of shares in Kerry Group plc. The move was viewed as novel and innovative within the Irish cooperative sector in Ireland and elsewhere. The Group has gone to global success based on product innovation ranging across a number of agricultural sectors and broadening beyond consumer products to food ingredients.

Box 9: Example of Coop/PO linking with supplier from abroad – Worldwide

Worldwide Fruit is an international fruit marketing and distribution company specialising in the supply of apples and pears to major UK multiple retailers. The business is a joint venture company that is owned in equal share by Fruition PO Limited, a UK producer organisation, and ENZA/Turners and Growers Limited, New Zealand’s leading distributor, marketer and exporter of fresh produce. The reason that the UK growers entered into this joint venture was to ensure a global supply of products to meet the 365 day expectations of their customers. By having access to year round production Worldwide Fruit can manage the category, ensure a smooth transition between seasons and ultimately deliver greater benefits for their shareholders, which in the case of Fruition means their grower members.

(Sourced through business interview)

What lessons do the successful examples cited above offer for cooperatives and POs in the UK? The cooperatives listed all demonstrated an intention to achieve a significant market share but this alone was not sufficient. In all cases the cooperatives sought to improve their members’ returns by capturing higher value by delivering improvements to production planning, logistics, fresh product quality and value adding processes including new product development. It follows that if the concentration of supply and/or the number of members is chosen as the measure of success there is a danger that the delivery of value adding activities will not be accorded the importance they merit.

Concentration and membership are necessary but may not be sufficient alone to provide members with an organisation that will increase the likelihood of the sustainability of their enterprises. However delivery of a range of value adding activities is likely to improve the profitability of members’ farms. The importance that the Kerry Group plc attached to it ability to raise capital has been noted but the foregoing examples also indicate the importance of good quality management.

7.5 Management and Leadership

We can be certain that the quality of management and the effectiveness of the decision making process is likely to vary widely across POs and cooperatives. Certainly the literature review reflected criticisms of their inefficient decision-making process and this must at least in part reflect on the quality of management. Figure III highlights that Governance and Management Skills are deemed the most important attributes of a PO/cooperative after member commitment, albeit it could be said that member commitment follows the right governance and management skills.
It falls to senior management to determine, with the support of the membership, a cooperative’s objectives as well as the organisational architecture and the strategies that have the highest probability of achieving them. The traditional cooperative consists of a Board of Directors, composed of elected farmer members with a chairman and one or two executive managers e.g. the CEO, although recent years have seen an increasing role played by external Non-Executive Directors or NEDs. Some larger scale cooperatives, particularly across the rest of the EU, have also created a second governing body; a Board of Supervisors consisting of members of the cooperative as a means of increasing the involvement of members.

Figure III: Important issues for Coops and POs

One of the key responsibilities for senior managers is to ensure that the cooperative’s organisational architecture includes structures and practices that result in democratic governance. We return to the importance of this aspect of management in the section dealing with members’ commitment below so we will be brief here.

The size of a cooperative’s membership impacts on the resources that must be devoted to communication. In a small cooperative it may be possible to accommodate the total membership in a meeting room and there is a greater likelihood of member homogeneity regarding needs and opinions, making it more probable that elected representatives will be ‘representative’. But as cooperatives grow into large memberships – and one of the aims of the PO Regulation is to encourage market concentration – so the share of management effort devoted to democratic decision making must increase. If members cannot be assembled in one place then getting members needs and opinions organised, articulated, and weighted becomes a complex issue. Above all, EFFP’s experience and the survey results show that this area of cooperative management is crucial, as evidenced in Figure IV below. The need is for individuals who not only understand the market place but also are able to empathise with, relate to and communicate with members.
In the user-owned and democratically controlled cooperative member-owners i.e. investors will be concerned with the cooperative’s financial performance but they will arguably be more concerned about its products and services as these have a much greater impact on their lives and/or businesses. A marketing cooperative's greatest value to its members is providing the market for the member's production and where appropriate added value through processing and product development. As noted above the Board will usually be composed of elected farmer members and although all will have experience of running their own businesses this is not the same as running a large organisation on behalf of its owners. Although there will be exceptions, it falls to the CEO to advise the Board on how to improve the efficiency of the cooperative’s operations and how to formulate and implement business strategy. For example, in recent years we have seen some of our more successful POs and cooperatives, such as Milk Link, Berry Gardens, First Milk, etc., employ a high calibre executive team with the experience and expertise to deliver the objectives set by the board.

It follows that senior managers running POs/cooperatives must take the role of member communications very seriously. This would seem to suggest a need for managers, at least in the very senior positions such as Chairman and CEO, who have previous experience of cooperatives. Interestingly though feedback from the surveys showed cooperative experience as being one of the least important attributes required by senior management as long as they are able to empathise with members and communicate well – Figure IV. However for a successful cooperative its senior management skills must also extend to those deemed necessary in an IOF. The senior managers must have both an external and internal focus. Internally it must determine the delegation of decision making, put in place routines and systems to monitor performance and quality while driving longer term improvements and it must design reward systems that appropriately motivate employees. Externally senior managers must be able to interpret the

**SURVEY QUOTE**

“[the key attributes of senior management are] a very real understanding of not just the members business but the customers and their business and their drivers for success”
external business environment and determine appropriate adjustments in the cooperative’s offerings to changing demand. These adjustments will include innovation and in the case of vertically integrated cooperatives new product design and production. Above all they must have a grasp of the cooperative’s financial condition at all times while keeping and distributing to members on a regular basis accurate financial information. They must also be able to raise, allocate and monitor capital expenditure. It is a failing of management if a firm is unable to invest in improvements necessary to help secure the future of the cooperative.

The foregoing calls for two very different management skills and both may not be found in one individual. Those skills required for the activities associated with a traditional marketing cooperative involve an ability to control costs and oversee efficient democratic structures. However, as cooperatives have become more market orientated and engaged in vertical activities so the attributes demanded of their senior managers have grown to include leadership and entrepreneurial skills; namely, the ability to identify opportunities others have neglected, the skills to attract others to embrace the vision associated with the opportunities and the tenacity to pursue them. This shift in the management model for POs/cooperatives must be appreciated by those keen to take advantage of the new CMO Regulation. It seems likely that the range of attributes required by senior management highlighted in figure IV reflects the differing nature and perhaps levels of maturity of the POs and cooperatives which took part on the survey.

Managers will be motivated by factors such as pay, power and prestige, and these motivations must be provided by PO/cooperatives if they are to attract experienced, high quality managers. Rewards such as stock options and leveraged buyouts are not on offer for senior cooperative managers, so in order to match market expectations in attracting the best managers cooperatives have to rely on the salary, (which can include performance incentives), benefits and pensions. This poses a problem for smaller-scale and even some larger scale cooperatives. Paying salaries and rewards for senior managers that are comparable to those offered by IOFs confronts a mindset amongst farmers who appear to have an aversion to paying large salaries to people they tend to view as their employees. It is a particular difficulty when members are struggling financially whilst not fully appreciating the demands on senior managers.

Experienced senior managers and their Board of Directors will know the importance of an ambition to grow the business and build a reputation but they will also be aware that the PO/cooperative can only pursue such goals to the extent that its members are themselves progressive and entrepreneurial. The cooperative will only develop at a speed and time that at least a majority of the membership is prepared to support. For an ambitious manager, and given the generally conservative attitude of farmers, this democratic control is likely to be frustrating and there is a danger that ambitious, strong leaders will look to IOFs rather than cooperatives for a management career.

The alignment of management - and sometimes the board - to the needs of the members can be one of the most challenging aspects of cooperative governance and can often be a difficult issue to resolve for the reasons set out above; but lack of alignment can lead the cooperative down a path that fails to meet member objectives and thus starts to alienate the membership. The industry surveys highlight a mixture of different management incentives but fair pay, a clear strategy, good communication and an element of performance related bonus are practices that come to the fore.
The arguments set out above suggest that a cooperative that has survived a number of years, has an active and satisfied membership (a low membership turnover) and can point to a record of growth and innovation is by definition a well-managed organisation. We can point to many such examples in the UK and beyond in the EU. This suggests that attracting and retaining appropriately qualified and experienced management teams is perfectly possible. Faced with the new CMO Regulation and potentially a greater short term focus on PO start-ups, the criteria for successful management is further extended to include the ability to secure sufficient capital before the start of operations, along with identifying and capturing, with the aid of marketing contracts, adequate outlets for members’ produce. In this situation leadership skills are dominant as senior managers have to create a vision of the future, convince potential members of the opportunities for them and keep them engaged while the PO is becoming established.

We can go further; our investigations have identified the importance of previous experience and continued management training for both managers and Board members. Our survey of senior managers in agricultural cooperatives largely confirmed the observation that cooperatives have a wider range of success criteria than is typical for a IOF; arguably members demand more attention than the average shareholder, the more so as there is no single measure of success for a cooperative and a wide range of barriers that need to be overcome.

### 7.6 Further Considerations on External Efficiencies

An efficiency gain that needs to be considered is the scope offered by POs/cooperatives to help farmers to adjust to a future environment as the real value of farm support under the CAP declines. POs came into existence for the EU’s fruit and vegetable sector in 1972, in part to compensate a sector that did not enjoy a price support regime. The establishment of the CMO was designed as an alternative, if less certain, method of price support and hence in principle the scheme could continue to function in such a role. Although Single Farm Payments are retained until 2020, there is little likelihood that they will be rapidly phased out in the following years. However, EU budget restrictions and a greater emphasis on Pillar II payments will ensure a steady decline in their real value. Membership of a well-run PO or cooperative offers individual farmers two methods of offsetting this adverse trend. Firstly, in principle, a PO/cooperative is, via economies of scale, in a position to help individual members reduce production costs through the pecuniary benefits of the bulk buying of key inputs and the provision – at shared cost – of practical farming/business advice. Secondly, through the value adding activities of professional marketing and/or vertical integration, a PO/cooperative offers individual members the prospect of higher returns for their produce.

The PO scheme brings with it the force of official support for collaboration across the agricultural industry. The introduction of the PO scheme for the fruit and vegetable sector saw a significant initial take up by growers. But as noted in the introduction, there was a subsequent decline in the numbers of POs; in large measure the result of the difficulties faced by many horticultural enterprises in complying with the rules governing the scheme where they had previously made alternative marketing arrangements (see the next section). A new drive, where both the government and the farmers’ unions are united in advancing the benefits of the PO scheme for individual farmers, could trigger widespread interest and

**SURVEY QUOTE**

“The NFU/DEFRA, etc. should openly promote active cooperation”
sow the seeds of an industry wide momentum for collaboration. This is even more pertinent if in the future the scheme opens up a new source of funding for cooperating farm businesses at a time of austerity. It is interesting to note that the surveys highlighted the provision of grant funding targeted at vertical supply chain collaboration as the most important action to raise the performance of POs/cooperatives (Figure V) but that other industry wide, and arguably government promoted initiatives, also featured highly.

Figure V: – External actions important to raising performance of POs/Cooperatives

Which of the following external actions could be important in raising the performance of cooperatives and producer organisations in the future?

(Coops / POs - respondents may record more than one choice)

- Grant funding specifically targeted at vertical supply chain collaboration
- Greater government and NFU support for collaborative activity
- Specific business support for collaborative ventures, e.g. strategic development, business planning, new collaborative start ups, etc.
- The creation of an investment fund to help finance collaborative activity
- An industry programme to develop and train farmer directors and farm leaders
- The introduction of an industry governance code of practice

Which of the following external actions could be important in raising the performance of cooperatives and producer organisations in the future?

(Stakeholders - respondents may record more than one choice)

- Grant funding specifically targeted at vertical supply chain collaboration
- Greater government and NFU support for collaborative activity
- Specific business support for collaborative ventures, e.g. strategic development, business planning, new collaborative start ups, etc.
- The creation of an investment fund to help finance collaborative activity
- An industry programme to develop and train farmer directors and farm leaders
- The introduction of an industry governance code of practice
8. Barriers to the development of POs/Cooperatives in the UK

Section summary

- Since 2005 for reasons largely to do with unfavourable EU audits the number of POs has declined as has the number of growers belonging to POs along with their share of VMP which is currently estimated at around 35 per cent.

- Turnovers range from £1m to £150m, thus the relative size of POs in the UK is significantly smaller than the Netherlands which has around 20 POs with turnovers ranging from £20m - £1.5 billion. Whilst there are very good examples of POs in the UK such as Berry Gardens there is a question as to why uptake and development of POs is relatively lower than the EU counterparts.

Scale

- Scale maybe a barrier (though many large scale farms are found in some of the most successful US, EU and UK cooperatives). However, for larger scale growers who have previously invested in vertical production / packaging facilities and relationships it is harder for a PO to demonstrate or at least convince that it can deliver these services to a higher level of effectiveness than the grower is already achieving.

- In the case of smaller growers, many are supplying larger scale growers offering them a route to market that they wouldn’t be able to access on their own. This would lower the incentive or attractiveness of a PO proposition.

Internal Influences

- When asked in the survey to identify the main barriers to success, respondents emphasised the lack of good leadership, governance and management skills as being key barriers to PO/cooperative success. Low levels of member commitment ranked highest, although this maybe the result of the other factors listed rather than a barrier in its own right. The issue of member commitment is discussed in more detail later in the report.

External factors may contribute to the lack of uptake of POs in the UK

- The power and market share of the retail sector may discourage formation of cooperatives (which will have the aim of securing higher prices for members). The UK is not unique as there is similar retailer concentration in many northern European countries but in the case of say Denmark and Holland powerful agriculture cooperatives preceded high levels of retail food concentration and therefore downstream customers developed in a very different environment than UK food companies.
There is a lack of interest in agricultural cooperatives amongst UK academics. Agricultural economics, as a specialist subject in British universities, is in steep decline but even at its height in the post-war period little was published on the subject.

Historically post war UK governments placed emphasis on the role of competition as a driver of economic efficiency and growth and cooperation between farmers in a particular sector was viewed cautiously. More recently EU and UK competition laws allow some exceptions under the CMO regulation. Likewise there has been a lack of interest and drive from the farming unions in this direction.

POs are not the only model used to achieve vertical supply chain collaboration

In recent years food retailers and processors have adopted a more strategic and collaborative approach to agricultural raw material sourcing. This has taken the form of informal groups of farmers provided with an innovative cost plus contract, without the need for a formal cooperative structure. The industry survey was virtually unanimous in the view that more vertical collaboration will be seen in the future.

Farmer attitudes are key to the development of any form of cooperation and there are a number of issues that influence their decisions discussed in detail in the next section.
Introduction

Following the 1996 revisions to the CMO for fruit and vegetable POs i.e., Council regulation (EC) No 2200/96, a number of POs were formed in the UK and by 2004 these cooperatives accounted for just over 50 per cent of the Value of Marketable production (VMP) in the fruit and vegetable sector – slightly above the EU average of 46 per cent. Since 2005 for reasons largely to do with unfavourable EU audits the number of POs has declined as has the number of growers belonging to POs along with their share of VMP which is currently estimated at around 35 per cent. Whilst POs in the UK account for a significantly lower share of VMP than is the case in certain other EU countries, the actual number of POs operating in the UK is higher. This translates into a relatively small size of POs in the UK with small numbers of members generating low turnovers compared to say, Holland where there are substantially fewer POs but with significantly greater turnover and numbers of members. For example, the Netherlands now has less than 20 POs but with turnovers ranging from £20 million to £1.5 billion whereas in the UK, as of December 2009, there were 51 with turnovers ranging from £1 million to £150 million.

At the very least this relatively low level involvement of UK growers in the PO scheme falls short of the objective of concentrating production and building market scale and influence. There are of course exceptions to this with some very good examples of best practice within UK POs where growers have come together to build scale and develop a much greater effectiveness in marketing members’ produce. Examples of this best practice would include Berry Gardens which has seen membership numbers and sales rise significantly in the past decade with turnover increasing from £18 million in 1995 to more than £200 million in 2011 driven by a strategy of product and production innovation and customer service. The fact that there are relatively few successful POs – in terms of building market share – or perhaps because such organisations are exceptions, raises the question as to whether UK producers face higher hurdles than their EU counterparts when it comes to forming a PO/cooperative.

An argument frequently advanced relates to the UK’s creation of marketing boards in the 1931 British Marketing Act. These were granted statutory powers to purchase all farm produce and thereby offering farmers an alternative means of price support. This, it is argued, influenced the mindset of two generations of farmers. Only when EU regulations required that the UK abandon its marketing boards and other forms of price support, so the argument goes, were UK farmers forced to confront their somewhat weakened and fragmented position. When the UK Milk Marketing Boards were disbanded and for the first time in 60 years farmers were free to choose their milk buyer some 65 per cent joined the Milk Marque cooperative, set up as a successor milk buyer. But membership declined in part due to Milk Marque’s failure to prevent the milk price it paid declining and an aggressive campaign by large IOFs to attract milk suppliers. As observed above, the UK fruit and vegetable sector embraced POs, reaching a peak of just over 50 per cent of the VMP in the fruit and vegetable sector by 2005. These examples suggest that given the expectation of higher returns and appropriate encouragement there would seem no reason to suppose that, as a population, British farmers would not be prepared to participate in cooperatives in greater numbers than is currently the case.
8.1 Structure and Scale

A Defra evaluation of the operation of the PO scheme in the UK put the emphasis on a lack of confidence and observed that until growers can feel confident about the scheme and its implementation an increase in numbers and participation is unlikely. Nor is an increase in POs developing and promoting their corporate brands likely in the absence of greater confidence. The phrase 'until growers can feel confident' hides a range of possible adverse influences. In EFFP’s experience there are a number of factors or indicators that suggest more of an indifference, rather than outright opposition, to POs/Cooperatives in the UK agricultural industry. One explanation – the structure of the UK agricultural industry – that has been advanced for the apparent lack of enthusiasm amongst farmers for participating in cooperatives does not stand up to close analysis. Taking the agriculture industry as a whole, a greater proportion of production is concentrated on larger farms in the UK than is the case across the EU. But this argument is confronted by the fact that many larger scale farms are found in some of the most successful US, EU and UK cooperatives. Scale itself does not appear to be a barrier.

If scale per se is not a barrier to participation it may indirectly be an adverse influence. The fact that the horticultural sector was for many years effectively sidelined by mainstream CAP policy and that a significant proportion of UK fresh produce growers are large scale compared to other EU growers may have generated a belief on the part of the owners of these enterprises that POs had relatively little to offer. Larger scale, relatively successful UK fresh produce growers realised some years ago that with the growth of the multiples their future lay in selling direct to retail. Consequently, prior to the advent of the current PO scheme, these larger scale growers had already invested in pack houses and established relationships and routes to market. Many of these enterprises worked in partnership with other growers to achieve critical mass thereby further reducing the attractiveness of joining a cooperative. And where growers were minded to come together to form a PO, the existence of previous investment in their own vertical facilities made it more difficult for the PO to demonstrate that it was fully in control of collection, storage, packing and marketing of their members produce.

Put simply, in the case of these larger scale growers who have previous invested in vertical production/packaging facilities and relationships, the hurdle for a PO in demonstrating clear benefits is higher than in the case of a smaller scale enterprise selling to the wholesale market. A higher hurdle is not in itself a reason to assume that a rational farm business would turn down the opportunity to participate in a PO/cooperative if it judged that the value of the benefits of membership at least equalled the additional costs. For larger scale enterprises these costs are influenced by the implied opportunity costs associated with previous investment in improving production planning, quality and marketing. Turning to a PO for such services means that the PO must be able to demonstrate, or at least convince in the case of a PO yet to be established, that it can deliver these services and more to a higher level of effectiveness than the grower is achieving from its current activities. It follows that these are two areas that need attention if the UK is to encourage greater involvement by growers and other agricultural sectors in POs.

If having previously invested in vertical production/packaging facilities and relationships is a barrier for larger scale enterprises this does not explain the relatively low proportion of smaller scale UK growers participating in POs. As many of the issues faced by smaller scale farms are directly addressed by participation in a cooperative we must seek an alternative explanation or hurdle. One issue identified in a previous study is the participation of large scale grower packers, particularly in
the vegetable sector. These larger scale growers often source produce from other smaller growers thereby offering them a route to market that they wouldn’t be able to access on their own. Having already established market access the incentive for a smaller grower to join a PO cooperative structure where they may also be expected to invest and carry additional risk may not be large. That said, as outlined above the fresh produce sector has developed in the absence of direct CAP support; for other sectors structure, particular in the red meat sector, remains largely fragmented and many businesses may well benefit from the consolidation that a PO could potentially bring if producers could be persuaded that cooperation offers a more sustainable route forward.

8.1 Internal Influences

As already discussed in this paper the role of senior management and the board is a key factor to the success of a PO/cooperative and therefore, it is no surprise the industry surveys emphasised the lack of good leadership, governance and management skills as being key barriers to PO/cooperative success – see Figure VI. Low levels of member commitment ranked highest, although it could be argued that a low level of commitment is the result of the other factors listed rather than a barrier in its own right. The issue of member commitment is discussed in more detail later in the report.

Figure VI: – Barriers to success

8.2 External Influences

Another argument frequently advanced for the lack of enthusiasm on the part of British farmers for cooperatives concerns the size of the country and its attitude towards trade. For smaller EU countries, development of their agricultural industry depended critically on a focus on exports and cooperatives provide both the critical mass and support. This argument has a superficial attraction if attention is confined to some of the smaller EU countries such as The Netherlands, Demark and Ireland. But again it does not explain the interest and growth of cooperatives in countries such as the US, France and Italy. There are however, three external factors that we
believe do on balance have a negative influence on the attitudes of farmers towards cooperatives. These three influences are the attitudes of farmers’ downstream customers, the limited interest in the subject by British academics and the approach of successive Governments who appear more reactive – to say a EU Regulation – than proactive in the cause of encouraging cooperation amongst farmers.

Turning first to farming’s customers in the food chain; the downstream markets that farmers sell into are better characterised by imperfect competition, indeed oligopoly at the retail level. This imbalance in the power relationship does not sit comfortably with ‘fair practices’ and it would be surprising if powerful buyers did not seek to drive prices to lower levels. It is very likely that the establishment of POs/cooperatives that account for the bulk of a sector’s VMP would impact on the way processors/manufacturers and retailers/food service businesses operate. If, as seems probable, well-run cooperatives secured higher prices for their members produce – much depends on the cooperative’s negotiating strength – a proportion of this additional cost would need to be passed down the supply chain to final consumers in the form of higher prices. Thus from the viewpoint of the financial performance of buyers, they have every incentive to encourage over-supply on the part of farmers and therefore processors would not rationally welcome the increased competition from vertically integrated cooperatives. That said, across the EU retail food markets are increasingly concentrating. In most EU countries, the market share of the largest three retailers ranges from 30 to 60 per cent. In the UK the concentration ratio for the largest three food retailers is around 60 per cent which is significantly lower than for many other member states. For example it is above 70 per cent in Ireland, almost 80 per cent in Sweden and almost 90 per cent in both Finland and Denmark.

As demonstrated by the ratios quoted for some EU countries, high levels of concentration do not appear, per se, to be adverse when it comes to establishing successful, large scale cooperatives. Denmark accounts for two of Europe’s largest cooperatives – Arla Foods and Danish Crown – and Ireland has a proud tradition of agricultural cooperation. Indeed, to the extent that a cooperative can provide greater assurance regarding the volume and quality of supply, so it offers an efficiency gain to the food chain. It is not unreasonable for downstream firms facing overseas competition and price conscious consumers to be wary of a development designed to increase the bargaining power of the farm sector but as the recent horsemeat debacle has demonstrated there are potential benefits to downstream customers if PO/cooperatives provided a means of greater certainty regarding product quality and traceability. One difference between the UK and its EU partners that may be pertinent is timing. In the case of say Denmark and Holland powerful agriculture cooperatives preceded high levels of retail food concentration and therefore downstream customers developed in a very different environment than UK food companies.

Going beyond the food chain we find a lack of interest in agricultural cooperatives amongst UK academics. Despite the Rochdale pioneers and a burst of interest in cooperatives generally during the 19th Century, as is clear from a reading of the literature review, this history has not resulted in significant interest in the subject in British universities. The overwhelming bulk of academic papers in this area originate from universities in North America and certain Scandinavian countries e.g. Holland. Agricultural economics, as a specialist subject in British universities, is in steep decline but even when at its height in the post-war period little was published by UK academics on the subject. In any event, highly theoretical, mathematical papers which seem increasingly to dominate the literature are unlikely to serve as a means of sparking practical interest on the part of farmers or even policy makers.
It is also pertinent that the relationship between farmers’ union and cooperatives is closer in many parts of the EU than in the UK. About eighteen months after the signing of the Treaty of Rome in 1957, farmers’ representatives in the original member states formed a European representative organisation, the Committee of Professional Agricultural Organisations (Copa) and one year later it was joined by the creation of the General Committee for Agricultural Cooperation (Cogeca). Since 1959 the two organisations have worked together as essentially the same organisation representing farmers at the level of the EU. This closeness has not traditionally existed in the UK between its farmers’ unions and the Federation of Agricultural Cooperatives; indeed, the FAC was not set up until 1937 – four years after the Agricultural Marketing Act had set out a role for marketing boards – and some 30 years after the founding of the E&W NFU. Part of the reason may be found in the essentially right-of-centre political views of the farmers’ union and the association of cooperatives with the labour movement in the UK (see below).

Another factor likely to have influenced the lacklustre UK approach to agricultural cooperatives is the lack of any clear initiative on the part of successive governments. Post war UK governments rightly placed great emphasis on the role of competition as a driver of economic efficiency and growth. As collusion and the abuse of a dominant position are key targets for competition legislation it was not surprising that cooperation between farmers in a particular sector was viewed somewhat cautiously if likely to give farmer cooperatives significant market power – Milk Marque struggled under this approach. That said, attitudes have to some extent changed in recent years. EU and UK competition laws allow some exceptions for certain agricultural products under the CMO Regulation. One of the influences on the 1996 revision to the CMO (Council regulation (EC) No 2200/96) was increasing concentration in the retail sector and the belief that cooperation in the marketing of fruit and vegetables was necessary to provide countervailing balance.

EU legislation and attitudes notwithstanding it would, in the view of EFFP, be more correct to describe the government’s position on POs/cooperatives as accommodating if they lead to improvements in the production and distribution of farm produce and/or technological advances. This is not the same as positive encouragement. The long standing commitment to competition remains an influence and historically the farmers’ unions’ lack of interest in cooperatives has reduced pressure from this source. Also until the 1990s farmers had the protection of the marketing boards and when the marketing boards were abolished devolution was on the political agenda. And with the devolution of powers and authority in different degrees to Wales, Northern Ireland and Scotland, as well as delivery of much economic policy via the Regional Development Agencies within England differences in the support for agricultural cooperatives across the UK emerged, further weakening the power of a united approach.

8.3 Attitudes of Farmers

As identified by many academics in the literature review, the attitudes of individual farmers are critical. These will in part be influenced by the alternatives available and partly by the attraction of collaboration. Risk averse farmers with access to capital e.g. the owners of larger scale farms may prefer to invest surplus capital in a range of IOFs spread across a number of industries. However the heightened risk associated with investing all or a large proportion of surplus capital in a cooperative is not the only issue concerning the decision to invest and we return to wider issues in section 10 below. All other factors remaining equal, we might expect interest in the principle of cooperation to be greater where there happens to be a tradition of
solidarity; that is, where farmers believe that the only route to greater prosperity is through the exercise of market power facilitated by the concentration of selling-thinking that underpins the Commission’s approach to POs. An alternative viewpoint, which relies less on the principle of solidarity, sees farmers attracted to cooperative ventures because they are viewed as an appropriate vehicle for improving the efficiency and hence, all other factors remaining equal, the survivability of their businesses.

We will return to the attitudes of farmers as an influence on their willingness to join a cooperative in the next section. Here our concern is the impact of farmer attitudes on the development of a cooperative venture. As a cooperative increases in scale and complexity so the social capital i.e. mutual benefits, associated with traditional cooperatives, is threatened.

**Box 10: A New Zealand example**

Based in New Zealand, Fonterra is one of the largest dairy cooperatives in the world marketing over 22 billion litres of milk each year representing 95 per cent of New Zealand’s dairy farmers. The Fonterra farmers have raised significant capital to invest into the business both at home and across the world and whilst they are very keen to debate and question how their money is being spent, it was obvious to the majority of farmers that such investment was required if they were to have a future in milk production. It is interesting to note that in 1990 the South Island represented just one per cent of the milk processed by Fonterra; by 2013 this is now 40 per cent which highlights a massive investment and massive belief in the benefits that investment can bring. Fonterra is a farmer owned business but a business that is owned by thousands of members. Maintaining the connection with members is crucial to the ability of the business to perform and to continue to grow. The connection with members is managed through a combination of factors such as having area management teams who provide local liaison with members – a team that is very well trained and knowledgeable about the business; a governance structure that includes a Council of farmer members whose role is to represent the interests of farmers and to hold the board to account. The council has its own budget to provide training and development for council members and to pay for any advice or support required to assess business performance; and probably the most innovative but also the simplest idea is that the chairman emails all members each week providing a succinct and straight forward message about the business.

*(Sourced through business interview)*

As membership becomes large it also becomes more anonymous as it spreads beyond an individual’s social network. This anonymity is exacerbated as the cooperatives’ business activities expand beyond the horizons of individual members and senior managers become aloof and distant. According to the literature review declining social capital is revealed in the difficulties cooperatives face in raising capital as they grow larger and seek to vertically integrate. As scale increases so it becomes more difficult to convince individual members that the cooperative is making investments that are in their interests and the ultimate collapse of social capital is when members have a tendency to free ride. It follows that the leaders of cooperatives have a role to play in protecting and developing social capital. This calls for a further dimension to the abilities of senior managers; namely the skills and sensitivities to assess the impact on social capital when they are considering strategies.
8.4 Vertical collaboration

Results from the surveys show that 94 per cent of respondents believe that there will be more vertical supply chain collaboration in the UK food and farming sector in the future. The focus of this paper has been on the PO/cooperative organisation as the means to which farmers can more meaningfully engage with the supply chains they supply, reduce costs of production and become more efficient. And, as previously noted, there has been a shift in the priorities of POs/cooperatives towards working more closely with supply chain partners to improve supply chain efficiency and create more value for members.

In recent years changes in the external market environment have also driven food retailers and processors towards a more strategic and collaborative approach to agricultural raw material sourcing. A real challenge for them in making this happen is being able to engage with large groups of farmer suppliers. Those POs/cooperatives which can effectively perform this function in the supply chain could potentially deliver real value to food companies trying to collaborate more closely with farmers. It is, however, important to point out that this is not always the model used; there are now a number of good examples of supply chain collaboration delivering significant value where farmers have been pulled into informal groups to achieve a specific aim led by their food company customer or retailer.

For example the Tesco’s and Sainsbury’s dairy groups offer their farmers innovative cost plus contracts and other benefits without requiring the farmers to form into formal cooperative structures and this type of model has the potential to become more common in the future. Whichever route is taken it is clear that we are likely to see more vertical supply chain collaboration in the future as Figure VII shows.

Figure VII: Are we likely to see more vertical collaboration in the future?

Our surveys indicate that vertical collaboration is a growing trend with benefits for both farmers and the rest of the supply chains they supply, but making vertical supply chain collaboration work can be challenging requiring trust, alignment of goals and equitable mechanisms to share the value and risks involved not just in the short-term but also into the long-term. Figure VIII highlights which attributes are the most important to making vertical supply chain collaboration work. When done in the right way, it can be very successful – we only need to look at the vehicle manufacturing sector to see excellent examples of integration such as the Toyota supply chain – but there are also numerous examples of where vertical collaboration has failed to deliver what it set out to achieve.
Box 11: Retailer view of farmer collaboration delivering on consumer demands

A number of retailers and food companies have in recent years developed supply chain groups in order to build stronger relationships through the supply chain back to farmers in order to secure and manage what has become an increasingly volatile supply of raw materials.

Asda led the way in the dairy sector some years ago working with Arla, a major European dairy cooperative. While they think farmer cooperation is a good idea they also recognise that it has often been the retailers in recent years in the UK that have driven cooperation and collaboration than the supply chain. They also point out that the independent nature of red meat producers means that they are less likely to voluntarily cooperate as compared to their dairy counterparts.

Nevertheless Morrisons have recently set up a beef improvement group which they believe delivers supply chain advantages such as consistency of product and a competitive advantage against imported beef. They point to the need for organisation and a professional management structure to make such organisations work and also to the fact that membership of such groups does not deliver a premium per se but is intended to deliver efficiency gains within the supply chain that can be shared by all.

There was a strong feeling from retailers that cooperative structures need to be focused on clear commercial outcomes. They say there could be a role for government to kick-start such groups but that a clear exit plan should be in place to ensure that they are sustainable without on-going government support.
9. The willingness to join and member commitment

Section summary

Defined by history but attitudes are changing

- All Member States have a cooperative tradition, although its origin and intensity differs markedly. The strong agricultural cooperative development in many European countries was far less marked in the UK for a range of reasons. Attitudes are now changing and the UK farmers’ unions are far more supportive and encouraging of their members to consider the benefits offered by POs/cooperatives. In the survey around 60% respondents indicated that farmers are more willing to join a PO/cooperative now than they were five years ago.

- The survey results firstly point to the fact that farmers recognise they need to gain more power in the market place to counter the power of very large upstream suppliers and downstream processors and retailers. Secondly is the belief that the PO/cooperative model is proving it can work and add value in the UK and thirdly there is an understanding that collaboration / cooperation can enable farmers to better meet customer needs. All the above thinking must also be influenced by the belief that the new generation of farmers have different attitudes and do not carry the baggage of their predecessors.

- Notwithstanding the positive views towards cooperation that came through in the survey, barriers still exist for some farmers, whether actual or perceived. The three main reasons when questioned why farmers don’t join or commit to cooperatives were firstly; that farmers perceive a loss of autonomy, tending to point to a risk averse nature and a preference to retain independence in decision making. Ranked at almost the same level of importance is the view that coops and POs have a tarnished reputation, no doubt reflecting on high profile failures which have occurred in the last 10 years. Thirdly but still a very important perception is that many POs and cooperatives require farmers to invest substantial funds, thereby raising an issue both of risk and the opportunity cost of investing on farm as opposed to off farm.

Member commitment is an underlining pre-requisite for success

- In principle PO/cooperative members have direct access to the decision-making process and can influence the organisation’s financing, benefits allocation, corporate governance, and strategic choices. In practice, as members are likely to possess varying preferences, then disagreements can emerge. Some members might strive to influence the management structure and decisions to reflect their preferences. Differing preferences are a feature of any group but it is important that these differences do not spill over into conflicts.
• This is more challenging as POs/cooperatives become more market oriented and less producer-driven. Many farmers are concerned about the impact of increasing scale and market orientation on their influence within the cooperative leaving the cooperative’s management to choose between expansion and members’ commitment.

• It is clear from the literature that as traditional cooperatives become large they necessarily become more complex business operations and may face difficulties in relation to their members. If members feel that they are losing control so they are likely to become dissatisfied with the cooperative and their commitment wanes.

• This can explain why many smaller cooperatives survive. Experience suggests that in many such cases members have a strong sense of loyalty and pride in their cooperative, which goes well beyond commercial considerations alone. This commitment tends to equate with active membership.

• On the contrary a significant problem is that of inactive members, who are no longer using the cooperative’s services, or users who are not members. Inactive members are unlikely to be willing to provide longer term finance and by definition non-members have no commitment to the longer term development of the cooperative. They may also become a source of irritation for active members or worse if they consider that their efforts are benefiting inactive members.

*Internal governance structures and procedures are key to addressing these issues*

• The traditional cooperative tends to consists of a Board of Directors, composed of elected farmer members with a chairman and one or two executive managers. Some larger scale cooperatives, particularly across the EU have also created a second governing body; a Board of Supervisors, consisting of members of the cooperative, as a means of increasing the involvement of members.

• Regular and well facilitated meetings of the membership including the detailed and timely distribution of information relating to the cooperative’s financial accounts, major investments and strategic plans are absolute necessities if members’ commitment is to be retained.

• Care must be taken to ensure that it is the members who have the final vote on matters relating to key decisions affecting the future direction and performance of the cooperative.
Introduction

So far we have referred to farmers and growers collectively as though their objectives, fears and attitudes towards risk are identical. Of course farmers and growers like any other sub-set of the population display a wide variety of preferences and attitudes. Given heterogeneous preferences and attitudes we should expect a wide range of responses to the idea of participating in cooperatives; indeed, even in the understanding of the role and potential benefits offered by membership. And the heterogeneous features extent beyond the willingness to join to those who are members and their commitment to the cooperative.

9.1 Developing Social Capital

All Member States have a cooperative tradition, although its origin and intensity differs markedly. In some countries, the cooperatives are directly linked to the transition from grain to livestock production with butter and bacon for overseas markets at the end of the 19th Century (e.g. Denmark, the Netherlands), or a movement for independence (e.g. Finland), or where the cooperative was used as a socialist planning tool (e.g. new Member States). Whatever the driving force, agricultural cooperatives evolved more strongly in many European countries generating a high degree of interest amongst farmers in such organisations. From Rochdale on, the cooperative movement in the UK was dominated by the labour movement and this tended to associate cooperation with socialism in the minds of many farmers who as a group (as noted above) were traditionally right-of-centre. Attitudes are now changing and the UK farmers' unions are far more supportive and encouraging of their members to consider the benefits offered by POs/cooperatives, reflecting a changing mind-set of their members, but history and tradition are rarely overturned in the short term. Figure IX shows that farmers are more willing to join a PO/Cooperative now than they were five years ago.

Figure IX: – Willingness of farmers to join a coop or PO

![Pie charts showing willingness to join a cooperative or producer organisation now versus five years ago.](image-url)
The development of networks involving relationships, reciprocity and trust is frequently referred to as ‘social capital’. The creation of a social capital network can give rise to a virtuous circle encouraging more relationship building, reciprocity and trust and in the process bring about a situation where cooperation is a widely accepted social norm. For a variety of reasons – some of which have been set out above – the social capital network appears much weaker in the UK than in many other member states. Closely associated are cultural values. We know that national and regional cultures influence the behaviour of societies and organisations and that these influences are persistent over time. Put simply, the forces that drove Danish and Dutch farmers to form cooperatives were not the same that drove French farmers or indeed those in New Member States. But in all cases shared experiences, social capital and culture will have played an important role.

The report Farming and Food: a sustainable future (the so-called Curry Report) pointed out the disconnected character of the UK farming sector. This was not defined but it seems safe to conclude that UK farmers, when compared to some of their EU counterparts, failed to develop the social capital and culture favourable to participation in a cooperative. The development of the necessary social capital and culture is driven by an economic and/or social need for cooperation and as argued above in the minds of many farmers such a need did not exist. It was not perceived that their livelihoods or the development of their farms depended upon membership of a well-functioning cooperative. Moreover the building of an appropriate mindset cannot be achieved by fiat. It requires communication, constructive engagement and a clear demonstration of the benefits. This means not only taking into account the problems and concerns of potential members but also practical examples of longer term success.

The survey results point to the reasons why farmers are more willing to join a PO/cooperative now than they were before. Figure X highlights that the recognition that they need to gain more power in the market place is the greatest incentive, but in terms of changing attitudes the fact that the PO/cooperative model is proving it can work and add value in the UK is having a positive influence on the virtuous circle of social capital and this is likely to continue.

**Figure X: – Why farmers are willing to join a PO/Cooperative**
9.2 Why farmers don’t join or commit to POs/cooperatives

It is encouraging that the evidence shows that farmers for various reasons are more willing now to join and commit to a PO/cooperative than they were previously, but it is important to recognise the barriers that still exist whether actual or perceived.

Whilst Figure X shows that farmers recognise that cooperation offers an opportunity to gain more power in the market place and highlights a change in mind-set, figure XI points to the fact that the historic reputation of cooperatives in the UK, including a number of more recent high profile failures has had a negative impact on a farmers willingness to join a PO/cooperative; particularly when significant investment is required, either financially or by level of commitment. Also revealed in Figure XI, as a key reason why farmers are not willing to join a PO/cooperative, is a perceived lack of autonomy. To overcome this barrier the farmer would require convincing that the benefits afforded are greater than the risks perceived. The research also directs us to conclude that the ability of the PO/cooperative to govern, set strategy and operate the business to in such a way as to minimise risk is a key attribute to their successful development.

Figure XI: – Why farmers are not willing to join a coop or PO

9.3 Member Commitment

In principle PO/cooperative members have direct access to the decision-making process and can influence the organisation’s financing, benefits allocation, corporate governance, and strategic choices. In practice, as members are likely to possess varying, even disparate preferences, then disagreements regarding such decisions are likely to emerge. Similarly, professional managers will, on the basis of their experience and capabilities, possess views and opinions as to how the organisation should operate and develop, raising scope for differences with, and in the extreme the alienation of individual members. For example, an attempt by a cooperative’s management to apply the same profit targets as in IOFs in the food industry is likely to discourage members as it not only overlooks the reason many join a cooperative but also implies greater pressure on their returns. Some members might strive to
influence the management structure and decisions to reflect their preferences. To the extent that such behaviour is allowed to fester so it gives rise to organisational politics that can in the extreme seriously damage the PO/cooperative’s ability to function efficiently. Differing preferences are an inescapable feature of any group of individuals but it is important that these differences do not spill over into conflicts.

According to conventional wisdom, considerable economies of scale are essential if agricultural cooperatives are to meet the needs of their members and the growing intensity of competition. The academic literature is very clear in stating that in the prevailing business environment, alongside growing scale, POs/cooperatives have to become more market oriented and less producer-driven. Many farmers are concerned about the impact of increasing scale and market orientation on their influence within the cooperative and indeed the links between the cooperative and the local community, leaving the cooperative’s management to choose between expansion and members’ commitment. Another influence on member commitment is the confidence they have in the effectiveness and democracy of the cooperative’s decision making processes.

As noted above one of the specific aims of the PO legislation is for members to achieve a large share of a sector’s VMP. But our experience causes us the concern, shared by the literature review, that as traditional cooperatives become large they necessarily become more complex business operations and may face difficulties in relation to their members. If members feel that they are losing control so they are likely to become dissatisfied with the cooperative and their commitment wanes. This discontent may manifest itself in the loss of trust in the management and Board who are ultimately responsible for ensuring that the cooperative as it develops meets its members’ objectives. This suggests than in setting-up a PO potential members need assurance that they would be adequately protected against any attempts by the cooperative’s management to expropriate, or to use a softer term, misuse capital invested.

These issues call for a strong Board and experienced executive management whose objectives are aligned with those of the members. This does not mean that the objectives are set in concrete but rather that open and participatory channels of communication must exist between the Board and the members. In this way members can be involved in strategic decisions concerning horizontal growth e.g. a merger, and vertical expansion such as value adding to increase competitiveness. There is no reason to assume that members would be obstructive providing they understand that organisational change is necessary for the cooperative to offer better returns and good services to the members. To achieve this it is important that a high degree of communication with the members should be the norm partly because of the contractual nature between the owners and senior managers and in part because of the uncertain environment in which the agricultural marketing cooperatives currently operate. The contract is necessarily incomplete – it cannot deal with all contingencies – and primarily concerned with allocating responsibilities, legal restrictions and penalties; whereas the uncertainty derived from nature, the market, technology and regulations make the dynamic adaptation of the PO/cooperative to events a critical issue when it comes to remaining competitive. External uncertainty reduces members’ ability to control hence the need for a members’ communication strategy to ensure understanding and alignment.

SURVEY QUOTE

“You have to have total 100% commitment from all the cooperative members to be really successful with good clear leadership”
In spite of the conventional wisdom, many smaller cooperatives survive and EFFP’s experience suggests that in many such cases members have a strong sense of loyalty and pride in their cooperative, which goes well beyond commercial considerations alone. This commitment tends to equate with active membership; that is, not only putting effort into honouring commitments regarding the quality and volume of produce delivered but also attending membership meetings and taking every reasonable opportunity to discuss operations and strategy with senior managers. A significant membership problem is that of inactive members i.e. members who are no longer using the cooperative’s services or users who are not members. Inactive members are unlikely to be willing to provide longer term finance and by definition non-members have no commitment to the longer term development of the cooperative. They may also become a source of irritation for active members or worse if active members decide that their efforts are benefiting inactive members.

Membership commitment is two way. All POs/cooperatives need proactive managers to demonstrate to members that their participation not only delivers real benefits but also they will have a democratic involvement in the policies and development of the cooperative. For the POs/cooperative’s senior managers this goes beyond financial issues such as the allocation of surpluses and equity redemption to the creation of, and the active participation in, supportive representative structures. Furthermore, given that the promotion of higher skills and business performance amongst members is a key objective for farmers and policy makers, it is important for senior managers to put in place the infrastructure for providing such help to its members as most farmers join cooperatives to benefit their businesses.

It follows that closely associated with membership commitment are the internal governance structures and procedures. As noted above, the traditional cooperative tends to consists of a Board of Directors, composed of elected farmer members with a chairman and one or two executive managers. Some larger scale cooperatives, particularly across the EU have also created a second governing body; a Board of Supervisors, consisting of members of the cooperative, as a means of increasing the involvement of members. Regular and well facilitated meetings of the membership including the detailed and timely distribution of information relating to the cooperative’s financial accounts, major investments and strategic plans are absolute necessities if members’ commitment is to be retained and hopefully boosted. And care must be taken to ensure that it is the members who have the final vote on matters relating to key decisions affecting the future direction and performance of the cooperative. EFFP’s involvement with cooperatives has taught that it is critical that there should be an alignment between the control members perceive they have and the control they perceive they should have.

If POs are to become cohesive, professional and successful they must put in place organisational architectures and business strategies which focus not only on the core function of marketing their members’ produce but also on the democratic involvement of members and the provision of a range of services to help improve their business.
10. The economic case for cooperation

Section summary

In the following analysis 'cooperative' is defined to mean an agricultural marketing cooperative, a particular form of which is a producer organisation. The performance of an organisation can only be judged against its objectives and therefore a cooperative cannot logically be assessed as a profit maximising firm when it seeks to maximise the profits of its farmer members rather than its own. That said, it is legitimate to ask whether cooperatives contribute positively to social welfare and if so how. The overriding purpose of cooperatives (as defined in this paper) is as economic organisations potentially capable of offering producers higher and more secure returns than are typically offered by IOFs.

Competitiveness and Competitive Advantage

- European agricultural markets have undergone significant changes in the last twenty years and in order to improve their competitiveness within this changing business environment producers have had to find ways to increase their efficiency, not only in production but also beyond the farm-gate.
- Farms as relatively small scale businesses operating in an industry with an atomistic structure face difficulties in achieving the highest levels of efficiency arising from a lack of scale, access to relevant and timely information and facing markets characterised by buyers with considerable market power.
- Cooperatives offer solutions to these market failures and allow farms to move from a position where competitiveness is largely based on comparative advantage to one based on competitive advantage i.e., the successful outcome of a deliberate strategy to achieve and sustain competitiveness.
- Cooperatives via horizontal cooperation within the sector enable smaller scale farms to participate in a wider set of activities and attributes capable of delivering competitive advantage. Collectively they can negotiate on more equal terms, vertically integrate to compete downstream and via innovation, can favourably influence the terms of competitiveness.

Contributing to efficiency

Efficiency is critical to minimising the unit costs of production and marketing. It embraces the optimal allocation and use of resources which membership of a cooperative can more easily deliver in the form of: economies of scale; vertical integration and producer coordination.

i) Economies of scale

- Physical scale economies relate to the actual processes of production or marketing and arise from the reduction in unit costs created by: sharing specialised inputs and people; gaining the economies inherent in larger scale buildings and plant; spreading overhead costs over a larger volume of output;
and the reduction in risk associated with massed reserves.

- Pecuniary economies of scale arise on the input side from the opportunity to extract larger discounts on purchases involving greater volumes and on the selling side, lower unit costs of promotion and marketing as output rises.

**ii) Vertical integration**

- A cooperative allows small scale, farm businesses, faced with the market failures associated with highly concentrated market power on the part of buyers, to bypass the market and conduct downstream transactions under their control.
- A cooperative in principle affords members the scope to: market produce at lower unit costs and greater focus; better match their output – in quality and volumes – with market demands; and to introduce new products and/or marketing innovations.

**iii) Member coordination**

- Cooperatives potentially offer coordination of supply with demand – volumes as well as quality - at lower transaction costs which could be decisive where the introduction of new products and/or improvement in logistic efficiencies also requires a coordinated effort amongst members.
- Cooperatives are social networks within which transaction costs are reduced or avoided and in this respect a cooperative has in principle a distinct advantage over an IOF. Where specific rather than general knowledge is the basis of value, social capital imparts an advantage.

**Innovation, Competitiveness and Growth**

While efficiency supports incomes and profits it is the achievement of competitive advantage and thereby growth that generates employment opportunities and earning capacities. Central to the process of competitive advantage is innovation. Innovation is a complex process, often involving considerable investment and specialised knowledge. But competitiveness is more likely to be profitable and sustained if it is based on innovation and difficult to replicate capabilities. Growth cannot be sustained in the absence of competitiveness or more correctly competitive advantage.

**i) Innovation** To the extent that cooperatives allow the mutual alignment of smaller scale businesses in the process of innovation so they potentially reinforce the farming and food industries competitive advantage.

**ii) Achieving Competitiveness**

- As a member of a cooperative an individual farm will have access to more extensive sources of learning and knowledge and thereby it will improve its opportunity to gain (jointly) competitive advantage be it in terms of unit costs and quality or the more difficult to replicate advantages of quality and innovation that are dependent on the coordination of joint actions.
- At the level of the cooperative, competitiveness starts with the nature of
governance; that is, the extent of its control over the actions of a group of
dedicated suppliers (its members) and the contribution this control (e.g. its
communication, routines and systems) makes to the competitiveness of
individual members. This is augmented by the extent to which the
cooperative develops distinctive capabilities that can be converted into value
adding activities which in turn are generated by the cooperative’s
accumulated knowledge.

- At the level of the industry competitiveness is based on focused on factors
  that can be grouped under the headings of industry capabilities, institutions
  (including education and financial systems); demand conditions; and inter-
  company networks e.g., cooperatives. Generally the degree of interaction
  between innovating firms in search of competitiveness has tended to rise
  substantially in recent years and there is no reason to suppose that
  agriculture is not also capable of gaining from the same trend.

**iii) Growth**

- A competitive well financed cooperative is in a strong position to engage in
  organic growth but also it has greater scope to grow rapidly by means of a
  merger or acquisition. Cooperatives have a positive incentive to pursue
  growth strategies as growth tends to be associated with longer term survival,
  the profitability and growth of members’ businesses and thereby their
  satisfaction.

- In an open trading environment industry competitiveness is critical. The
  addition of cooperatives to the food sector’s IOFs offers scope to enhance
  competition if only by offering customers/consumers wider choice. The more
  cooperatives engage in value adding activities and in particular the
  development of innovative products the greater the contribution to the
  national industry’s growth by making foreign entry more difficult while opening
  up overseas opportunities.

**Challenges**

The introduction of marketing cooperatives to the agricultural sector can in principle
contribute positively to social welfare via the economic performance trinity: efficiency,
competitiveness; and sustainable growth. However, cooperatives face a number of
challenges – the key ones are set out below – that must be resolved if cooperatives
are to make a positive contribution to social welfare that individual small scale farms
would struggle to achieve on their own.

**i) Market Dominance**

- In the agricultural sector the horizontal grouping of small scale enterprises
  within local cooperatives would be very unlikely to pose a threat to
  competition but a national cooperative could in principle hold a dominant
  position. However unlikely this outcome, care should be taken in the setting
  up of marketing cooperatives to preserve competition; the more so if the
  establishment of a cooperative has been supported by public funds.
ii) Raising Capital

- Raising capital is a recognised challenge for cooperatives, particularly when planning value adding activities. Many larger scale cooperatives have experimented with new organisational forms in order to facilitate external funding but this raises questions as to how these new organisational types adhere to the concept of cooperatives i.e., the user-owner principle.

iii) Does Sector Matter?

- Marketing cooperatives have been a feature of most, if not all farm sectors in many parts of the world which suggests that sector per se does not present an inherent obstacle. That said supply and demand volatility varies from sector to sector as does the scope for downstream processing and manufacture.
Introduction

This section summarises the economic case for agricultural cooperatives. It builds on the Literature Review set out in Chapter 6 and its purpose is to outline how agricultural cooperatives might facilitate more efficient, competitive and growth orientated agricultural and food industry sectors. It seeks to explain how cooperatives can in principle improve social welfare by equalling or surpassing IOFs in these areas. We will examine the potential advantages of cooperation in the areas of unit costs, assured markets, knowledge transfer, innovation and social capital i.e. the creation of intangible value by the elimination or reduction in the need for expensive contractual arrangements.

In what follows the word cooperative is defined to mean an agricultural marketing cooperative, a particular form of which is a producer organisation. A defining characteristic of a cooperative is that the interests of the capital investor are subordinate to those of the business user, or patron, and consequently capital returns tend to be lower (Knoeber and Baumer, 1983). Cooperative control is in the hands of its member-patrons, who democratically elect the board of directors. Traditionally, member-patrons are the primary source of equity capital, and net earnings are allocated on the basis of patronage instead of investment. These characteristics can be summarised as: user ownership, user control and user benefit.

A cooperative is a special case of a club whereby an exclusive group has ownership of consumption rights. Group consumption rights lie on a continuum between the purely private where only members have access to the same club services and the purely public consumption rights where access is open and unregulated. According to the theory of clubs as the number of members increases so the cost per member declines, but for a given size of cooperative there will exist an optimal number of members in order to prevent the benefits of membership being decreased by congestion (Buchanan, 1965). As a club, a cooperative will have different, or more correctly a wider set of objectives than are typical for an IOF. As argued above, ultimately the success of a cooperative can only be judged against its objectives and therefore it makes little sense to compare the two forms of productive organisation on the same basis. In particular, a cooperative cannot logically be assessed as a profit maximising firm when it seeks to maximise the profits of its farmer members rather than its own profits. That said, it is legitimate for society to ask whether cooperatives contribute positively to social welfare and if so how.

As a nation we seek three unambiguous outcomes from our businesses; efficiency, competitiveness and sustainable growth. This trinity of economic outcomes is generally, but not necessarily, mutually inclusive and competitiveness is primus inter pares (Lall, 2001). Each outcome can be analysed at more than one level. In the case of cooperatives, the analysis can in principle be conducted at the individual member level, the industry or sector level in which the cooperative operates and where trade is involved at the level of the nation state. As is detailed in the literature review and summarised below, cooperatives offer significant scope to: improve productive and allocative efficiency; enhanced competitiveness; and thereby contribute positively to economic growth at all three levels.

Cooperatives are often misunderstood, in part by a mistaken desire to impart social or political connotations to cooperatives. It is however the case that the overriding purpose of cooperatives (as defined in this paper) is as economic organisations
potentially capable of offering producers higher and more secure returns than are typically offered by IOFs sourcing raw materials from an atomistic and uncoordinated supply base.

What follows is divided into four sections. The first explains the difference between competitiveness and competitive advantage and outlines how a cooperative can potentially increase these attributes, not only for its members but also for the sector in the supply chain in which it operates, as well as the nation in an open trading environment. The second looks in more detail at how cooperatives can in principle enhance efficiency by bringing the advantages of scale, vertical integration and knowledge transfer to bear on the cooperative’s operations and vicariously on its members’ businesses. The third section examines the relationship between innovation, competitiveness and growth and the contribution that cooperatives can make to these attributes. The final section briefly summarises some caveats that should be taken into account when attempting to place the economic contribution of cooperatives in context.

10.1 Competitiveness and Competitive Advantage

European agricultural markets have undergone significant changes in the last twenty-five years. Globalisation has increased competition, consumers have become more demanding, technology has made transport and storage more efficient and retail businesses have become much more concentrated (Bager, 1997): in 2012, the share of the UK grocery market (including on-line) accounted for by the largest six supermarkets was 75 per cent (Mintel, 2013). In order to improve their competitiveness within this changing business environment producers have had to find ways to increase their efficiency, not only in production but also beyond the farm-gate in the areas of distribution, marketing and product innovation. Relatively small scale producers operating in an industry with an atomistic structure face a number of problems in achieving these objectives arising from limitations in terms of purchasing power, access to specialised resources and marketing. They also face difficulties in obtaining relevant and timely information on cultivation advances, technical developments and marketing opportunities. In addition the growing concentration of retail and food service markets creates a disincentive for individual producers to innovate or attempt to differentiate their products; indeed, to even put additional effort into increasing product quality above the average.

Cooperatives offer solutions to these market failures and in addition have a clear role where producers are subject to oligopoly power in its input markets and oligopsony in its output markets (Fulton, 1999, Sexton and Iskow, 1988, LeVey, 1983). Through membership of a cooperative, producers can gain a countervailing power and to the extent that this creates greater balance between sellers and buyers and thereby the terms-of-trade for producers generally within the sector (Sexton, 1990), so it stimulates a more competitive outcome. Cooperatives focus on bringing a fair share of the market value to the producer no matter if there is excess supply or not, whereas an IOF’s objective is to bring value to its shareholders sometimes at a cost to producers. Before looking in more detail how cooperatives might deliver greater efficiencies and competitiveness we need first to define competitiveness and its associated competitive advantage. Competitiveness, at the firm level, is ultimately the ability to supply a product for sale that market participants judge offers greater value than rivals’ offerings and competitive advantage arises when rivals are unable for a period of time to duplicate the source of competitiveness. Profitability is the outcome of the combination of competitiveness and efficiency and the generated profits provide the funding for investment which is not only necessary to further improve efficiency but also to drive competitiveness.
Competitive advantage is the successful outcome of a deliberate strategy to achieve and sustain competitiveness, the sources of which are varied and to an extent determined by the level at which it is being assessed (Porter, 1985). If the definition relates to foreign markets then factors such as the exchange rate and trade barriers come into play. At an industry level, or more appropriately here, industry sector level, competitiveness is influenced by the proximate business environment as summarised in the modified Five Forces model – see Figure XII – though the original model (Porter, 1980) did not include important factors such as the stage in the industry’s life cycle and the extent of cooperation, be it horizontal with other producers within the sector, or vertical with suppliers and/or customers. Within a commodity industry with an atomistic structure, such as farming, individual farms are overwhelmingly price takers and competitiveness is largely based on comparative advantage (i.e. a cost advantage) subject to quality thresholds. Competitiveness, founded on a cost advantage, can be sustained if it is based on a unique attribute such as location but not if others can easily replicate the source. Cooperatives offer individual members the opportunity to benefit from competitive advantage and this is demonstrated with the aid of Figure XII; a modified version of Porter’s proximate business environment model that focuses on a specific agricultural sector and explicitly allows for horizontal cooperation within the sector in the form of producer-marketing cooperatives as a basis for gaining competitive advantage. The additional arrow between the sector and its customers, represents the scope cooperation affords individual, commodity farms to counter the potential market failure associated with selling to oligopsonistic buyers therefore enabling negotiation on more equal terms, and/or to collectively vertically integrate to compete directly at a downstream stage in the supply chain.

Figure XII: A Modified Five Forces Model
As members of a cooperative, smaller scale businesses can, collectively, participate in a wider set of attributes that deliver competitive advantage. From this perspective the entrance of a marketing cooperative in principle enhances competitiveness at the sector, industry and national levels while enabling its individual members to focus on the more traditional approach of comparative advantage i.e. efficiency in production. Unlike relatively, small scale individual farm businesses a larger scale cooperative can make a deliberate and conscious effort to be different from all other players in the sector, it can better identify and secure a position neglected or under supplied by competitors and via innovation it can influence the terms of competitiveness in its favour. Formulating such a strategy requires the ability to analyse not only competitors but also the areas where scope exists to create a unique value adding position and in turn this necessitates the ability to collect and analyse data.

10.2 Contributions to Efficiency

We observed in the introduction the importance of business efficiency, competitiveness and growth to the nation’s social welfare. Efficiency is critical to minimising the unit costs of production and marketing; although unit costs are not sufficient to achieve competitiveness. Efficiency is a wide concept embracing the optimal allocation and use of resources including the minimisation of waste and pollution. The efficiency of the cooperative and its impact on the efficiency of its members’ businesses are necessarily integrated. To the extent that a cooperative helps it members achieve higher levels of efficiency than they could attain by themselves so it increases their survivability. In this section we investigate the potential contribution of cooperatives to economic efficiency by examining three separate but interrelated sources of efficiency: economies of scale; vertical integration; and producer coordination. Figure XIII summarises the efficiency gains that are potentially realisable from cooperatives.

Figure XIII: -Three Sources of Improved Efficiency


10.2.a Economies of Scale

Economies of scale have traditionally been put forward as the primary basis for the creation of club production (Ariyaratne, et al., 2000, van Dijk, 1997, Schroeder, 1992). By pooling their products within a cooperative, members can benefit from the efficiencies and unit cost reductions that are optimised with scale. Two types of economies of scale can be distinguished; physical and pecuniary and both can be analysed at the level of individual products or at the level of the cooperative. Physical scale economies relate to the actual processes of production or marketing and arise from the scope created by sharing. These economies may result from a number of attributes such as specialisation – the larger the volumes the greater the opportunities to lever the efficiencies stemming from specialisation in both inputs and people – the opportunities to share capital services and access to support services (Scherer and Ross, 1990). Pecuniary economies arise from the opportunity to extract larger discounts on purchases of inputs afforded by larger volumes (Polson and Hudson, 1990) and on the selling side where per unit costs of promotion and marketing fall as output rises, allowing producers to more efficiently market differentiated products.

A closer examination of physical economies of scale shows that they arise partly from the technical cost advantages inherent in larger buildings and plant and partly from the sharing of overhead costs – e.g. management, logistics, and specialists. For example, technical cost advantages result from the fact that the cost of building a storage facility rises at a lower rate than the capacity as do energy costs. By spreading overheads over a large volume – and ideally over a related but diversified product range e.g. vegetables – the unit cost of support activities are reduced and if scale supports diversification it is also likely to deliver economies of scope. Some of the pecuniary economies arising from membership of a cooperative overlap with those outlined for products e.g., the ability to obtain discounts on purchases and obtain much better terms when it comes to per unit selling and marketing costs. Two potentially important economies arising from the pooling of individual members’ outputs are the reduction in risk associated with ‘massed reserves’ and the economies of obtaining and disseminating relevant information. A larger organisation is in a stronger position to respond to contingencies and provide members with timely and pertinent advice regarding new practices and technical innovations. This not only helps better decision making by individual members but also helps raise quality and market alignment for the cooperative. Cooperatives can also be a source of new knowledge, for example by using their scale to work with breeders and other specialists to solve specific problems.

10.2.b Vertical Integration

Although distinct there is a large overlap between scale and vertical integration; notably the effectiveness of the latter is enhanced by the former. We noted in the introduction that small scale, farm businesses are faced with the market failures associated with highly concentrated market power on the part of buyers. A well-recognised response to such market failures is vertical integration; that is, to bypass the market and conduct upstream or downstream transactions within a cooperative (Riordan, 2005, Masson and Eisenstat, 1978). As we are primarily focused on marketing cooperatives we will concentrate on the downstream benefits of which the assured access to markets on more favourable terms – and hence a reduction in risk – is a major efficiency benefit for members. Market assurance reduces risk while supporting longer-term planning on the part of producers and thereby investment to deliver greater production efficiencies. By using management rather than the market to align two or more stages in the supply chain, vertical integration reduces transaction costs, which include search, contracting, monitoring and enforcement.
costs, thereby facilitating the use of specialised assets – see the problem of hold-up below – to improve choice and competition in the market (Williamson, 1971). These favourable outcomes are achieved by the ability of a cooperative to engage in one or a combination of the following three activities: to market members produce at lower cost and with greater focus; to better match the output of members – in terms of both consistent quality and appropriate volumes – with market demands; and to introduce new products and/or marketing innovations.

Marketing produce at a lower per unit cost and providing members, customers and consumers with more information in order to promote choice are unambiguous efficiency gains. Better matching of quality and volumes to market demands reduces waste, a major source of inefficiency. Moreover, efficiency is further enhanced by encouraging members to apply effort to improving quality and responsiveness. Innovation is arguably more a contribution to competitiveness, or more correctly competitive advantage than efficiency (OECD, 2007; Giannakas and Fulton, 2005) and we consider the drivers of innovation in more detail below. From the perspective of economic efficiency innovation that better satisfies demand is unequivocally an allocative efficiency gain and very likely also a productivity gain. The advantage a cooperative offers in the area of new products and innovation is particularly pertinent when a relationship-specific investment is required. Such investments only have value within a dedicated relationship e.g. a product or process designed to meet a specific need and once completed can be exploited by a third party buyer. In these situations contracts are costly or impossible to enforce, giving rise to the so-called ‘hold-up’ problem i.e. the investment is unlikely to be made.

**10.2.c Member Coordination**

Cooperatives where members have the objective of working together also have an advantage when it comes to countering coordination X-inefficiencies; namely, the failure to minimise unit costs because, *inter alia*, individuals lack sufficient or appropriate information to make the best joint decisions. Horizontal and vertical coordination within cooperatives not only facilitates the sharing and dissemination of information, thereby reducing risk and enabling production decisions across members to be optimised (van Dijk, 1997) but also supports value enhancing joint actions such as bargaining (Shaffer, 1987, Staatz, 1987c, Helmberger and Hoos, 1965). For example, the harvesting of fruits and vegetables must be coordinated to minimise the problem of over supply while avoiding idleness at the packaging or processing stage. This requires complex information exchange, not only regarding supply and demand, but also on the quality requirements of retail customers and final consumers. Cooperatives potentially offer such coordination at lower transaction costs which could be decisive where the introduction of new products or improvement in logistic efficiencies require a coordinated effort amongst members.

There is a widespread consensus amongst economists that social networks can benefit economic performance (Henning, *et al.* 2012). As discussed in the previous section membership of a cooperative is an investment in relationships formed with the motivation of mutual benefit and the expectation of collective actions among members. Relationships reinforced by working together are a means of increasing trust, reciprocity and guarding against market failure arising from asymmetric information. The strength of a cooperative lies in its ability to cultivate a feeling of trust and confidence amongst its members and in their commitment (Barraud-Didier, *et al.* 2012). Within a social network, transaction costs are reduced or avoided and in this respect a cooperative has a distinct advantage over an IOF. Where specific rather than general knowledge is the basis of value, social capital imparts an advantage.
10.3 Innovation, Competitiveness and Growth

10.3.a The Innovation Process

As made clear in the introduction, competitiveness is the primary goal and the proven basis for sustained economic growth. While it is necessarily true that efficiency supports incomes and profits it is the achievement of competitive advantage and thereby growth that generates employment opportunities and earning capacities. Central to the process of competitive advantage is innovation (Teece, et al. 1997) and we therefore start this section with an overview of the role cooperatives can play in the process. The innovation process set out in Figure XIV is based on Schumpeter’s (1942) trilogy and is fundamentally a three stage process of investment.

Figure XIV: The Innovation Process

Based on Rosegger (1986)

At each stage of the process there are activities requiring inputs of knowledge, experience and investment, but also each stage, if successful, produces an output that is fed to the next stage or fed-back to earlier stages. The first stage, labelled invention, is the process of discovering new or improved knowledge. This may relate to a product, a process - production or marketing – or the way business is organised. All of this activity is frequently lumped together as research but it represents pre-commercial activity by a variety of agents – for example public research institutions, universities, lone inventors, individual firms – working as individuals or in partnership. The next stage, labelled innovation, takes the new knowledge and attempts to convert it into a commercial proposition. This may involve some applied research to develop the idea including market testing and if the process is to progress to the final stage the individual firm will have to commit the necessary investment funds. The final stage, broadly characterised as diffusion, covers the stage when the firm seeks to earn a return on its investment. It is also the stage when competitors will respond to the new competition; the more successful the advance the more intense the competition. The diffusion stage will also generate the public good of positive externalities in the form of spill-over benefits to
competing firms, generating further incremental improvements via feed-back processes and advancing competitiveness at the industry level.

The foregoing makes clear that innovation is a complex process, deriving from a wide range of sources and its development involves various stages, often involving considerable investment and specialist knowledge. It is thus pertinent to consider how the introduction of a cooperative to an atomistic industry sector can help advance the process of innovation. While scientists and entrepreneurs are central actors in the process, there is a critical role for the gathering of information, the application of expertise as well as the ability to apply sufficient funding. It is these resources and capabilities at the second stage of innovation that drive competitiveness and it is at this stage that studies suggest cooperatives offer an advantage over small scale, farm businesses (Giannakas and Fulton, 2005). The pace of innovation will vary from one industry to another, influenced in part by the prevailing technology but also by the proximate business environment and the intensity and nature of competition. In other words, innovation requires an appropriate mix of inter-firm rivalry and cooperation and it is this recognition that has resulted in more open approach to trade policies over recent years (Gerossi, 1995, Blundell, et al. 1999). But aligned with benefits arising from openness should be the creation, or scope to create institutional structures that can enable smaller scale business to nourish, over the longer term, the necessary resources and capabilities to compete. This may require shifting the balance towards cooperation in order to respond effectively. To express this another way, cooperatives allow the mutual alignment of smaller scale businesses in the process of innovation thereby potentially reinforcing the agricultural and food industries competitive advantage.

10.3.b Achieving Competitiveness

Unit costs can be a source of competitiveness but to be a source of competitive advantage the source must be difficult to imitate. Our focus is the competitiveness that arises from competitive advantage and this can be examined at the level of the individual member, at the level of the cooperative or at the industry level (see Schendel (1994) for an overview of firm and industry sources of competitiveness). At the producer level unit costs are highly relevant when competing for market share with international competitors but other factors are also important such as strict quality control, a willingness to innovate – with support from the cooperative – as well as an ability to adapt and respond rapidly to changing market demands. At the farm level scale limitations place the emphasis on the cumulative and incremental learning experience of the farmer but the distinctiveness of an individual farm’s accumulated experience and knowledge in terms of its own and the sector’s competitiveness is likely to be limited. We noted in the previous section the efficiency contribution in the sharing and dissemination of information. Thus, to the extent that as a member of a cooperative an individual farm will have access to more extensive sources of learning and knowledge so it will improve its opportunity to gain (jointly) competitive advantage be it in terms of unit costs or the more difficult to replicate advantages of quality and innovation that are dependent on the coordination of joint actions (Hueth and Marcoul, 2003, van Dijk, 1997). A summary of the competitiveness enhancing attributes that an individual farm potentially gains from membership of a cooperative is set out on the left-hand side of Figure XV.

At the level of the cooperative, competitiveness starts with the nature of governance; that is, the extent of its control over the actions of a group of dedicated suppliers (its members) and the contribution this control (e.g. its communication, routines and systems) makes to the competitiveness of individual members (Schmitz, 2008). Competitiveness at this level depends in part on the ability of the coop’s senior managers to harness this commitment to their understanding of rival’s behaviour and
market trends (Barraud-Didier, *et al.* op cit). That is, governance must be augmented by the coop’s ability to develop distinctive capabilities that can be converted into value adding activities which in turn are generated by the cooperative’s accumulated knowledge. Such capabilities would normally be generated from the coop’s experience and accumulated knowledge which determines the set of opportunities for growth which senior managers perceive when assessing value adding opportunities arising from technological developments and/or the external business environment. Value adding innovation may include the launch of new or improved products but it can also involve strategies relating to distribution and marketing. Combining accumulated knowledge resources with effective control over its suppliers together with access to sufficient funding creates, in principle, the basis for an increase in competition by enabling cooperatives to challenge existing IOFs for market share.

As noted above, if a cooperative is to gain competitive advantage, it must also possess the capabilities to identify the priority sectors for their members’ output and engage in appropriate downstream activities (PWC, 2013); for example by entering into partnerships with other entities to exploit competitive opportunities e.g., a food service provider. A summary of the attributes that enable cooperatives to seek competitive advantage are set out on the right-hand side of Figure XV.

**Figure XV: Sources of Competitiveness**

At the level of the industry the attributes that influence competitiveness are traditionally focused on factors that can be grouped under the headings of resources or capabilities, institutions (including education and financial systems) and demand conditions but also relevant are inter-company networks (Porter, 2000) and hence cooperatives. Indeed, it is worth emphasising that looking at industries in general, the degree of interaction between innovating firms in search of competitiveness has tended to rise substantially in recent years in order to better create and share advances in knowledge. There is no reason to suppose that agriculture is not also capable of gaining from the same trend. Cooperatives can positively contribute to inter-firm rivalry and networks and even emerge as industry leaders by adopting an
aggressive focus on knowledge creation (PWC, 2013). From a country perspective it is in practice industry level competitiveness that is the major influence on what is frequently referred to as country level competitiveness. Relevant here is the scope and support of government policy. The growing importance of science and technologies calls for investment in science and higher education on the part of governments but also for their part, investment in capital and capabilities by firms in the industry (Hämäläinen, 2003). While macro factors such as labour market legislation and exchange rates can influence competitiveness, the weight of contemporary academic thinking would view neither as being sustainable sources. For example, if lower wages results in lower productivity or a fall in the exchange rate sparks domestic inflation.

10.3.c Growth

At the start of this section we observed that competitiveness is needed to sustain growth in an open, trading environment (Lall, op cit). Again growth can be considered at the level of an individual member, at the level of the cooperative and at the industry or sector level. At the farm level the cost and scarcity of land places the emphasis on a combination of productivity growth and access to a secure market for its output. We have explained above how membership of a cooperative can in principle contribute positively to these two necessary requirements for growth. However, in order for this growth to be sustainable it must be reinforced by investment in farm level capital and capabilities and a successful cooperative will also deliver higher returns to its members and hence greater ability to reinforce productivity and efficiency by investment. These aids to the growth of members’ businesses are summarised in Figure XVI.

At the level of the cooperative, a competitive, well financed cooperative is in a strong position to engage in organic growth but it will also have greater scope to grow rapidly by means of a merger or acquisition. Cooperatives have a positive incentive to pursue a growth strategy as it tends to be associated with the longer term survival of the cooperative and it also has a direct link to the profitability and growth of members’ businesses and thereby to their satisfaction. A well-managed cooperative will work with its members to balance the growth of production and thereby achieve better alignment with market demands, avoid situations of over-supply and maintain quality levels. The cooperative can expand demand for its members’ produce by using its knowledge, capabilities and marketing resources to expand market share and/or enter new markets; aggressively engaging in value adding production stages; and establishing a capability to develop innovative products. Cooperatives are not only in a stronger position to identify the priority sectors for their members’ output but also they can better enter into partnerships with other entities to exploit competitive opportunities e.g. a food service provider. These contributions to growth are set out in Figure XVI.
In an open trading environment industry competitiveness is a sustainable basis for industry growth. We noted above the contribution of inter-firm rivalry and cooperation to the process of innovation and for food chains in developed nations innovation is critical to securing the national industry’s competitiveness when facing open trade policies. The addition of cooperatives to the food sector’s IOFs will enhance competition if only by offering customers/consumers wider choice. But if cooperative engage in value adding activities and in particular the development of innovative products they will not only contribute to their internal growth but also in an open trading environment they will aid industry’s growth by making foreign entry more difficult while opening up overseas opportunities. This reinforces the point made above, that the contemporary approach to national competitiveness plays down the unit cost of labour and interest rates and focuses much more on the generation of knowledge including that arising from alliances, partnerships and other forms of cooperation (Hämäläinen, op cit). The addition of successful marketing cooperatives to the food industry, particularly those bringing new knowledge to bear, increases the overall efficiency and competitiveness of the industry and thereby improves its contribution to GDP growth and the trade balance. These contributions to growth complete the summary in Figure XVI.

10.4 Challenges

The foregoing has sought to demonstrate how the introduction of marketing cooperatives to the agricultural sector can in principle contribute positively to social welfare via the economic performance trinity: efficiency, competitiveness; and sustainable growth. However, the phrase ‘in principle’ implies that cooperatives face a number of challenges as discussed elsewhere in this report; particularly as they grow in size and in some situations their contribution to the economic performance trinity becomes problematic. In this final section we set out some of the challenges that must be resolved if cooperatives are to make a positive contribution to social welfare that individual small scale farms would struggle to achieve on their own. .
A dominant market share is not *per se* anti-competitive but it would afford a cooperative – indeed any IOF – the scope to abuse its power to the detriment of social welfare. The competition authorities apply a *de minimis* rule when an enterprise has a small market share but will not tolerate any attempt to fix prices or market shares (Commission, 2001). As market share, or more correctly, sector share increases so a cooperative’s ability to influence the market price – by engaging in anti-competitive agreements with rivals or restricting supply – increases. From the perspective of social welfare, efficiency and competitiveness are the guarantees of low prices, real value and choice. Thus, anything that restricts competitiveness not only adversely influences social welfare but also affords firms scope to tolerate some slack and therefore lower levels of efficiency as profits can be enhanced by the higher prices associated with reduced competition. In short, the formation of a cooperative with a dominant market share, or a grouping of cooperatives to achieve a collective dominance, would be unlikely to be beneficial to social welfare.

A dominant position is not precisely defined but exists when an undertaking has sufficient market power to bring pressure to bear on competitors; for example to follow a price lead or by engaging in behaviour designed to drive smaller competitors from the market (Commission, 2009). In an agricultural sector the horizontal grouping of small scale enterprises within a local cooperative would be very unlikely to pose a threat to competition but a national cooperative could hold a dominant position. That said, it is only when a dominant position is abused that the law is broken and the ability to engage in such behaviour depends on the extent of the market – national or European – the existence of close substitutes and switching costs. Although agricultural cooperatives enjoy some exclusion under existing competition legislation the abuse of a dominant position would almost certainly result in the authorities withdrawing the agricultural exclusion.

It follows that in encouraging the setting up of marketing cooperatives care should be taken to preserve competition; the more so if the establishment of a cooperative has been supported by public funds. However, the assumption that the entry of a dominant cooperative to a sector would be accompanied by a reduction in competition is not automatic. The Five Forces model set out above identified barriers to entry as a key influence on the competitive behaviour of incumbents. If new entrants (to the sector) are deterred by being placed at a competitive disadvantage post-entry, as a result of say higher production costs or the lack of a strong brand, then incumbents have greater freedom to collectively abuse their position. But if the formation of a cooperative amounts to a new entry then the sector is by definition contestable i.e. new entrants judge that they would be at no competitive disadvantage compared to incumbents, and in this situation the threat of entry will prevent incumbents from abusing their market power. However, this implicitly assumes that the scale of entry by a cooperative is on a par with incumbents; a scale of entry that is so large that the cooperative moves immediately to a dominant position should be discouraged.

The foregoing has implicitly been concerned with horizontal grouping of farms as members of a cooperative but also a potential concern are vertical collaborations between a cooperative and a downstream customer e.g. a food processor. Again the test is whether the vertical agreement restricts competition; for example, if the agreement gives the buyer or seller a large market share, or it prevents the buyer purchasing from an alternative supplier. That said the competition authorities tend to look more favourably on vertical collaborations as there is wide recognition that
such agreements can improve efficiencies (particularly in logistics) and competitiveness via quality improvements and joint innovation.

10.4.b Raising Capital

Although market dominance can raise competitive issues we have explained above the advantages of scale for efficiency and competitiveness. But scale requires investment in fixed assets and capabilities including value adding. We have made much of the potential competitive gains arising from a co-operative’s involvement in value adding activities including product innovation but such activities involve risk and capital expenditure. A major issue, identified in the academic literature, in judging the potential economic success of co-operatives is their ability to raise capital (Cook and Iliopoulos, 2000, Vitaliano 1983) and this issue is discussed in more detail in section (12). The prevailing view is that marketing co-operatives when planning vertical integration in order to engage in value adding activities face funding constraints if the move involves significant demands on members. In order to overcome these constraints, many larger scale co-operatives have experimented with new organisational forms in order to facilitate external funding (see Cook et al. 2004, Kyriakopoulos and Van Bekkum, 1999 for a discussion of the trends). In turn this raises questions as to how these new organisational types adhere to the concept of co-operatives i.e. the user-owner principle. As implied funding and scale are positively related and in establishing a co-operative mangers need to ensure that funding is sufficient to implement the planned strategy. This suggests, smaller scale co-operatives with a supportive membership and low credit risk are likely to be less constrained and it places in perspective the concern that the entry of a new co-operative could be of such a scale that it threatens rather than enhances competition.

10.4.c Does Sector Matter

This report has been prepared against the background of EC policy reform relating to producer organisations. These special forms of marketing co-operatives were first introduced in the fruit and vegetable sectors but are now to be widened to other sectors e.g. dairy. Marketing co-operatives have been a feature of most, if not all farm sectors in many parts of the world which suggests that sector per se does not present an inherent obstacle. That said, supply and demand characteristics vary from sector to sector. Short term volatility is a feature of fruit and vegetable production and the sector is closer to the final consumer than say cereals. The closer a sector to the final consumer the more responsive producers must be to demands for convenience, taste, variety, quality and food safety. We might therefore expect that a successful co-operative operating in the fruit and vegetable sector is one that minimises the impact on members’ returns of supply fluctuations while meeting the demands of consumers (dell’Aquila and Petriccione, 2012).

Another, characteristic that varies across sectors is the bargaining power of buyers which has been greatly increased by increasing levels of concentration, particularly in the retail sector and the expansion of multinational food businesses. In these sectors countervailing power is a relevant consideration and this calls for larger scale co-operatives whose senior managers are capable negotiators (Mishra, et al. 2004). Yet another characteristic that varies across sectors is the extent of downstream processing. This creates greater scope for vertical relationships with processors/manufacturers and also for vertical integration(Mishra, op cit). Again these aspects would appear to demand that a co-operative’s strategic focus should vary according to the sector’s prevailing conditions of supply and demand and this is likely to involve variations in the capital that must be raised from members e.g. for processing or new product development. It would however, be safe to conclude, on
the basis of many academic studies and practical experience, that the efficiency and competitiveness of any agricultural sector would be enhanced by the entry of a marketing cooperative.

10.4.d A Final Observation on Scale

A common theme of this section has been the importance of a sufficient scale of operation for the success of a cooperative; indeed, the main economic reason for joining a cooperative is so that smaller scale businesses can benefit from the gains that generally accompany an increasing scale of operation. And as made clear in the literature review (see Appendix 13.1), marketing cooperatives are capable of realising significant economies of scale. This suggests that cooperatives should seek to gain at least that scale of operation that is consistent with the lowest possible unit costs. However, this minimum scale of operation, which is largely determined by advances in technology and organisational management, need not be large in terms of market share. Scale, as noted above, brings with it many economic advantages but it also brings problems of control and, as we have discussed, the potential at larger scales to engage in anti-competitive behaviour.

The reference to the market – which generally, in the case of agriculture, will be a sector – is important because what appears small scale in terms of turnover, or members could be significant, even dominant in its chosen market. Dominance and the abuse of market power are issues for the competition authorities and the foregoing has explained that a crude measure of concentration is unlikely be sufficient to make a judgement regarding the impact on efficiency and competitiveness. There is no rule regarding the appropriate size of a cooperative; each situation deserves to be examined against a range of criteria and in particular its opportunity costs. A smaller scale cooperative is likely to have fewer control and funding issues as well as the capability to respond more quickly to a change in demand. Alternatively, in other situations efficiency and competitiveness might best be served by capturing the cost and revenue advantages inherent in larger scale. In short, we must conclude that the optimal size for a cooperative at any point in time will be the product of multiple influences and ultimately the only test is the extent of its contribution to the trinity of economic performance: efficiency; competitiveness; and growth. These caveats are discussed in more detail in section (12).
11. Transferability of fruit and vegetable POs to other sectors

Section summary

- The fruit and vegetable sector has many similarities to other farm sectors but some characteristics that are more unique, including the perishable nature of its products and the vulnerability to weather changes. Not only can the weather influence availability and yields but also it changes consumption patterns and hence, market power along the food chain.

- Milk may have some similarities; the growing uncertainty over milk prices within the UK has stimulated interest in the role POs could potentially play for dairy farmers. According to the NFU they offer a way to encourage greater supply chain collaboration, putting farmers on a stronger footing not just to rebalance bargaining power but also to develop more mutually beneficial relationships between all parties across the supply chain. In the dairy sector cooperation has always had a very major presence across the world albeit has only gained a strong foothold in the UK over the last 20 years.

- The situation in the livestock sector is very different where the market share of cooperatives in the UK is much smaller. This is due to a number of reasons; animals may be reared on several farms during their lifetime; less pressure to move product off a farm on a particular date; carcasses are broken up and sold to a number of different customers and there remains a strongly independent trading mentality among livestock farmers.

- Thus while a case can be made for greater cooperation in the red meat sector some significant challenges and barriers exist and progress is likely to remain slow. This view was echoed by participants in the industry workshop but they did believe that farmers should have the option of setting up POs if they so wished.

- Cereals, unlike fresh produce and milk, can be stored and there is a transparent and relatively sophisticated world market in existence which reacts instantly to supply and demand changes and has a very active futures market. Overall the market is competitive and no one player dominates. There is also a range of different uses for cereals other than human consumption to which crops can be diverted as an alternative outlet. At present there is nothing to stop cereal farmers collaborating to gain strength in the market place and there are a number of well recognised cooperatives.

- Despite these uncertainties, when the survey asked ‘Would the introduction of POs to other sectors be a positive development?’ 52% of coop / PO respondents and 73% of stakeholder respondents answered positively. Furthermore there was a view in the industry workshop that the introduction of POs could stimulate more collaborative activity, and whilst it is difficult to predict uptake of POs it was considered important that farmers were made aware and had the opportunity to do so if they wished. Similarly it was felt that potential opportunities and benefits might in the future be offered to those with a PO structure e.g. grant schemes.
Introduction

The fruit and vegetable sector has many similarities when compared to other farm sectors but also some characteristics that are less common. One distinguishing feature is the perishable nature of its products and their strong vulnerability to weather changes. Not only can the weather influence availability and yields but also it changes consumption patterns and hence, market power along the food chain.

Until the 2007 reform of the CMO, POs were explicitly charged with bringing about a high degree of stabilisation: nevertheless, the sector frequently suffered (indeed suffers) market crises. The 2007 reform had two objectives: to integrate the fruit and vegetable sector into the single payment scheme; and to move the sector towards a greater market orientation and therefore increased exposure to market fluctuations.

To this extent the sector has been aligned with other agricultural sectors under the Common Agricultural Policy (CAP). As the EU Commission is proposing to maintain the existing support framework for POs there would appear in principle no conflict – at least from a policy perspective – to transferring the PO approach to other sectors. Indeed, as shown in Figure XVII the survey results highlight that the majority of those surveyed think that the introduction of POs into other sectors would be a positive development.

Figure XVII: – Would the introduction of POs to other sectors be a positive development?

SURVEY QUOTE

“Properly run POs are the best way of concentrating supply and providing a support structure for smaller growers to strengthen their position in the market place. They enable the supply chain to be shortened and for producers to take more control over their marketing”
11.1 Dairy and livestock

What the fruit and vegetable sector has in common with other agricultural sectors, indeed the reason for the development of the CMO by the EU, are the long-term changes relating to: the structure of global food supply chains; the growing concentration of downstream customers; more intense consumers’ demands for value, variety and convenience; increasing food safety regulation; and growing measures to protect the environment.

Seasonal prices for fruit and vegetables have traditionally been more volatile than for other sectors though over recent years greater volatility has become more of a feature of agriculture in general. The growing uncertainty over milk prices within the UK has stimulated interest in POs in other sectors and in the first instance the role that they could potentially play for dairy farmers. According to the NFU they offer a way to encourage greater supply chain collaboration, putting farmers on a stronger footing within the supply chain not just to rebalance bargaining power but also to develop better more mutually beneficial relationships between all parties across the supply chain.

While a variety of business models exist in the dairy sector, cooperation has always had a very major presence in many countries in dairy across the world albeit has only gained a strong foothold in the UK over the last 20 years. The situation in the livestock sector is very different where the market share of cooperatives in the UK is much smaller. In the pig sector there are some major European cooperatives including Danish Crown and Vion as well as some long established and important cooperatives in the UK including Scotlean, Yorkshire pigs and Thames Valley Cambac. The weakness of cooperation in the beef and sheep sectors is not confined to the UK. For example, while a range of livestock cooperatives have developed in the United States they still only have a relatively small market share. In the EU there are some large livestock cooperatives including Vion and Westfleich that operate in the beef and sheep sectors but market share remains significantly less than in the dairy sector. In the UK cooperation in the red meat sector is even weaker accounting for only a 5-10 per cent market share.

A number of reasons have been put forward to explain this disparity including: the fact that animals are reared on several farms during their lifetime; there is less pressure to move product off a farm on a particular date as compared to fresh produce, dairy or pig sectors; carcasses are broken up and sold to a number of different customers; there remains a strongly independent trading mentality among livestock farmers and; a long established and successful system of livestock markets exists for the marketing of beef and sheep animals.

Thus while a strong theoretical case can be made for the benefits of greater cooperation in the red meat sector some significant challenges and barriers exist which mean that progress in this direction is likely to remain slow. This view was echoed by participants in the industry workshop although they did believe that farmers should have the option of setting up POs if they so wished.

**SURVEY QUOTE**

“POs have the potential to improve the marketing position of farmers, but they mustn’t be seen as a panacea. The success of a PO will rely on the willingness of farmers within them to adapt production to collaborative marketing strategy rather than just for price leverage in the market place”

---

81
11.2 Cereals

In the cereal sector where the majority of crops are sold to marketing intermediaries or by cooperatives and farmer controlled businesses to processors rather than direct to retail the benefits of PO formation are less obvious. If the cereal sector was to adopt POs it would be vital that it learn lessons from the fresh produce sector and developed clear, unambiguous objectives.

There are a number of significant differences between the cereal sector and the fresh produce sector which need to be considered. There has to be a compelling reason for the creation of POs in other sectors, for instance where there is market failure and the need to provide a countervailing force in an unbalanced marketplace. This is cited as one of the reason for the proposed creation in the dairy sector. Unlike fresh produce, cereals can be stored and there is a transparent and relatively sophisticated world market in existence which reacts instantly to supply and demand changes and has a very active futures market. There are many financial instruments used to arrive at a market price on a daily basis for cereals and despite a number of very large trading businesses in the UK and across the world the market is competitive and no one player dominates.

Another significant difference between fresh produce and cereals is the nature of the farmers’ customers. In the case of fresh produce the major routes to market are either through marketing intermediaries to retailer or direct to retailer where there is a high level of dominance and control by the supermarkets. In contrast for cereals there are many processing and manufacturing intermediaries between farmer and consumer. There is also a range of different uses for cereals other than human consumption to which crops can be diverted as an alternative outlet. Thus, cereal farmers are not so wholly at the behest of dominant downstream businesses.

At present there is nothing to stop cereal farmers collaborating to gain strength in the market place. There are a number of well recognised cooperatives, the largest and best known being Openfield which markets on behalf of some 4,000 farmers and handles around 20 per cent of the annual UK cereal crop. In comparison the largest merchanting business is Frontier (50 per cent owned by the multi-national commodity business, Cargill) with around 25 per cent of the cereal market.

11.3 Other issues

We noted above that it was not clear that POs could offer a significant advantage over marketing cooperatives but the industry forum revealed a belief that the introduction of POs could stimulate more collaborative activity, possibly leading to more formalisation of some of the loose supply group arrangements and that whilst it is difficult to predict uptake of POs it was considered important that farmers were made aware and had the opportunity to do so if they wished. Similarly it was felt that potential opportunities and benefits might in the future be offered to those with a PO structure e.g. grant schemes or would at least strengthen an application under a future RDPE scheme.

Other lessons regarding the transferability of the PO scheme to other sectors concern the operation of the scheme itself. UK experience of POs, with critical audit reports and consequential disallowance, has not served to create confidence on the part of farmers. A further issue is the scheme’s complexity and ambiguity concerning the regulations which have necessitated a significant number of
supplementary guidance notes to be issued concerning the eligibility of outsourcing activities, the role of members as marketing agents and the imperative for POs to control all aspects of storage, packing and marketing of members' produce. Also significantly for existing cooperatives the scheme’s requirement that only additional activities, not routine business practices, attract support.

That said, as the extension of POs into other sectors will not be accompanied by financial assistance this should make the rules attached to such POs simpler, less onerous, easier to understand and manage. The UK’s experience shows that EU legislation for the extension of the PO scheme to other sectors should be communicated in plain language with no room for differing interpretations.

In particular there would also seem to be a requirement for better communication not only with farmers but also between Member States, the EU Commission, and the EU Court of Auditors. As the scheme’s objectives are applicable across all EU states and farm sectors this will, as a matter of reality, mean that the objectives will have to cope with the very considerable variation across EU agricultural sectors. The scheme’s Competent Authority’s will need to have high levels of competence and specific sector knowledge - as well as understanding company rules, accounts and cooperative principles – and be aware of the importance of creating, as far as possible, a level playing field for POs. Certainly, great care should be exercised by the UK authorities to ensure through their interpretation of the rules that domestic POs are not placed at a competitive disadvantage to their EU counterparts.
12. Potential downsides of POs/Cooperatives

Section summary

The PO Scheme has potential benefits for individual farmers, the agricultural industry, its customers in the food chain and consumers but there are also potential disadvantages:

- It could encourage too many POs, many of which would be small scale with a very small market share and fail to achieve economies of scale.

- Such POs are also likely to struggle to attract high quality managers.

- At the other end of the scale, whilst the regulation allows a PO to negotiate contracts, including price, on behalf of its members, the risk is that larger scale POs could find themselves hampered by the attention of the OFT (and potentially the Competition Commission). The experience of Milk Marque serves as a warning.

- Without a clear business case, the active support of members and the recruitment of experienced and skilled senior managers, forming a PO is unlikely to deliver much added value.

- If a cooperative’s strategic plan involves processing and new product development the inability to raise sufficient capital from members for expensive investments is an important risk. Whilst there are a number of new cooperative structures that seek to overcome the horizon problem they may not easily fit the intentions of the CMO for the PO scheme.

It should be clear that in our view the PO Scheme has potential benefits for individual farmers, the agricultural industry, its customers in the food chain and consumers but there are also potential disadvantages. A potential disadvantage of the PO Scheme is that it could encourage too many POs, many of which would necessarily be small scale therefore each would only account for a very small market share. POs accounting for only a limited share of total production in the sector would fail to meet the scheme’s objectives in terms of concentrated power. Such POs are also likely to deny their members the full benefits of economies of scale in terms of the provision of services and it is reasonable to assume that small scale POs would struggle to attract high quality managers. In the extreme the effect of the scheme could be to create, in terms of marketing, a more fragmented sector leading to little, if any, gain in either

SURVEY QUOTE

“It all comes down to the right motivation for doing them. Just setting them up without a clear objective about what they are trying to achieve is doomed to failure”
internal or external efficiencies. Even worse, if could result in smaller scale POs competing with each other thereby tending to reduce market prices and in the process undermining existing marketing cooperatives.

Another potential disadvantage arises from the regulation that allows a PO to negotiate contracts, including price, on behalf of its members providing the volume of raw produce covered by the negotiation does not exceed 33 per cent of the total production of the member state in the case of dairy; and 15 per cent in the case of cereals and beef. Despite this provision POs are not immune from investigation by the member state’s competition authority. The risk is that larger scale POs in the UK could find themselves hampered by the attention of the OFT – or even a reference to the Competition Commission – forcing them into costly, legal investigations and the risk of having to reopen the negotiation. The experience of Milk Marque serves as a warning, where processors responded to countervailing power by resorting to legal proceedings which ended with the Competition Commission forcing the break-up of Milk Marque.

We must further observe that without the active support of members and the recruitment of experienced and skilled senior managers the act of forming a PO is unlikely to deliver much added value. In addition there must be a clear business case and as previously observed the appointment of a senior manager with good leadership and entrepreneurial flair.

12.1 Capital Constraints

We noted in section (6) that traditional cooperatives suffer three inherent weaknesses: the horizon problem, in which short ownership periods discourage long-term investment; the free-rider problem, in which active members benefit from past members’ equity contributions; and the portfolio problem, in which fixed-value equity shares discourage investments with risky upside potential. We have considered the impact of the horizontal problem and free riding when discussing membership commitment above – see section (9) here we turn to capital constraints and first to the problem of financing investments. As noted above risk averse owners of larger scale farms might prefer to invest their surplus capital in IOFs spread across a range of industries. The literature review made clear that traditional cooperatives generally operate at a capital disadvantage to IOFs when it comes to investing in brands and innovation; moreover, a liquidity shortfall has been responsible for a number of mergers and bankruptcies amongst agricultural cooperatives.

The limitations of cooperatives when it comes to raising capital for expensive investments must be acknowledged and addressed if a cooperative’s strategic plan is to be engaged in activities such as processing and new product development. The capital constraint arises in the case of traditional cooperatives because they adhere to exclusive members’ ownership in the form of direct investments or retained patronage refunds. This begs the question as to whether the capital constraints imposed by the traditional model potentially limit the cooperative’s success. Much is made in the literature about the changing external environment in which agricultural cooperatives have to compete – e.g. global competition and more stringent consumer demands – and the importance of innovation and technological advance to achieve competitive advantage. As noted previously in this environment POs/cooperatives have responded by becoming more market oriented, instead of producer driven, and in many cases adaptation of a marketing strategy involves substantial capital investment.
A significant element in the literature on agricultural cooperatives describes various attempts to overcome the capital constraint by means of a variety of new cooperative structures. This raises the possibility that in the form intended by the CMO POs are unlikely to be in a position to invest at levels comparable with IOFs in developing value adding new products and exploring innovative opportunities and technological advances. In the fruit and vegetable sector, where generally the highest prices are paid for fresh produce, this may not be a significant disadvantage. However, in other sectors for example, milk, where the opportunities for new product development are much greater and where vertically integrated POs would face considerable competition from IOFs the lack of sufficient capital could be a serious disadvantage.
13. Appendices

13.1 Literature review

Contents

I. Introduction

II. Traditional Cooperative Objectives in Theory and Practice

III. The Functional Scope and Various Forms of Cooperative / PO models

IV. Success Factors and Support for a Competitive Farming Sector


VI. Annex II: Recognition criteria and outline of Operational Programme required structure for Producer Organisations in the Fresh Produce sector

VII. References

I. Introduction

I.1 The academic literature on agricultural cooperatives is extensive and reveals that there is no archetypical cooperative: both the market orientation and the internal organisation of cooperatives varies considerably (see Hind, 1997 for a detailed discussion), or to paraphrase Ivan Emelianoff (1995) the diversity of cooperatives is kaleidoscopic and their variability literally infinite. The size of agricultural cooperatives range from micro to very large; some are concerned with procurement, others are focused on commodity markets and many concentrate on value-adding activities. As regards internal organisation the relationships between a cooperative and its members in terms of transactions, investment and governance also varies widely depending in part on the degree of flexibility in the formal and informal institutional laws, decrees, and practices that promote or allow for incorporation. Within this spectrum of objectives and organisational factors lie the cooperatives that qualify for funding under the EU Fruit and Vegetables Regime as Producer Organisations (POs).

I.2 The modern cooperative originated in Europe and spread to other industrialising countries during the late 19th century as a self-help method to counter extreme conditions of poverty (Hoyt, 1989). One development that is generally regarded as having the greatest singular impact on determining agricultural cooperatives’ unique operating principles was the formation in 1844 of a consumer cooperative, the Rochdale Society of Equitable Pioneers, Ltd though the first recorded dairy and cheese cooperatives were organised in 1810 in the US (CfC, 2012). The first agricultural co-operative in Britain was formed some twenty years later in 1867 under the name of the Agricultural and Horticultural Association to supply seeds and fertilizers to members. In the ensuing years
the development of agricultural cooperatives was slower than the industrial ones, due to the opposition of landowners, but the farming slump at the turn of the century created a more suitable atmosphere for agricultural cooperation (Bailey, 1988). The latter half of the 19th century saw the development of both supply and marketing cooperatives across Europe (Morales-Gutiérrez, et al, 2005) and Denmark is generally regarded as the most outstanding example of early and successful cooperative agricultural marketing.

I.3 By 1900 the cooperative movement was some sixty years old and owed its origins to the tumult of the industrial revolution in the mid-19th Century. Progress for the movement would correctly be described as slow but steady and in the 115 years since the founding of the International Cooperative Alliance, membership has grown to 227 member organisations, in 98 countries representing over one billion individuals (ICA, 2012a). The ICA represents cooperatives ranging from workers to housing but prominent are agricultural cooperatives which account for 36 per cent of the total (ICAO, 2012). There are essentially five types of cooperative: consumer; producer/marketing; supply, worker and hybrid. This literature review is primarily concerned with agricultural producer cooperatives; namely, cooperatives that are owned by farmers and have the objective of jointly marketing and/or processing the members production. Although supply cooperatives where businesses band together to enhance their purchasing power, are also a feature of agriculture it is the characteristics and development issues that confront producer cooperatives that are most relevant to POs. It should also be noted that agricultural producer cooperatives are frequently referred to as Farmer Controlled Business (FCBs) in the UK.

I.4 The International Cooperative Alliance (ICA, 2012b) defines 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 seven internationally recognised cooperative principles are: voluntary and open membership; democratic member control; member economic participation; autonomy and independence; provision of education, training and information; cooperation among cooperatives; and concern for the community. In 1987 the United States Department of Agriculture (USDA) adopted just the three principles of user ownership, user control and user benefit (roughly the first three ICA principles). However, the point to be emphasised is that there are more than one set of principles of cooperation and in a world that is rapidly changing and industries becoming more global and rivalrous it is important that the principles should not become overly restrictive.

I.5 A key consideration when analysing cooperative production is the issue of property rights. That is, who has control over, and who receives income from the cooperative i.e. how control rights and income rights are allocated. Property rights, generally perceived to be individual rights, are held in common in a cooperative and this has the advantage, particularly where members’ output is subject to unpredictable variability, that members are less likely to act opportunistically and take more care in ensuring the quality or nature of the produce they supply to the cooperative (Fulton, 1995). This common property rights structure is manifested in three characteristics (LeVay, 1983; Staatz, 1987b,
Barton, 1989): the owners of the firm are the users of the firm’s services; the benefits of the firm accrue to the owners through and in proportion to their use of the firm’s services; and control over the firm lies with all users together based on decisions that are taken democratically. Hence, there is every reason to use the label ‘traditional cooperative’ for this organisational model. An important contrast between the traditional cooperative and the Investor Owned Firm (IOF) is that the cooperative’s investors are not residual claimants; their return becomes a prior charge (LeVay, op cit). In practice cooperatives have in common a principal-agent relationship between members and management with directors functioning as the elected representatives of the members (Reynolds, 2000).

I.6 Academic studies of agricultural cooperatives can be traced back to the 1920s and to two influential Americans: Edwin Nourse; and Aaron Sapiro. In 1922 Nourse attempted to rationalise the role of the agricultural cooperative arguing that it offered …

…. the inherently decentralised industry of agriculture a workable and expansible scheme of organisation designed to set up an agency for the progressive study and adjustment of the larger problems which are being forced upon this industry by the inescapable process of our economic evolution (Nourse, 1922, p597).

Sensitive to what he viewed as farmer victimisation arising from inequalities in size between producers and those they transacted with, Nourse saw cooperatives as compensating for market failure by offering producers more equal opportunities (Knapp, 1980, Hogeland, 2006). One year later, in his role as an attorney, Aaron Sapiro established the ‘California Plan’ model of agricultural cooperation based on the success of Sunkist, the Southern California Fruit Growers’ Exchange. In contrast to Nourse, Sapiro’s system of marketing agricultural products was based on the principles of bilateral monopoly, matching the market power of the seller to that of the buyer. Nourse’s and Sapiro’s ideas, augmented by general economic theory, brought deductive power to the study of cooperatives and in so doing opened the door to scientific analysis rather than ‘proselytizing fervour’ that accompanied much of the discussion of cooperatives (Staatz, 1994). In setting the basis for the development of greater understanding of the objectives and performance of agricultural cooperatives the work of these two academics serves as a starting point for this literature review.

I.7 Broadening out beyond America it is possible to define alternative approaches by American and European academics to agricultural cooperatives. A characteristic of the American approach is that it is steeped in pragmatism whereas some European schools of thought were immersed in the social reforms and associated philosophies of the times (Torgerson, et al, 1997). But this broad comparison is too general. In some countries such as France, Italy, Portugal and Belgium the development of cooperatives would more correctly be associated with an ideological-utopian-perspective whereas in other countries such as Denmark and Holland the growth of cooperatives can better be explained as a spontaneous liberal response to the market (Morales Gutiérrez, et al, 2005). Cogeca (2010), the General Confederation of Agricultural
Cooperatives in the EU, represents the interests of some 40,000 agricultural cooperatives identifies significant variation between the North and South of Europe. It points out that cooperatives in the North have, via mergers, achieved a higher level of integration whereas in the South the prevalence of small scale cooperatives is due, amongst other factors, to a higher resistance of members and local entities to mergers.

I.8 Whilst agricultural cooperatives evolved widely on the European continent, generally with government support, the pace of development in the UK was much slower. A number of explanations have been advanced; in 1924 Sir Daniel Hall, Chairman of the Plunkett Foundation suggested that compared to their European counterparts, the average British farm is a comparatively large scale and that British farmers were less enthusiastic about cooperatives because they did not focus on exports (Rhodes, 2009). Another reason widely advanced was the creation of marketing boards with statutory powers to purchase all farm produce following the British Marketing Act of 1931 that offered an alternative means of price support (Bhatti, 2010). When EU membership required that the UK abandon marketing boards and other forms of price support, UK farmers found themselves fragmented and weak when exposed to the market, and unfamiliar with agricultural marketing co-ops.

I.9 According to Cogeca (2010) statistical information on European agricultural cooperatives is very scarce and in an attempt to provide information it periodically carries out a survey of its members. The results of the 2008 survey – based on the 16 out of the EU’s 27 members that took part – were published in a series of tables (op cit, p33-40). Data for the EU’s ten largest horticultural cooperatives are set out in Table 1 and Appendix I shows the EU’s 25 largest agricultural cooperatives.

<table>
<thead>
<tr>
<th>Name</th>
<th>Country</th>
<th>Activity</th>
<th>Turnover (€ billion)</th>
<th>Members ('000)</th>
<th>Employees ('000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FloraHolland</td>
<td>Netherlands</td>
<td>Flowers &amp; plants</td>
<td>4.075</td>
<td>5,124</td>
<td>3,555</td>
</tr>
<tr>
<td>The Greenery</td>
<td>Netherlands</td>
<td>Vegetables</td>
<td>1,308</td>
<td>1,150</td>
<td>1,661</td>
</tr>
<tr>
<td>Landgard</td>
<td>Demark</td>
<td>Fruit, veg. &amp; plants</td>
<td>1,269</td>
<td>4,000</td>
<td>2,500</td>
</tr>
<tr>
<td>Conserve Italia</td>
<td>Italy</td>
<td>Fruit &amp; vegetables</td>
<td>0.963</td>
<td>17,500</td>
<td>6,000</td>
</tr>
<tr>
<td>Apoconerpo</td>
<td>Italy</td>
<td>Fruit &amp; vegetables</td>
<td>0.522</td>
<td>9,850</td>
<td>:</td>
</tr>
<tr>
<td>ANECOOP</td>
<td>Spain</td>
<td>Fruit</td>
<td>0.412</td>
<td>135,000</td>
<td>176</td>
</tr>
<tr>
<td>FresQ, De Lier</td>
<td>Netherlands</td>
<td>Vegetables</td>
<td>0.393</td>
<td>:</td>
<td>:</td>
</tr>
<tr>
<td>CNB</td>
<td>Netherlands</td>
<td>Flower bulbs</td>
<td>0.318</td>
<td>1,700</td>
<td>133</td>
</tr>
<tr>
<td>Fruitmasters</td>
<td>Netherlands</td>
<td>Fruit</td>
<td>0.295</td>
<td>0.554</td>
<td>357</td>
</tr>
<tr>
<td>Agrintesa</td>
<td>Italy</td>
<td>Fruit &amp; vegetables</td>
<td>0.250</td>
<td>:</td>
<td>:</td>
</tr>
<tr>
<td>Consorzio Melinda</td>
<td>Italy</td>
<td>Frit &amp; vegetables</td>
<td>0.244</td>
<td>:</td>
<td>:</td>
</tr>
</tbody>
</table>

Notes, 1 = 2003; : = Data not available
The UK did not take part in the survey but given the fact that the scale of cooperative activity is significantly greater in other EU countries than in the UK (Rawson, 2007) no UK cooperative is likely to rank amongst the largest European cooperatives. The Cogeca data – albeit for 2008 – reveals that of the EU largest agricultural cooperatives, the dairy sector has the biggest share with eight cooperatives followed by supply cooperatives with six. FloraHolland, ranked 11 is the only horticultural cooperative to make it into the top 25. A significant outcome of the results of the 2008 survey when compared to an earlier 2003 survey is the growth of the largest cooperatives which according to Cogeca (2010, p32) is the result of concentration, development of higher value added products, improved market positioning and overall strategy.

The purpose of this literature review is to provide an overview of the development of cooperative theory and research as a prelude to an analysis of the potential offered by the wider adoption of POs in the UK. EU legislation regarding the setting up of POs in the fruit and vegetable sectors dates back to the early 1970s i.e. Article 13 of Regulation (EC) No. 1035/72 and in subsequent years has undergone various reforms in 1996, 2003 and 2007. The 1996 revision defined by the Common Market Organisation (CMO) in fruit and vegetables, as laid down in the Council regulation (EC) No 2200/96 – now replaced by the Council regulation (EC) No 1234/2007 (consolidated version) – followed the MacSharry Reform of the Common Agricultural Policy (CAP) and the coming into effect of the Uruguay GATT Agreement which threatened to increase the competitive pressures on EU fruit and vegetables growers. The 2003 and 2007 reforms had the intention of bringing support for the sector into line with the CAP and the Single Payments Scheme (Camanzi, et al, 2009).

Following the introduction of support for POs under the CAP in 1996 a number of such organisations were set up in the UK with the introduction of the Fruit and Vegetable Aid Scheme. To comply with the Council regulations POs have to have the following objectives: to collectively market all members produce through the PO; and to provide facilities for the collection, storage, packing and marketing of all members' production. In order to achieve recognition by a Member State’s Competent Authority, a PO has to meet a number of criteria in order to be eligible to submit an application for support under the legislation. A summary of these criteria are set out in Annexe 1. In practice many of the POs formed in the UK were later judged not meet the Scheme's recognition criteria for a number of reasons including the primary objective of supporting and promoting marketing on a consolidated basis. EU Auditors who visited nine UK POs in 2005 reported that in their view five of the POs visited had been created artificially as vehicles to enable growers to access grant aid without meeting the criteria or engaging with the objectives of the Scheme (RPA, 2012). Since 2005, UK POs have been forced to meet the requirements of the Scheme but this has led to a reduction in the number of recognised PO’s to 40 at December 2011 compared to a high of 73 in 2005 (Defra, 2012).
I.13 What follows is divided into three sections. The first provides an historical summary of the development, in theory and practice of traditional agricultural cooperatives. This section, by setting out the theoretical and historical background, provides a basis for understanding contemporary thinking on agricultural marketing cooperatives and their evaluation. In particular it seeks to explain why the traditional marketing cooperative has attracted not so much criticism but widespread concern with the academic literature as to its ability to cope in a deregulated and increasingly internationally competitive industry. The second section will examine how from the mid-1990s, the academic literature, drawing heavily on new insights into the organisation and behaviour of businesses, embarked on a fundamental revision of the functional scope and models of marketing cooperatives. It is around this time that some literature begins to refer explicitly to POs but overwhelmingly these organisations are marketing cooperatives and it is to literature on these organisations that we must refer for valuable and relevant insights. The literature reveals the growing diversification and sophistication of agricultural cooperatives and explains the wide range of functions and organisational architectures that now characterise the modern marketing cooperative. It will specifically cover the circumstances that are relevant to POs particularly, in the fruit, vegetables and dairy sectors with a view to providing insights into the successful organisation and objectives for POs.

I.14 The third section will build on the previous section to reveal what the literature offers on the relative performance of marketing cooperatives, the factors that are deemed to contribute success together with an assessment as to how such organisations support a competitive farming sector. Studies will be identified that relate either implicitly or explicitly to fruit and vegetable POs and performance will broaden beyond finance to take specific account of the objectives of cooperatives and their contribution to innovation and competitiveness. A final section will provide a brief summary and identify key gaps in the literature. This literature review is focused on North America and Europe and is confined to articles published in English – the presumption being that readers will want to be directed to sources that are accessible to the English reader. North America is included because as noted above, it is responsible for the bulk of the early studies of agricultural cooperatives.

II. Traditional Cooperative Objectives in Theory and Practice

II.1 Despite considerable activity, both in Europe and North America, on the part of agricultural cooperatives as well as those that sought to represent them, by the third decade of the 20th Century it was pointed out in a seminal paper by Edwin Nourse (1922) that cooperatives were long on practice but short on theory. Nourse went on to set out the three ‘fundamentals’ he believed constituted the theoretical basis for cooperation, namely … increased efficiency or reduced costs ….. popular distribution of savings or profits …[and] … democratic control, each member voting as an individual (op cit, p578). And in so doing he founded an academic economic interest in agricultural cooperatives. For Nourse cooperatives did not exists to influence the ‘true’ market price but rather to …
reflect these markets conditions back most promptly and fully to producers (Nourse, 1942 [1992]). The Nourse school contended that cooperatives should function as ‘competitive yardsticks’; that is, they should not try to monopolise commodity markets but through their enhanced efficiency add competition to the market (Cotterill, 1992). Once this objective was attained, Nourse recommended that cooperatives should be content with an efficient operation rather than seek to expand to dominate the sector (Nourse, 1945). By scaling back to a shadow ‘watchdog’, monitoring markets for potential intervention, the Nourse model reinforced the message that the ideal cooperative was small and that the agricultural marketing system would not work to the farmers’ benefit without continual vigilance (Hogeland, 2006).

II.2 In contrast, Aaron Sapiro, based on his wide experience of working with Californian growers, argued that the prime purpose of farmer cooperatives was to unify farmers on a commodity basis in order to exert market power (Staatz, 1989). It is noteworthy that Sapiro was operating in the only region of the US where the climate was suitable for ‘Mediterranean’ crops whereas Nourse was operating in the vastness of the Midwest. Amongst Californian growers Sapiro could build on a commodity mindset to utilise producer commitment to attain through scale the control and capital for longer-term, aggressive marketing. Sapiro’s ‘California Plan’ recognised the imperative of ... organising from a commodity standpoint and not from a local standpoint (Sapiro, 1993, p85); that is, the cooperative’s scale of operation must go beyond a geographic locality to dominate sales of a commodity. The Sapiro school argued that cooperatives, organised along commodity lines, not only improved marketing coordination but also corrected imbalances in traditional buyer-supplier relationships of agricultural commodities (Larsen and Erdman, 1962). To achieve this outcome cooperatives should be organised on a ‘huge scale’ garnering 90 per cent plus of growers for a particular crop (Sapiro 1993) and Sapiro’s system of orderly marketing became the conceptual basis for commodity-specialised cooperatives pursuing a large market share (Hogeland, 2006). What does seem generally agreed is that the prime motive in early organising efforts was the atomistic structure of farming compared to a limited number of buyers and/or sellers of farm outputs and/or inputs (Torgerson, 1977).

II.3 Nourse’s and Sapiro’s ideas have helped shape how academics and policy makers have approached cooperatives. For both schools of thought, cooperatives provide some balancing of market power by affecting the terms-of-trade, a la Sapiro or stimulating competition in specific markets a la Nourse. That said, formal modelling of the concept of an agricultural cooperative did not begin in the US until the 1940s (Cook, et al, 2004) and in the ensuing years economists came to view the cooperative in one of three ways: as a form of vertical integration; as an independent firm; and as a coalition of firms (Staatz, 1987a, 1989). The vertical integration approach is credited to Emelianoff (1942) though we follow here Phillips (1953) who advanced this approach. Phillips argued that although it is descriptively correct to say that a cooperative association is a business organisation owned and controlled by its members and operated for their benefit such a statement contributes nothing to the understanding of its economic structure. For Phillips an agricultural cooperative
should be viewed as an extension of the members’ farms; that is, a multi-plant, vertically integrated firm whose operational efficiency cannot be separated from the individual operations of the participating businesses and therefore it is impossible to determine … the exact amount of net income which specifically arises from the operation of the joint plant (op cit, p86).

II.4 For nearly a decade following the publication of Phillips article, virtually all articles published on cooperative theory were written in response (Royer, 1994). The difference between Phillips’ article and earlier work by agricultural economists was that it attempted a formal economic analysis based on an objective function from which rules for optimal behaviour could be derived (op cit, p88). Critics of Phillips’ model pointed out it involved a very diffuse decision making process and failed to address issues such as the degree of participation on the part of individual members (Staatz, 1989). In the Phillips model according to their relative efficiencies, members determine their profit-maximising levels of participation via a ‘heroic’ Cournot-Nash iterative process (Cook, et al, 2004). Much less discussed in the subsequent literature was Phillips’ analysis of the role cooperatives could play in stabilising farmers’ returns through risk pooling which anticipated contemporary discussions on cooperatives (Staatz, 1994).

II.5 Phillips’ identified cooperatives as non-profit, non-capital accumulating organisations offering services to members at cost and therefore failing to meet the classical definition of the firm. But this view was strongly challenged by Savage (1954) who argued that that the economic nature of cooperatives cannot be adequately explained as an extension of the standard neo-classical theory of the firm, a theory that rests on individualist competition and indeed the neo-classical paradigm of the firm. Savage went on to point out that in practice although farmers own their cooperative they …do not make all or most of the entrepreneurial decisions (op cit, p531) concerning the cooperative. For Savage the cooperative is a firm in its own right capable of making entrepreneurial decisions, as its members have pooled some of their entrepreneurial functions and in so doing authorised the cooperative to carry out these functions for them. In the process a principle-agent relationship is created whereby individual members defer some of their … individual prerogatives in order to obtain greater advantage (op cit, p532).

II.6 In fact the concept of a cooperative ‘as an independent firm’ with its own management hierarchy had first been advanced by Enke (1945) who pointed out that it was cooperative managers who were responsible for decisions regarding what to maximise e.g. sales, refunds, profits etc. Critics drawing, inter alia on Enke’s work argued that the revocable delegation of day-to-day decision-making authority to hired managers elevated the cooperative to an independent organisation (Staatz, 1987b). Helmberger and Hoos (1962) took Enke’s approach forward by developing models of marketing cooperatives using tools associated with the standard neo-classical theory of the investor-owned firm (IOF). At the heart of their approach is an organisation that has the nature of a stand-alone firm but whose business operations are determined by the need to meet one or more of the shared goals of members and this became the standard
model in cooperative theory for some 20 years (Sexton, 1995). Such an organisation can legitimately be viewed as a firm because it ....

...embodies persons and privately owned physical plant. It mobilizes factors of production, produces goods and services, and relies primarily on the proceeds from the sale of its product to meet the costs which it incurs, much as would any business enterprise. Yet, its economic character differs from that of the usual type of enterprise in numerous respects. (Helmberger and Hoos, 1962, p279-280).

II.7 The differentiating ‘economic character’ referred to by Helmberger and Hoos arises from their hypothesis that the theory of a profit maximising firm cannot be directly applied to cooperatives who do not seek to maximise their own profits but rather those of their farmer members by operating on a zero-profit basis and returning all their surplus (net margin) to their members. Helmberger and Hoos argued that the cooperative’s managers would attempt to maximise member benefits by maximising the average member’s surplus which is rebated to members according to their patronage. The average member’s surplus is determined by the coincidence of the total produce supplied by members and the cooperative’s marginal costs. Faced with a downward sloping demand function and rising marginal costs this points to a restricted or closed membership policy and significantly centralised decision making by the cooperative’s managers (Staatz, 1989) raising a conflict for the organisation of the traditional cooperative which Nilsson (1988) reminds us has in addition to one member one vote a collective equity capital and open membership.

II.8 One can separate these studies of cooperatives into external market and internal organisational issues. What the Phillips and the Helmberger and Hoos’ approaches had in common was an attempt to specify the objectives of the traditional cooperative within an external business environment where an imbalance of power exists between sellers and buyers of agricultural products. But when it came to organisational issues decision making in the Phillips’ model is entirely decentralised residing solely with the farmer members, whereas for Helmberger and Hoos’ decision making resides with the cooperative’s senior managers. In practice decision making lies somewhere between these two extremes; that is, in order to analyse how decisions are actually made in cooperatives it is necessary to look at how farmer members and the management work out strategies that serve both their interests, which may not be entirely congruent. It is therefore the internal organisation of a cooperative that determines its ability to respond efficiently to changes in the external business and both these areas increasingly attracted the attention of academics during the 1990s. Nilsson (1998) identified a number of problems with the traditional model’s seeking of countervailing power in either selling raw or first stage processed products in markets that were becoming more international so that the market price for the cooperatives output was increasingly vulnerable to the country that is the most competitive. Moreover, as markets become saturated so the economies of scale offered by traditional cooperatives are undermined by increasing marketing costs.
II.9 It is in the area of marketing that Van Dijk (1999) finds a real difference between the behaviour of agricultural (or more correctly producer) and consumer cooperatives compared to the behaviour of IOFs. In the case of an IOF performance in terms of quality and price to the customer is enforced by competition and such performance is also the primary goal for consumer cooperative firms. In the case of the traditional agricultural cooperative it cannot autonomously decide on the volume of production to be marketed. If volumes increase the cooperative will have to find markets and in this situation the prime rational for investment is not to enhance quality and price but to achieve lower costs so as to secure new markets for its produce. That is, the traditional cooperative is focused on bringing as much as possible of the market value to the producer, no matter if there is excess supply or not, whereas for an IOF the intention is to bring it to the investors or shareholders.

II.10 By the mid-1990s academics where focused on the emerging challenges to the traditional marketing cooperative model summarised by Hakelius (1999) as speeding-up and making more transparent the decision-making process, becoming more market oriented, raising risk capital for investment and exploiting opportunities across national borders. The problem identified by academics (see Van Dijk, 1999) for cooperatives with a traditional democratic decision-making system was that they were not equipped for decision making in a more market-driven economy, becoming more diversified as well as more international and in which market power is increasingly transferred towards those who are close to, or have direct access to, consumers. In this changing environment the marketing emphasis turns from homogeneous commodities to differentiated products and in this respect traditional marketing co-operatives faced an additional constraint in providing the necessary capital investment with a high level of asset specificity, such as developing brand names (Hendrikse and Veerman, 2001). In the traditional cooperative it is the farmer-member who makes, or endorses, investment decisions. According to Szabó (2006) this can create a conflict as to whether to put money into his farm and/or into the cooperative i.e. the decision to accumulate capital for further vertical integration is offset by the temptation to invest in the farms’ assets. Also the co-operative finds it difficult to gather funds from external sources because the membership control principle entails worse terms.

II.11 Cooperatives compete with IOFs and for the latter quality enhancing and product innovation activity are judged key to performance. In contrast there appears relatively little published academic research on such activity in cooperatives. Part of the reason for this lack of research is that cooperatives have not traditionally played a major role in quality-enhancing, product innovation activity. Indeed, the standard view has been that cooperatives are largely concentrated in the vertical stages just before and just after the farm enterprise and focused on cost-reducing innovation activity (Drivas and Giannakas, 2006). When it comes to product differentiation this highly analytical paper demonstrates that the involvement of cooperatives in R&D can be quality and welfare enhancing by increasing the arrival rate of product innovations and reducing the prices of food products but this depends on the nature of product differentiation and the relative quality of its products. Saitone
and Sexton (2009) take issue with the view that cooperatives are at a
dependable disadvantage relative to IOFs in quality-differentiated markets.
Their analysis seeks to demonstrate that revenue pooling can confer two
strategic advantages; it attenuates the incentive of competitive farmers to
overproduce a high-quality product and it insures risk-averse farmers against
adverse realizations of quality (see also Mérel et al., 2009 on the advantages of
revenue pooling for product quality).

II.12 Further empirical support for the view that a cooperative is capable of
delivering higher quality than an IOF is provided by Cechin et al.’s (2013) study
of the Brazilian broiler industry. The authors are cautious in their results but
suggest that there are some important differences regarding relationship
characteristics that could account for the cooperative’s farmers’ production
practices delivering a higher average quality. These include higher
commitment, a higher dependence on the buyer, greater certainty regarding the
buyer’s behaviour and market risk reduction. The authors considered that
cooperative relationships were likely to prevent suppliers from shirking and to
induce commitment. Moreover, cooperative suppliers received more technical
support from their buyer for adapting to new quality requirements than IOF
suppliers. The importance of the cooperative’s ability to coordinate it members
output decisions for the delivery of quality is discussed in Pennerstorfer and
Weiss (2009) while Bogetoft and Olesen (2004) using examples from Danish
coopervatives emphasize the importance of the design of contracts in delivering
quality. The limited research in this area is frustrating given that quality
assurance and information exchange are features that POs have to be able to
demonstrate as part of the requirements for continued recognition.

II.13 Nearly 50 years ago Helmberger (1966), concluded his paper on the future of
the traditional agricultural cooperatives by observing that such cooperatives
were in jeopardy. Observing the growth of large scale, integrated ‘farm-
product factories’ more akin to industrial corporations than the traditional farm in
an ‘atomistic setting’ he opined that the … disappearance of atomism will cause
the rationale to vanish with it (op cit, p1,434). Towards the end of the 1980s a
report prepared for the USDA (Sexton and Iskow, 1988) observed that the failure
rate among new cooperatives is often high and it identified insufficient
membership, business volume and a poor initial equity base as critical problems.
Indeed these failures mainly amongst traditional cooperatives have been a
feature of the last four decades in both Europe and North America (Nilsson, et
al, 2009) and as noted above the apparent shortcomings of traditional
coopervatives in the contemporary business environment have caught the
interest of many researchers. A number of explanations have been advanced
for these shortcomings: Cook and Iliopoulos (2000) as well as Holmström (1999)
pinpointed issues arising from heterogeneous memberships; Bager (1996)
focused on low involvement of members and Hogeland (2006) a misalignment of
members and managers’ objectives. Harte (1997) identified problems arising
from increasing scale and Kühl (2011) observed that as size increases so a
coopervative’s governance deviates from the traditional model, becoming similar
to that of an IOF. In response to the academic literature’s widespread
agreement that increasing scale and internationalisation called for changes in
the organisation of traditional cooperatives Nilsson, et al, (2009) carried out a survey to empirically test the effects of large size and great complexity and the findings indicated that …

…. traditional cooperatives, when they become very large and get very complex business operations, may face difficulties in relation to their members. The members are no longer able to control the cooperative, and so they become dissatisfied with the cooperative and they lose their involvement in it. This discontent results in the loss of trust in the leadership who must be held responsible for the development of the cooperative. The consequence may be that the members do not believe that it is possible to restore a well-functioning member control through remodelling the cooperative (op cit, p117).

III. The Functional Scope and Various Forms of Cooperative/PO models

III.1 Dissatisfaction amongst academics with the traditional cooperative model that played down the likelihood of differences in members’ relative efficiencies and objectives (see Hind, 1999), gave rise to yet another approach that allowed for membership heterogeneity; namely the cooperative as a coalition. That is, a cooperative should be viewed as a coalition of utility maximising groups and research in this vein made an important contribution to the literature on group choice (Héndrikse, 2004). As early as the 1950s a number of academics, (see for example Kaarlehto, 1956, Ohm, 1956, and Triffon, 1961) argued that member heterogeneity implied that bargaining and conflict was an integral part of collective action and therefore it was more appropriate to study cooperatives as coalitions. Issues such as decisions regarding the prices paid according to patronage, the location of facilities and the allocation of overhead costs turned academic attention towards concepts such as game theory (Staatz, 1983, Sexton, 1986) and principal-agency theory (Vitaliano, 1983) in a concern to examine how managers’ and members’ interests were aligned. These studies chimed with a more general shift in economic studies of the firm whereby, the restrictive neoclassical approach of profit-maximisation was augmented by increasingly comprehensive theories more accommodating of the complexities that arise when ownership and management are split. Many of these theories were identified with ‘new institutional economics’ (NIE) a school of thought originating with Williamson (1975) but whose antecedents are generally viewed as originating with Coase’s (1937) seminal paper.

III.2 The NIE school is interested in the economic, social and political institutions that govern everyday life but couches its explanations in terms of not only objectives but also the actions of individuals. This approach places much emphasis on researching the inner workings, or intra-coordination of organisations and as such was embraced by academics keen to explore cooperatives as coalitions. The result was significant advances in the understanding of cooperatives; in particular, capital constraints and organisational design, both in America and Europe, during the 1990s. Van Dijk (1996) classified four ‘generations’ of cooperatives: the first aimed at building market power via economies of scale is likely to adhere to one vote per member; the second is characterised by
integrating downstream to add processing involving higher investment and member participation; the third unlike the first two restricts membership in order to better align demand and supply; and the fourth emerges from the second generation where trust is replaced with formal contracts between members and the cooperative.

III.3 We noted above Nilsson’s (1998) concerns regarding the traditional model’s ability to cope with increasingly competitive and demanding markets. In response he identified an emerging cooperative model, which he defined as the entrepreneurial – or external investor – cooperative model. Drawing on work by a number of researchers (see in particular, Barton, 1989, Meulenberg, 1996, Van Dijk, 1997, Galle, 1997, Kyriakopoulos, 2000) he outlined the characteristics of the emerging model involving a more ‘business like’ relationships with members, an operational focus on the latter stages of the processing chain and procuring only sufficient quantities of raw materials to meet the demand for their processed products. This emerging cooperative seeks a market leader strategy involving product differentiation and vertical integration where downstream processing is undertaken by private companies, owned jointly by the cooperative and external investors.

III.4 The belief that changing external economic and institutional factors, such as global liberalisation, more stringent consumer demands, technological developments and the tightening of food quality and safety legislation, created difficulties for the traditional agricultural cooperative provides the background to Cook’s (1995) seminal paper. In the emerging environment cooperatives needed to become more market oriented rather than producer driven. Both Cook (1997) and Bijman and Ruben (2005) argued that the success of agricultural cooperatives in increasingly competitive global food markets depended on their ability to achieve a sustainable competitive advantage by developing value adding processing strategies, brand-name development and global expansion. Yet, the adaptation of these new strategies requires restructuring of the coops’ financial structure and substantial capital investments (Baourakis, et al. 2002).

III.5 Particularly influential was an article by Cook (1995), which extended earlier work by Porter and Scully (1987), Staatz (1987b) and Milgrom and Roberts (1990), and identified property rights as critical to explaining the behaviour and performance of agricultural cooperatives. Cook (op cit) responding to a challenge by LeVay (1983) was keen to place the behaviour of agricultural cooperatives – both strategic and organisational – within a life-cycle framework capable of explaining the genesis, growth, decline and demise of agricultural cooperatives. Cook identified five categories of cooperatives and placed these in a dynamic context by proposing a five stage life-cycle model.

III.6 Cook’s article remains highly influential and merits some repetition here but similar analyses can be found in Nilsson (1999). The five categories identified, and set out in Table 2, are based on the thoughts of the two founding fathers of American cooperative thought; Norse and Sapiro. A Nourse I cooperative is
created to provide a missing service or achieve an economy of scale or scope with the objective of keeping IOF’s competitive; A Nourse II cooperative may integrate forward or backward beyond the first handler or wholesaling levels with the objective of operating more efficiently at these levels than the alternatives available; A Sapiro I cooperative is a bargaining cooperative to guarantee a market and influence the term-of-trade in favour of members; A Sapiro II cooperative is a marketing cooperative taking the form of producer vertical integration (for more details on this taxonomy see Cook, 1993). Cook’s fifth category termed the Sapiro III is the ‘New Generation Cooperative’ (NGC) that emerged during the 1990s and which has received considerable attention for its application of NIE principles, see for example Harris, et al, 1996 and van Bekkum, 2001.

### Table 2: Residual Claimant and Decision Control Problems

<table>
<thead>
<tr>
<th>Property Right Constraint</th>
<th>Cooperative Type</th>
<th>Nourse I (1)</th>
<th>Nourse II (2)</th>
<th>Sapiro I (3)</th>
<th>Sapiro II (4)</th>
<th>Sapiro III (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Free rider problem</td>
<td>major</td>
<td>minor</td>
<td>major</td>
<td>minor</td>
<td>minimal</td>
<td></td>
</tr>
<tr>
<td>Horizon problem</td>
<td>major</td>
<td>major</td>
<td>none</td>
<td>minor</td>
<td>minimal</td>
<td></td>
</tr>
<tr>
<td>Portfolio problem</td>
<td>minor</td>
<td>major</td>
<td>minor</td>
<td>major</td>
<td>minimal</td>
<td></td>
</tr>
<tr>
<td>Control Problem</td>
<td>minor</td>
<td>major</td>
<td>minor</td>
<td>major</td>
<td>minor</td>
<td></td>
</tr>
<tr>
<td>Influence costs problem</td>
<td>major</td>
<td>major</td>
<td>minimal</td>
<td>minor</td>
<td>minor</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Cook 1995*

III.7 To understand the Sapiro III cooperative it is necessary to return to Cook’s five life-cycle stages. Stages 1 and 2 concern the reasons for setting up the cooperative and the demonstration that once launched the benefits are deemed to out-weight the costs respectively. According to Cook cooperatives surviving Stage 2 are increasingly scrutinised by members regarding the transaction costs of patronage which arise from a user versus investor set of property rights ….

….. These vaguely defined property rights lead to conflicts over residual claims and decision control—especially as cooperatives become increasingly complex in their organizational structure (Cook, 1995, p1156).

III.8 Property rights theory is concerned with the contractual assignment of rights and Cook’s contribution was to hypothesise that these emerge in Stage 3 when conflicts over residual claims and decision-control emerge caused by the unique user driven characteristics of cooperatives. Cook placed these issues under the five headings set out in the first column of Table 1. Cook is less concerned with the ‘external free rider’ problem arising from a non-member who captures the benefit of the improved terms-of-trade than the ‘internal free rider’. This occurs when new members obtain the same patronage and residual rights as existing members and are entitled to the same payment per unit of patronage and the resulting dilution of the rate of return to existing members creates a disincentive to invest in their cooperative. The ‘horizon’ and ‘portfolio’ problems arise from restrictions on the transferability of residual claimant rights and both
create an investment environment in which there is a disincentive for members to contribute to growth opportunities. In the case of the former the severity of this problem intensifies when the investment under consideration is a sunk cost e.g. advertising and consequently management is pressured to accelerate equity redemptions at the expense of retained earnings. In the case of the latter the lack of transferability prevents members from adjusting their cooperative asset portfolios to match their personal risk preferences.

III.9 The ‘control problem’ relates to the costs, within an environment of incomplete information, associated with trying to prevent a divergence of interests between cooperative members (principals) and their hired senior managers (agents). The information provided and external pressure exerted by publicly traded equities is not present in agricultural cooperatives and this problem becomes further exaggerated as the size and complexity of a cooperative increases. Finally the ‘influence costs’ problem (Milgrom and Roberts, 1990) arises when organisational decisions affect the distribution of wealth or other benefits among members or constituent groups of the organisation and when in pursuit of their selfish interests, individuals or groups attempt to influence the decision to their benefit. The magnitude of these costs depends on the procedures that govern decision making and the degree of homogeneity or conflict in the interests of cooperative members.

III.10 Columns (1) – (4) in Table 1 represent Cook’s ranking of how constraining these property rights factors are on the strategies and structures of the cooperative types identified. Stage 4 is defined by Cook as the stage in which cooperatives become aware of these property right issues and Stage 5 the cooperative chooses between three alternative strategies: exiting the industry; continuing; or becoming a New Generation Cooperative (NGC). Exiting is self-explanatory whereas continuing means addressing the tendency to under-capitalise. This may involve seeking outside equity or pursing a proportionality strategy of internally generated capital. The ‘proportionality concept’ is discussed at length in Royer (1990) but essentially involves the cooperative moving from democratic control based on one member, one vote to proportional voting based on stock ownership. In contrast the NGC is a value-added marketing cooperative that tempers the disincentives of the five property rights that emerge in Stage 3 by attempting to ....

... ameliorate the aforementioned disincentives by developing asset appreciation mechanisms, increasing share liquidity by creating delivery right clearing houses, base equity capital plans, and membership policies that eliminate the external free rider (Cook, 1995, p1158).

III.11 The value of Cook’s work was not that NGCs represented the future and all other models would gravitate to a particular cooperative model but rather he provided an important bridge between the business behaviour of cooperatives and contemporary research on the organisational structures of firms. Unfortunately, a lot of the literature post Cook’s seminal 1995 paper uses the term NGC loosely to describe a cooperative that in investing downstream in value-added products. That is, in contrast to the defensive stance of traditional
cooperatives the label NGC has been erroneously applied widely to cooperatives pursing a value-added strategy when a more generic term such as a ‘new organisational form’ or ‘entrepreneurial’ (see Nilsson, 1998) would be more appropriate allowing for the inclusion of a range of emerging models.

III.12 As discussed in the previous section, the traditional cooperative’s production orientation demand for an increasing scale in order to capitalise on cost advantages in the raw material handling, first level processing, and distribution was not sufficient in many cases to ensure survivability. This according to Nilsson (1998) was because economies of scale could not alone provide the necessary competitive edge as growing internationalisation demanded higher levels of competition. A number of academics (see for example Boehlje, et al, 1995) viewed not only the internationalisation of food and agribusiness but also the proliferation of technology and managerial know-how, the deregulation of the markets, and heterogeneity in consumer behaviour as combining to mark a major economic shift from production to market-oriented competition. For Nilsson it was clear that in order to survive cooperatives would increasingly be forced to seek …

…… new organisational structures in their attempt to be competitive on the increasingly internationalised, deregulated and demanding markets. There are good reasons to believe that this trend will become even more pronounced in the following years as internationalisation will proceed and competition will become even harder (op cit, p8).

III.13 For traditional marketing cooperatives the reality of the emerging international competitive market place was creating tensions between the democratic and the economic aims of cooperatives (Torgerson, et al, 1997). Much as anticipated by the main lines of research within Europe in the 1990s there was considerable organisational changes within agricultural marketing cooperatives (Nilsson, 1999) and these changes themselves invoked further research into the characteristics of these new organisational models. Cook et al, (2004) provide a wide-ranging review of these theoretical developments. Iliopoulos (2002) examined the relevance, for agricultural co-operatives in the EU, of the analysis underlying the NGC models and concluded that the model being gradually adopted for long-term financing methods possessed one or more of the characteristics found in successful American NGCs. However, in his opinion European cooperatives pay less attention to the design of their organisational structures (e.g. membership policies) which he believes might inhibit their efforts to gain a competitive advantage over IOFs. This study reinforced the conclusion of Van Dijk’s (1997) earlier study that, from a European perspective, traditional cooperative principles were no longer valid and Kyriakopoulos and Van Bekkum (1999) argue that as cooperatives are increasingly compelled to develop market oriented strategies this poses challenges regarding the ownership, decision making, and business conduct of cooperatives which the authors believe are confirmed by cooperative restructuring in the Netherlands. However, Nilsson (1998) is less than all-embracing of the deficiencies in traditional cooperatives and points out that empiricism shows that in many countries cooperatives are thriving businesses
and therefore a diversity of cooperative models according to strategic considerations should be advanced. In terms of market shares rather than numbers cooperatives appear to have reached something of a plateau in the EU with little evidence of decline (Pennerstorfer and Weiss, 2006).

III.14 A comprehensive empirical study (Van Bekkum and Van Dijk, 1997) of agricultural cooperatives in fifteen EU member states, defined four additions to the traditional model: see Table 3. Nilsson (op cit) argues that these new organisational forms still retain the characteristics of cooperatives because, following Barton (1989) the user-owner principle remains intact, those using it have control and the benefits of the co-operative are distributed to its users on the basis of their use. That said, there may be some uncertainty as to how these new organisational types adhere to the concept of cooperatives. For example, if the ownership criterion is interpreted as full ownership some of the new organisational models must be rejected as cooperatives, but if it is understood as majority ownership they conform. Exactly the same can be said about the control criterion. However, the benefit criterion is not negotiable – all the cooperative models have the objective of providing the best possible benefits to the members.

Table 3: Main structural characteristics of EU agricultural cooperatives

<table>
<thead>
<tr>
<th>Attributes</th>
<th>Cooperative Organisational Models</th>
<th>Proportional tradable shares coop</th>
<th>PLC cooperative VE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Traditional Cooperatives</td>
<td>Cooperative with subsidiary</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Participation Shares Cooperative</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entry</td>
<td>Free</td>
<td>Free</td>
<td>Variable</td>
</tr>
<tr>
<td>Individualised equity</td>
<td>No</td>
<td>Only for investors</td>
<td>Only for investors</td>
</tr>
<tr>
<td>Assets appreciation</td>
<td>No</td>
<td>For investors</td>
<td>Yes</td>
</tr>
<tr>
<td>Voting schemes</td>
<td>Equality</td>
<td>Members: use Investors: share</td>
<td>Members: use Investors: share</td>
</tr>
<tr>
<td>Majority of decision control</td>
<td>Members</td>
<td>Members</td>
<td>Members via the co-op</td>
</tr>
<tr>
<td>External participation</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Members equity contribution</td>
<td>Equal</td>
<td>Equal</td>
<td>Equal via the cooperative</td>
</tr>
<tr>
<td>Value-added activities</td>
<td>Limited</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Professional manager</td>
<td>No</td>
<td>Not always</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Source: Van Bekkum and Van Dijk, 1997 p171
III.15 The four new models set out in Table 3 are what Nilsson (1999) describes as entrepreneurial organisational models. The four ‘entrepreneurial’ models reveal more and more radical deviations from the traditional type as one moves from left to right. As concerns legal form; the first three new ones are still co-operative societies with members. In the last one the entire cooperative is organised as a PLC and hence, instead of members the patrons are shareholders. Cooperative ideology which is important to the traditional cooperative loses more and more significance when going to the right in the table, and current or mainstream economic thinking becomes increasingly applicable. The common element in the entrepreneurial models is that there are investors who expect to earn a return on their investment though the type of investor may vary with the models. In the participation shares and subsidiary cooperatives the investors consist of non-members, while the proportional tradable shares cooperatives i.e. NGC, and the Plc cooperatives have members/patrons as investors. Hence, Nilsson (op cit) describes the first two as external-investor cooperatives, and the last two, member-investor cooperatives.

III.16 A key driver of attempts to define alternative ‘entrepreneurial’ cooperative models was the sources of investment capital (see also Hendrikse and Veerman, 1997). However, in the view of Van Bekkum (2001) a shortcoming of these various models is that in focusing on their organisational structures they ignore how these compliment or conflict with desired alternative business strategies. Developing Porter’s (1980) discussion of three generic strategies of these cooperatives Van Bekkum defines four ‘basic’ models: the village; niche; commodity; and value added cooperative (op cit, p49). The commodity model focuses on a low cost strategy whereas the niche model is dedicated to differentiation. The value-added model is a weighting of these two strategies while the village model does not have a clearly defined strategy. Van Bekkum completes his taxonomy by defining two organisational structures: collective; and individualised. The former would adhere to the traditional model whereas the latter is the management response to increasing complexity in terms of market strategy and operations including restricted membership, proportional voting and differential pricing (op cit, p38). It follows that it would be ‘nonlogical’ for a commodity cooperative to adopt a highly individualised organisational structure and a niche cooperative with a collective structure would be ‘non-sustainable’.

III.17 What makes the Van Bekkum approach interesting is that he applied his taxonomy to nine case studies of the world’s largest dairy cooperatives in the EU, Australia and New Zealand. The four EU cooperatives were Arla Foods, Campina, Friesland Coberco and Glanbia. He concludes that the analysis provides evidence in support of the hypothesis of a positive relationship between a vertical growth strategy (differentiation) and the degree of individualisation of organisational structure. He goes on …

.... the coherence of strategy–structures matches was confirmed by calculations of investment incentive problems. Outlier cases on the ‘too-collective’ side .... were explained by the resort to external capital to
supplement inadequate member funds where member investment incentives were very poor and by a high degree of industry concentration which offered very limited alternatives to dissatisfied members (op cit, p147)

III.18 The development of new organisational forms does not appear to have spread to POs or indeed to be a consideration in the legislation. The concentration of production is the primary objective assigned to POs if they are to access EU support (Camanzi, et al, 2009) which reflects the thinking of a traditional Sapiro model and in terms of Van Bekkum’s taxonomy the POs would fall between the commodity and value-added models. The concentration, or as it is frequently referred to in the literature the ‘horizontal coordination’ of production can be seen as a means to gaining access to marketing channels (Shaw and Gibbs, 1996) by providing, through economies of scale, improved bargaining power, as well as access to specialised expertise and information. In this respect it would appear that POs have the potential to satisfy the strict requirements related to volume, services and product specifications, demanded by industrial processors and large retailers identified by Sexton (1986b) 25 years ago. The CMO for fruit and vegetables foresaw the financing of POs marketing activity by means of an ‘operational fund’ co-financed by both the producers and the Member States, within the limit of 4.1 per cent of the value of marketed production (VMP) in a reference period. However, a study of POs in France, Italy and Spain noted that this target had not been reached which may … signify a low level of commitment by producers (Camanzi, et al, 2009, p13). The survival of any cooperative ultimately depends upon the commitment of its members to patronise the organisation (Fulton and Adamowicz, 1993)

III.19 It would however be wrong to draw EU wide conclusion from the Camanzi, et al study, particularly as a distinction can be identified between the South and the North of Europe. The former (Spain, Portugal, Italy, Greece, France) have a larger number of POs of reduced size - VMP is lower than €15mn on average - whereas for the latter there are fewer POs of larger size and a very high rate of concentration. In 2006 in three Member States (the Netherlands, Belgium, Ireland) concentration rates for POs had risen to over 80 per cent whereas the rates for most of the new Member States, Portugal, Greece and Finland did not reach 15 per cent, the average for other Member States is around 35 per cent and the concentration rates for Spain and Italy, the two biggest fruit and vegetable producers in the EU, were below this average (Agrosynergie, 2008). In 2007 the total value of fruit and vegetable production in the EU-27 was €53.3bn and the total VMP for of POs was €17.7bn i.e. 33 per cent. In order to test the extent of the supply concentration and marketing performance of fruit and vegetable POs a study was undertaken by Camanzi, et al, (op cit) of fruit and vegetable POs in France Italy and Spain.

III.20 Despite the role of POs since the 1996 CMO reform, the sector suffers frequently recurring market crises and the integration of the fruit and vegetable sector into the single payment scheme has moved it further towards market orientation and increased exposure to market fluctuations (dell'Aquila and Petriccione, 2012). Underlying the short term volatility of fruit and vegetable production are the long term changes previously identified (see for example,
Nilsson, 1998) relating to the increasing demands of consumers for convenience, taste, variety, quality and food safety. These changes are further compounded by the bargaining power of a highly concentrated retail sector and expansion of multinational agribusinesses due to communication, information and transport technologies that enable fresh products to be transported from many origins (EU Parliament, 2011). While there are a few European studies that attempt to assess the success of POs in the fruit and vegetable sectors to the best of our knowledge there is no academic assessment on the strategy-structure coherence (a la Van Bekkam) of the PO model.

IV. Success Factors and Support for a Competitive Farming Sector

IV.1. Considerable attention within the academic literature has been devoted to comparing the performance of agricultural cooperatives with IOFs (see for example, Staatz, 1987b; Hendrikse and Veerman, 1997). Albaek and Schultz (1998) predict that the tendency of cooperatives to overproduce due to the decentralisation of output decisions serves as a commitment device for credibly and profitably gaining market shares, so suggested that **** in the long run all farmers would be members of the cooperative (op cit, p 401). However, this strong prediction is not supported empirically. While cooperatives have large market shares in some countries and some markets e.g. milk production in Ireland, they are virtually non-existent in other markets e.g. beef production in Belgium or Greece (Pennerstorfer and Weiss, 2006). Within individual countries market shares for cooperatives vary widely e.g. Denmark where poultry accounts for zero per cent compared to 97 per cent for pork and within a specific sectors market shares differ from 8 per cent in Ireland and 90 per cent in Denmark for vegetables (Hendrikse, 1998). While the market share for milk accounted for by cooperatives in the US gives some support to Albaek and Schultz (op cit) increasing from 48 per cent in 1935 to 86 per cent in 2002 (USDA, 2005) the market shares in other markets remains fairly stable e.g. in the fruit and vegetable sector or declined slightly e.g. in livestock (Pennerstorfer and Weiss, op cit).

IV.2. An important consideration when attempting to measure the performance of a cooperative is that the members’ objectives do not align to those of a traditional IOF. The first point of difference in such comparisons is that the users of the firm’s services are also the owners. This means the equity needed for the activities of the cooperative come from the users and returns will be in the form of access to the services of the cooperative, a limited (if any) dividend and capital appreciation is not a major benefit of ownership. In essence, cooperative owners benefit by using its services whereas the owners of an IOF benefit by the return on their investment. If usage is a measure of performance then membership commitment is important and closely associated is the issue of trust. Trust between members and between members and the cooperative’s management are important predictors of group cohesion (Hansen, et al, 2002). A study of 2,250 Swedish farmers found that members who were satisfied with the profitability of their farm operations tended to have low levels of trust in the boards and governance of their cooperatives (Österberg, et al, 2007). The authors offer an explanation for this finding; namely, that as cooperatives to a
large extent have social as well as economic aims, services become more important than prices. The same study found a negative relationship between trust in the board – perhaps reflecting the fact that over time cooperatives have faced increasing pressures – and a positive relationship to democratic control.

IV.3. Notwithstanding the fact that the objectives set by members for their cooperative are likely to vary from those of IOFs, a number of attempts have been made to compare the respective performance of these two organisational forms. In order to measure the performance of an agricultural cooperative a comparator is needed. This could be cooperatives in the same or other sectors or it could be IOF operating in the same sector. It makes little sense to compare across agricultural sectors as each is impacted by different institutional and competitive conditions. A USDA (2007) study compared the performance of agricultural cooperatives across and within sectors over two time periods – 1992-96 and 2000-2004 – revealing a mixed picture. In the time periods considered at least one cooperative in each sector (with the exception of sugar) was able to add value sufficient to reward members for the use of their capital at a rate akin to the historic return-to-equity investments but the range of performances within each sector indicated that factors other than the commodities handled were playing a role (op cit, p13).

IV.4. The performance of the cooperatives and their ability to function efficiently in competitive and global markets in comparison to the IOFs has long been debated in literature (see Soboh et al, 2009). The academic literature comparing the performance of cooperatives with IOFs can be divided into two main approaches (Kalogeras, et al, 2011). The first adopts a neoclassical approach to analyse the efficiency of the two organisational forms and, consequently, the influence on their functioning in the marketplace (see for example, Fulton and Giannakas, 2001; Notta and Vlachvei, 2007). The second seeks to compare the financial ratios of cooperatives and IOFs (e.g. Gentzoglanis, 1997; Harris and Fulton, 1996). The identification of differences in ratios allows for a comparison of the financial performance of both organisational forms. These studies often emphasise the superiority, in terms of financial performance, of the IOF-like models though see Royer (1991) for an alternative viewpoint. Despite these findings agribusiness cooperatives have experienced an inherently dynamic restructuring process (Kalogeras, et al, 2009), and in order to adapt to agricultural industrialisation have increasingly been involved in value-adding processing, branding and market-oriented activities and strategies (Chaddad and Cook, 2004, Benos, 2009). Hence, as discussed above, new models have emerged that relaxed their financial equity constraints by attracting outside equity (Chaddad and Cook, 2004; van Bekkum and Bijman, 2006). As a consequence, property rights, ownership rights and residual claim rights are redistributed in the intra-organisational cooperative environment (Iliopoulos, 1998).

IV.5. A European study compared the performance of dairy cooperatives and IOFs in major European dairy producing countries using a traditional approach, which views both types of firms as cost minimisers, and an alternative approach, which considers the objectives of the cooperatives (Soboh, et al, 2009). The study
concluded that on average, cooperatives under-perform the IOFs in terms of productive and allocative efficiencies. However, the performance of the cooperatives in comparison to the IOFs improved when variables such as the expansion of output were included and the differences in the scale efficiencies between the two types of firm disappeared. The improvement suggests that in order to provide a relevant comparison of the performance of cooperatives and IOFs analysts should incorporate the interest of the owners of the firm. The authors conclude with the observation that cooperatives and IOFs … need different tools to evaluate their performances (op cit, p8).

IV.6. A major issue in judging the potential economic success of a cooperative is its ability to raise capital. In this respect the literature reflects a perception that agricultural cooperatives face financial constraints resulting from restricted residual claims and imperfect access to external sources of finance in an increasingly concentrated, tightly coordinated, and capital intensive food system (Vitaliano 1983). Chaddad and Cook (2002) set out to test this Capital Constraint Hypothesis that agricultural cooperatives are unable to acquire sufficient risk capital to finance profitable investment opportunities. Using firm-level data for US agricultural cooperatives for the years 1991-2000, the authors find that cooperatives face binding financial constraints when making investment decisions but some appear to be less financially constrained than others. In particular, small cooperatives with relatively high amounts of permanent equity capital, and low credit risk cooperatives were found to be less constrained than their large, low permanent equity capital, and high credit risk counterparts (op cit, p21).

IV.7. Apart from constraints in raising capital the ability to engage in inter-firm consolidation and collaboration strategies is also a performance criterion. Van Der Krogt et al, (2007) investigated whether the organisational attributes of cooperative firms’ democratic decision-making structures and equity capital constraints affected collaboration and consolidation activities. Focusing on the EU’s 15 largest dairy processing firms, comprising seven cooperatives and eight IOFs, it was found that between January 1998 and October 2002 198 alliances, mergers and acquisitions were initiated. This appears to accord with Cogeca’s (2010) observation that the growth of Europe’s largest agricultural cooperatives is in part the result of concentration and improved market positioning. However, when Krogt et al, compared cooperatives and IOFs it revealed that cooperative firms preferred to engage in mergers, licensing, explorative collaboration, and joint ventures, whereas IOFs mainly focused on take-over strategies through acquisitions and strategic equity share holdings (op cit, p470). The authors concluded that the research supported the proposition that cooperatives’ democratic decision making based on members’ current patronage results in cautious growth strategies, and limited access to equity capital results in cautiousness as concerns choice of strategies.

IV.8. In a study of NGCs drawn largely from Illinois in the US, Carlberg et al, (2006) exclusively targeted cooperative managers to ascertain their success criteria. Bearing in mind the previous discussion of the rather wide use of the term NGC the cooperatives surveyed all had in common restricted membership
and had vertically integrated downstream. The research reported three key recommendations: planning is paramount, most managers identified factors in the planning and development category as critically important to success; cost control particularly with respect to operations and financing; and one size does not fit all i.e. success factors can vary significantly depending upon commodity group (op cit, p47-48). Bruynis, et al, (2010) identified several variables linked to the success of emerging marketing cooperatives, including sufficient equity before start up, keeping transparent and accurate financial records and previous cooperative experience for managers (op cit, p21). Sexton and Iskow (1988) provide a more practical step-by-step guide to preparing the ground for success which involves, inter alia, an emphasis on planning, ensuring sufficient capital, developing a plan to return equity back to members, and appropriate membership policies which may involve restricting membership (op cit, p46).

IV.9. Assuming that that the members of the cooperative are paid according to the quantity they deliver and that the quality of the inputs is non-contractible between independent actors, there is a strong incentive to free-ride and deliver low quality. This free rider problem among members of cooperatives is a well-recognised problem in the literature (see, among others, Cook 1995 and Fulton 1995) and in practice mechanisms to control and reward members in terms of quality are now widespread. The IOF on the other hand is assumed to be vertically integrated and thus is not plagued by a quality coordination problem. The free rider problem within the cooperative with respect to product quality suggests that the investor owned firm will sell products of higher quality. In contrast to Albaek and Schultz (1998) the investor owned firm will be able to gain a large market share. However, Pennerstorfer and Weiss (2006) find that free-riding among members of the cooperative may not be strong enough to ensure that IOF will always supply higher quality than cooperatives. In markets, where delivering high quality is highly rewarded by consumers and/or the costs of producing high quality are low, the cooperative will produce the higher quality product. Despite the fact that the IOF is vertically integrated (and thus does not face a coordination problem with respect to product quality) the quality of its product will be lower.

IV.10. The prime goal of IOF’s is to maximise shareholder value, whereas the cooperative is required to maximise member value or customer value (Van Dijk, 1999). As indicated above many studies have investigated the economic performance of cooperatives however, none of these studies have specifically investigated the role of farm supply and marketing cooperatives in the success of small farms. In an attempt to rectify this omission Mishra et al, (2004) used regression analysis to analyse the factors that contribute to the success of small farms and paid particular attention to the effect of participation in marketing and supply cooperatives on the success of small farms. Although defining success as the return to the farm for labour and management the study failed to demonstrate – using US data for 1998 – that participation in marketing cooperatives was (statistically) significant. However, the authors conclude that evidence from the study indicates participation by small farms in marketing and supply cooperatives … increases their success in farming (op cit, p45).
IV.11. According to the objectives set for POs a high level of concentration would be viewed as a success, though this is not the same as economic efficiency. As far as the concentration of supply is concerned, the performance of POs in terms of number of producer members and value of the production marketed the results are ambiguous. In the seven years to 2009 some countries saw increases and others decreases. Overall, the CMO does not seem to have been able to foster the creation of new structures: in spite of the large number of POs existing in most Member States (Camanzi, et al, 2009). The development of POs appears to be limited with some exceptions and the authors of a large scale evaluation of the PO scheme (Agrosynergie, 2008) believe this is linked to the POs’ perception of the necessity to improve competitiveness.

IV.12. The ability to measure the economic importance of cooperatives to communities is not purely an academic question. Policy makers, cooperative organisations, and community development practitioners are increasingly asking for such information. Several studies have used input-output analysis to assess the economic impact of cooperatives (see for example Coon and Leistritz, 2001, Folsom 2003) but such analysis according to Zeuli and Deller (2007) is based on abstraction and they list specific factors that complicate attempts to measure the economic impact of cooperatives. For example, the geographic scope, the appropriate multiplier, the treatment of patronage refunds and spending patterns. The authors conclude that measuring the local economic impact of a cooperative is daunting but not impossible, the problems largely stemming from the likelihood that cooperatives … may have a different relationship with local economies than other business structures (op cit, p13). That said there have been a number of US studies (see for example USDA, 2003) that demonstrate a wider benefit for the local community in terms of incomes and jobs. However, a coherent measure of cooperatives’ local economic impact must account not only for market power effects, but also their ability to correct another market failures. For example, how many businesses in local communities exist only because they are structured as cooperatives?

IV.13. Turning to the wider issue of the impact of marketing cooperatives on the overall competitiveness of the farming sector we are unaware of any academic study that explicitly addresses this question. Indirectly research that shows cooperatives as improving cost efficiencies and marketing would indicate a competitive advantage but as discussed above IOFs seem generally, on the available evidence, to perform better in this respect.

V: Summary and Areas for Further Research

V.1. Explicit analysis of POs is very limited in the academic literature but this is neither surprising nor a matter of concern. In essence POs are marketing cooperatives and therefore the research that has been published regarding the development of these organisations is directly relevant. The very clear, indeed, overwhelming conclusion to be drawn from this literature review is that academic
research casts doubt on the ability of the traditional marketing cooperative with its democratic organisational structure to compete effectively with IOFs.

V.2. While the foregoing contributes to a better understanding of cooperative performance and management a number of caveats must be entered. First, while considerable empirical research has been undertaken with respect to dairy cooperatives, studies on fruit and vegetable cooperatives are more limited. There may be characteristics of this sector e.g. seasonality and freshness that have implications for the organisation and performance that differ markedly from other produce. Another area that does not appear to have attracted much attention in the literature is the influence of variables beyond organisation and culture that might influence market orientation and performance. For example, the stage and degree of product differentiation (Gruber, et al, 2000) and demand conditions.

V.3. Another concern not deeply researched in the literature is the observation (see for example Fulton, 1999) that member commitment to the traditional form of cooperative appears to be waning. This loss of commitment is coming at a time when cooperatives are facing some tremendous challenges from outside competition requiring the development of marketing systems in which product quality and differentiation are essential. In light of this development, research into policies that will re-introduce member commitment would be of significant value. Member commitment is created when a cooperative finds a set of characteristics that appeals to the members but not to the non-members and this suggests the need for greater cooperative differentiation.
## Sub Annex I: EU Top 25 Agricultural Cooperatives in 2008

<table>
<thead>
<tr>
<th>Rank</th>
<th>Name</th>
<th>Country</th>
<th>Sector</th>
<th>Turnover (million €)</th>
<th>Members ('000)</th>
<th>Employees ('000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>FrieslandCampina</td>
<td>NL</td>
<td>Dairy</td>
<td>9,481</td>
<td>15,837</td>
<td>20,568</td>
</tr>
<tr>
<td>2</td>
<td>Bay Wa</td>
<td>DE</td>
<td>Supplies</td>
<td>8,795</td>
<td>:</td>
<td>15,540&lt;sup&gt;1&lt;/sup&gt;</td>
</tr>
<tr>
<td>3</td>
<td>Vion</td>
<td>NL</td>
<td>Meat</td>
<td>8,540</td>
<td>:</td>
<td>33,580</td>
</tr>
<tr>
<td>4</td>
<td>Metsäliito</td>
<td>FL</td>
<td>Forestry</td>
<td>6,434</td>
<td>129,270</td>
<td>17,540</td>
</tr>
<tr>
<td>5</td>
<td>Arla Foods</td>
<td>DK</td>
<td>Dairy</td>
<td>6,200</td>
<td>7,625</td>
<td>16,200</td>
</tr>
<tr>
<td>6</td>
<td>Danish Crown</td>
<td>DK</td>
<td>Meat</td>
<td>6,000</td>
<td>10,700</td>
<td>23,500</td>
</tr>
<tr>
<td>7</td>
<td>AGRAVIS</td>
<td>DE</td>
<td>Supplies</td>
<td>5,811</td>
<td>:</td>
<td>4,000&lt;sup&gt;1&lt;/sup&gt;</td>
</tr>
<tr>
<td>8</td>
<td>Union IN VIVO</td>
<td>FR</td>
<td>Cereals Supplies</td>
<td>5,200</td>
<td>:</td>
<td>1,500</td>
</tr>
<tr>
<td>9</td>
<td>KERRY</td>
<td>IE</td>
<td>Dairy</td>
<td>4,700</td>
<td>9,700</td>
<td>22,300</td>
</tr>
<tr>
<td>10</td>
<td>DLG</td>
<td>DK</td>
<td>Supplies</td>
<td>4,600</td>
<td>28,000</td>
<td>5,000</td>
</tr>
<tr>
<td>11</td>
<td>FloraHolland</td>
<td>NL</td>
<td>Horticulture</td>
<td>4,074</td>
<td>5,124</td>
<td>3,555</td>
</tr>
<tr>
<td>12</td>
<td>TERRENA</td>
<td>FR</td>
<td>Multipurpose</td>
<td>3,900</td>
<td>27,500</td>
<td>9,900</td>
</tr>
<tr>
<td>13</td>
<td>TEREOS</td>
<td>FR</td>
<td>Sugar</td>
<td>3,800</td>
<td>9,500</td>
<td>9,000</td>
</tr>
<tr>
<td>14</td>
<td>Lantmännchen</td>
<td>SE</td>
<td>Cereals Feeds</td>
<td>3,656</td>
<td>7,625</td>
<td>16,200</td>
</tr>
<tr>
<td>15</td>
<td>SODIAAL</td>
<td>FR</td>
<td>Dairy</td>
<td>2,746</td>
<td>13,000</td>
<td>7,700</td>
</tr>
<tr>
<td>16</td>
<td>Nordmilch</td>
<td>DE</td>
<td>Dairy</td>
<td>2,500</td>
<td>7,989</td>
<td>7,989</td>
</tr>
<tr>
<td>17</td>
<td>DLA</td>
<td>DK</td>
<td>Supplies</td>
<td>2,450</td>
<td>20,000</td>
<td>2,300</td>
</tr>
<tr>
<td>18</td>
<td>Agricola Tre Valli</td>
<td>IT</td>
<td>Meat Feeds</td>
<td>2,332</td>
<td>:</td>
<td>:</td>
</tr>
<tr>
<td>19</td>
<td>Humana Milchunion</td>
<td>DE</td>
<td>Dairy</td>
<td>2,200</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>20</td>
<td>GLANBIA</td>
<td>IE</td>
<td>Dairy</td>
<td>2,200</td>
<td>18,600</td>
<td>4,900</td>
</tr>
<tr>
<td>21</td>
<td>RWZ</td>
<td>DE</td>
<td>Supplies</td>
<td>2,119</td>
<td>:</td>
<td>:</td>
</tr>
<tr>
<td>22</td>
<td>Irish Dairy Board</td>
<td>IE</td>
<td>Dairy</td>
<td>2,110</td>
<td>0.070</td>
<td>3,788</td>
</tr>
<tr>
<td>23</td>
<td>Westfleisch</td>
<td>DE</td>
<td>Meat</td>
<td>2,008</td>
<td>:</td>
<td>:</td>
</tr>
<tr>
<td>24</td>
<td>RWA</td>
<td>At</td>
<td>Supplies</td>
<td>2,000</td>
<td>122,000</td>
<td>13,000</td>
</tr>
<tr>
<td>25</td>
<td>Coopagri</td>
<td>FR</td>
<td>Multipurpose</td>
<td>1,950</td>
<td>:</td>
<td>:</td>
</tr>
</tbody>
</table>

Notes: 1 = 2003; : = Data not available
Sub Annex II: Recognition criteria and outline of Operational Programme required structure for Producer Organisations in the Fresh Produce sector

To achieve recognition by a Member State Competent Authority a Producer Organisation must have at least five distinct members and a value of marketed production of at least one million Euros. In addition the PO must be able to demonstrate:-

- that they are formed on the initiative of growers and are controlled by their producer members;
- the eligible crops for they will be recognised;
- that they have the ability to store, pack and market their members produce (outsourcing of some of these functions is allowed subject to agreement of the MS Competent Authority); and
- their membership agreement includes the following aims:
  - ensuring production is planned and adjusted to demand, particularly in terms of quality and quantity;
  - promoting concentration of supply and placing members’ production on the market;
  - reducing production costs and stabilising producer prices; and
  - promoting the use of cultivation practices, production techniques and environmentally sound waste management practices, in particular to protect the quality of water, soil and landscape and preserve and/or encourage biodiversity. NB the elements may all be included in the PO membership agreement.

The EU supports PO’s in implementing Operational Programmes at an intervention rate of 50 per cent on up to 4.1 per cent of the value of marketed production. Operational Programmes can run for 3-5 years. Such support is significant in a sector where net margins are often less than 4 per cent (source). To benefit from such support PO’s must submit an application for an Operational Programme containing actions from within the range of measures supplied by the EU. The following measures are currently available within the scheme in the UK:

- Improving planning and production
- Quality improvement
- Improving marketing
- Research and experimental production
- Training and access to advisory services
- Crisis prevention and management
- Environmental actions
References


Camanzi, L., Malorigo, T. and Garcia Azcárate, T., (2009), The role of Producer Organizations in supply concentration and marketing: a comparison between European Countries in the fruit and vegetables sector, Paper presented at the 113th
EAAE Seminar *A resilient European food industry and food chain in a challenging world*, Chania, Crete, September 3-6.


Commission, (2001), *Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (de minimis)*, Official Journal, C368, December

Commission, (2009), *Guidance on its enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, Official Journal, C45, pp7-20, February

Cook, M. L., (1993), *Cooperatives and Group Action*, in D. I. Padberg (Ed), *Food and Agricultural Marketing Issues for the 21st Century*, College Station, TX, Texas A&M University,


Héndrikse, G. W., (2004), Restructuring Agricultural Cooperatives, Erasmus University of Rotterdam, Rotterdam School of Management.


ICA, (2012), ICAO website, [http://www.agricoop.org/about/about.htm](http://www.agricoop.org/about/about.htm)


NCA, (2012), National Co-operative Archive website, [http://archiveshub.ac.uk/data/gb1499-fac?page=1#id770628](http://archiveshub.ac.uk/data/gb1499-fac?page=1#id770628)


Sexton, R. J. and Iskow, J., (1988), Factors Critical to the Success or Failure of Emerging Agricultural Cooperatives, Giannini Foundation Information Series No. 88, Department of Agricultural and Resource Economics University of California, June.


Shaffer, J. D., (1987), Thinking about Farmers’ Cooperatives, Contracts, and Economic Coordination, in J. Royer (Ed.) Cooperative Theory: New Approaches, pp61-86, ACS Report 18, USDA.


13.2 Survey

13.2.a Survey details

Two surveys were undertaken to gather evidence to support the research undertaken for this project.

<table>
<thead>
<tr>
<th>Survey population</th>
<th>Number of businesses/people to which survey sent</th>
<th>Usable Responses</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>POs and cooperatives</td>
<td>96</td>
<td>38</td>
<td>40</td>
</tr>
<tr>
<td>Industry stakeholders</td>
<td>120*</td>
<td>33</td>
<td>28</td>
</tr>
</tbody>
</table>

*estimate

13.2.b Survey results (PO results shown where notable difference seen)

Key:  Blue = POs/Coops  Green = POs  Red = Industry stakeholders

**POs & CO-OPERATIVES**

<table>
<thead>
<tr>
<th>What is your position in the coop / PO?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chief Executive or MD</td>
</tr>
<tr>
<td>Chairman</td>
</tr>
<tr>
<td>Farmer Director</td>
</tr>
<tr>
<td>Company Secretary</td>
</tr>
<tr>
<td>Finance Director</td>
</tr>
</tbody>
</table>

**INDUSTRY STAKEHOLDERS**

<table>
<thead>
<tr>
<th>What is your role?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farmer</td>
</tr>
<tr>
<td>Representative of AHDB</td>
</tr>
<tr>
<td>Representative of NFU</td>
</tr>
<tr>
<td>Representative of TFA</td>
</tr>
<tr>
<td>Other</td>
</tr>
</tbody>
</table>
Additional measures suggested:

From co-ops/POs

Improved profitability of members' businesses as a result of marketing produce through POICoop because without this members won't realize benefit of being members to POICoop. Ability of members' businesses to reinvest in production efficiency and new technologies/scientific knowledge because this is the only way that industry can grow market share and replace imports.

Growth in consumer demand and retail listings.

Productivity of members (tonnes per hectare). To recognise members who could improve their output and quality.

Non-profit making buying and discussion group.
From stakeholders

using European funding to keep harvesting and packing facilities modern and up to date. The returns we receive from our customers are insufficient to allow this to happen.

the ability of a co-operative to withstand bullying from large and ever powerful buyers is of key importance.

No.

Value added to business Costs saved Back office integration

Access to the latest technology and best growing practices.

Cutting costs.

Additional suggestions:

From co-ops/POs

see kpi measures described in 3.

None.

Realistic approach to capital measures such as green waste and biological control.

Government/EU to support our industry in the long term to enable us to expand and develop our business.

The ability to work with other organisations along the supply chain. To capture premium markets.
communication of events to membership to give clear understanding on what is being achieved on their behalf

From stakeholders

Trust and transparency through clear communication to members about the strategy and direction of the business.

A level of advice from the Govt, which is clear and consistent and does not lead to P.O.’s being disallowed because of poor and inconsistent advice from the Govt. of the day.

The need for innovation and keeping up to date with current technology and using it to benefit the organisation and its members through better communication, financial data and technological advances in fruit grading, processing, storage and distribution.

You have to have total 100% commitment from all the cooperative members to be really successful with good clear leadership.

Support from both DEFRA and RPA.

Investment in good staff training.
Additional suggestions:

**From co-ops/POs**

- Inherent independence of farmers and growers in running their own business
  - 7/4/2013 11:40 PM  View Responses

- Slow moving bureaucracy that can impede the businesses ability to adapt to commercial change such as EU legislation and restrictions on eligible items within programs
  - 7/4/2013 11:16 AM  View Responses

- None of the above are barriers to GMSCo’s success
  - 7/4/2013 11:01 AM  View Responses

- Balance of programme with spend restrictions in certain actions/measures
  - 7/4/2013 10:35 AM  View Responses

- Local Authorities Planning Issues
  - 7/4/2013 2:42 PM  View Responses

- None of the above except 1 and 2 are barriers
  - 7/2/2013 3:02 PM  View Responses

- The main barrier by some distance is the way the fresh produce food chain operates and the dominance of the UK retail sector
  - 6/29/2013 12:25 AM  View Responses

- As regards question 11 I think we are fairly well sorted so none of these really apply
  - 5/26/2013 11:19 PM  View Responses

- People are key
  - 5/26/2013 11:35 AM  View Responses

- Climatic restraints and customer demand
  - 5/27/2013 3:45 PM  View Responses

- A lack of government acknowledgment that cooperatives are part of the answer to a competitive and successful agricultural industry. Raising the profile of this type of arrangement would make membership a mainstream option for many. Rapidly shrinking supply options for key commodities. This makes negotiation of price and quality of a much more difficult
  - 5/27/2013 1:00 PM  View Responses

- Question 11 is directly opposite to 10 and not entirely relevant. All the above can be and have been addressed and barriers listed to enable growth; the one that is not is a geographical one with the North Sea five miles to the east and Channel ten miles to the west!
  - 5/27/2013 9:36 AM  View Responses

- Promotion for membership growth. We feel we address all the above so very difficult to put in order - similar priority to previous question
  - 5/27/2013 6:39 AM  View Responses

- Lack of engagement with customers.
  - 5/9/2013 11:35 PM  View Responses
Q – How does your cooperative or producer organisation ensure that management is aligned and incentivised to deliver against the businesses objectives?

From co-ops/POs

- Continual monthly monitoring and annual appraisal
- Senior executives are rewarded by an executive bonus scheme that can pay 30% of salary, although that is no substitute for proper base salaries
- Personal objectives are set and rewarded against, for each of the commercial team. Objectives that are aligned with the overall objectives of the business.
- The business plan is clear and provides a framework for management to work within. A strong commercial agenda focussing on ensuring best returns for growers is fundamental.
- Majority of annual bonus reward for employees is based on comparative performance of business on milk price vs. competitors
- Motivation, communication, controls (KPIs) and a small bonus scheme
- Board consists of member growers who understand the trends and realistic factors affecting the industry.
- Annual meetings and discussions and working with other companies of same criteria
- Through benchmarking with other similar businesses.
- Targets and good communication
- The management is well paid and as the business is growing fast there is good career progression within the business. The management is well led by the MD
- All board are active farming members, management is kept small and is actively involved in all decisions.
- clear KPIs for CEO and Board with outside monitoring from Nomination/Remuneration Committee
We select and pay well qualified people and communicate well with staff and members.

Challenging our team to be the best.

Customers' demands and predictions are published 12 to 18 months ahead of supply, thus ensuring that the co-operative is fully incentivised to deliver.

The Board and Management endeavour to work closely together to ensure focus on the way forward for the business and co-operative as a whole.

We listen to our members. Meetings are held, shows visited and the AGM is a formal option for member appraisal of the operation. As financial throughput is member dictated, no manager financial incentives are appropriate.

Regular financial review of performance. Benchmarking against other grain co-ops. Fair salary structure with element of performance bonus based on throughputs.

From co-ops/POs

Clear understanding of legislative frameworks governing operation of POs/Coops.

A very real understanding of not just the members business but the customers and their business and their drivers for success.

Diplomacy and sound business acumen.
From stakeholders

Long term strategic planner. Track record of commercially respectable. Respectable.
7/26/2013 5:11 PM  View Responses

A good networker with full knowledge of the P.O. system and how it works at all levels.
7/23/2013 8:29 PM  View Responses

Good IT skills
7/19/2013 2:24 PM  View Responses

Industry figurehead for their sector
7/19/2013 8:35 AM  View Responses

Ability to manage a team
7/19/2013 8:55 AM  View Responses
Q – You may be aware that producer organisations have recently been introduced into the dairy sector and that there are proposals to introduce them into other sectors such as arable and livestock. Note that there is no operational funding attached to POs in other sectors. Given your experience with POs under the fruit and vegetable aid scheme what do you think the benefits would be for farmers in other sectors to join or set up a PO?

From POs

Collaboration in selling and price negotiation with customers. Collaboration in R&D to deliver production efficiency improvements. Collaboration in marketing product and PR of product to consumers.

7/17/2013 1:43 PM  View Responses

Properly run POs are the best way of controlling supply and providing a support structure for smaller growers to strengthen their position in the market place. They enable the supply chain to be shortened and for producers to take more control over their marketing.

7/16/2013 11:33 AM  View Responses

I have too little experience to comment.

7/15/2013 10:43 AM  View Responses


7/13/2013 6:23 PM  View Responses

The PO fits well with our Floe Operation but in other sectors the structure of businesses does not lend itself so readily. Retailers want to trade with the producer/packer they know they do not want to trade with an entity (PO Marketing Organization) which is new and unknown to them.

7/13/2013 5:47 PM  View Responses

The horticultural coop is under the PO regime but obviously our potato cooperative is not. My personal view is that we would be better served if there was no PO regime in the UK but as there is we have to try and maximise our opportunity. The UK co-op model does not fit easily with the EU regime and that causes problems. All subsidies distort trade, particularly capital grants and adjusting a business model to access grants is not the way to create an efficient business structure. The PO regime encourages unnecessary spending on capital and reduces business flexibility, it has resulted in the destaffing of fresh produce processing capacity in the UK.

5/29/2013 1:40 AM  View Responses

A bigger voice and the opportunity for smaller businesses to get involved with the big boys.

5/29/2013 1:32 PM  View Responses

Collective thinking and creating a medium to long term future. Most on farm thinking is and in most cases has to be short term thinking as it requires the input of a long term strategic research and thinking.

5/28/2013 11:43 AM  View Responses

Central market Central management and administration.

5/27/2013 3:55 PM  View Responses
Q – What possible downsides are there to the introduction of the PO model in other sectors?

From POs

Lack of operational funding will deter potential members/formation of POs
7/12/2013 1:48 PM  View Responses

Member buy-in. UK growers are generally well invested and quite independent making collaborative activity challenging
7/12/2013 11:33 AM  View Responses

I have too little experience to comment
7/12/2013 10:43 AM  View Responses

Red tape going at the speed of the slowest loss of independence
7/12/2013 8:20 PM  View Responses

Change in business structure and commitment to common marketing organization
8/30/2013 12:44 AM  View Responses

Giving up control to some parts of your business to others
8/28/2013 1:22 PM  View Responses

They will be judged on short term performance rather than allowed to evolve around a strategic pathway. The benefits in terms of market alignment and engagement will be hugely beneficial but may take time.
8/28/2013 11:43 AM  View Responses

Financial on an output pro rata basis
8/27/2013 3:56 PM  View Responses

You may be aware that producer organisations have recently been introduced into the dairy sector and that there are proposals to introduce them into other sectors such as arable and livestock. Do you see this as a positive development?

Coop / PO response

YES 52%
Not sure / No opinion 35%
NO 12%

Stakeholder response

YES 73%
Not sure / No opinion 18.2%
NO 9%
From Stakeholders

POs have the potential to improve the marketing position of farmers, but they must not be seen as a panacea. The success of a PO will rely on the willingness of farmers within them to adapt production to collaborative marketing strategy, rather than just for price leverage in the marketplace.

Each sector operates in a different manner and setting generic rules that work for one will be very difficult.

Introducing a new concept to sectors which others have not engaged with collaboration or co-operation. If the potential partners are not fully committed then the schemes will possibly fail and then no one from those sectors is likely to engage in the future.

Don't know

Greater group strength, better bargaining power, are upsides, downsides have been shown previously to be other commercial operators combining to cause co-operators to fail. There is always the risk of management working to further their own iden rather than that of the members.

Loss of individual control of outcomes, better for the industry as a whole as everything is more streamlined, weeds out poor farmers, farmers have little control over pricing.

Too many producer organisations will become self-dealing in the marketplace, too many producers have their own individual routes to market to protect.

The upside is we should be stronger collectively with good leadership. The downside is government with all their rules, regs and hoops of paperwork, out growers off.

Will this dilute the pot of funding for existing POs.

PO should be banned. It's pointless and they exist merely to access grant funding. Why should one business who is a member have access to grant funding and another who is not be able to receive no funding. It creates an unbalanced sector. Funding should be available to all growers across the EU or none at all. Most of the PO's that I am aware of are there purely to access funding. We have a unique product that does not warrant a PO but a neighbour who wants to copy our model who is in a PO can get access to funding and thus has a competitive advantage that is fair. Funding for all or nothing for none but it's unfair and crazy as the current model.

Better pricing: Input and output. Closer network of producers. Downside - co-operatives become the 'place to beat'.

Co-operative activity generally gives strength in the marketplace but this can and has been abused in the past.

Only downside can be if there are not the EU funds to support all POs, otherwise can only see it as a good thing.

Offer an element of choice for farmers and growers, backed by regulation which may enable some farmers to become a part of a co-operative when they previously wouldn't have considered it. Downside is that POs introduce further cost to the supply chain without benefitting farmers.

It all comes down to the right motivation for doing them. Just starting them up without a clear objective about what they are trying to achieve is doomed to failure. The debate alone is a worthwhile exercise.
Q – Are there any particular barriers that prevent the formation of vertical supply chain collaboration?

From co-ops/POs

Vertical collaboration is already advancing in Fresh Produce owing to need of businesses to create efficiencies and hence improve profitability. Retailer attitudes are important in that they do recognise need to have resilient value chains. Collaboration within these chains can build this resilience, retailers need to support this evolution.

7/11/2013 11:40 PM  View Responses

Increased volatility in the cost of production (COP) for livestock producers as a consequence of global commodity price variation can create huge variances between COPs and market prices. End customers, processors, are reluctant to have involvement in COPs that can put them at a serious disadvantage to the market as their customers, mainly retailers, in most cases, are unwilling to be involved although they the retailer will for long term commitment of supply they also like to maintain the ability to switch supply to cheaper importa product.

7/11/2013 9:25 AM  View Responses
### From Stakeholders

**Trust and lack of openness.** Business unwilling to move from traditional transactional relationships towards collaborative ones.

7/25/2013 5:17 PM  View Responses

**Not enough large P.O.’s or F.C.’s to provide sufficient quantities of product to attract the processors or consumers into entering into a vertical supply chain arrangement.**

7/25/2013 9:40 PM  View Responses

**End users not interested, do not like change and happy to keep exploiting producers.**

7/22/2013 4:58 PM  View Responses

**Depends on how the supermarket management is structured.**

7/19/2013 2:30 PM  View Responses

**Too many intermediate businesses which have their own commercial interests e.g. importers.**

7/19/2013 9:30 AM  View Responses
Q – Can you give any examples or evidence that the existence of cooperatives and/or collaborative activity improves the competitiveness of UK agriculture?

From co-ops/POs


OMSco, First Milk and Milk Link Ltd formed the Alliance to market all organic members milk through OMSco. 65% of the market supply through the organisation has resulted in £2 million successful generic campaign (return to market growth), 80 million litres of airport, NFD and improved supply chain efficiency and flexibility. In summary, it has resulted in maintaining a reasonable farm gate return during a period of extreme oversupply and a return to supply/demand balance much faster than would have been possible without co-operation.

If you have little experience to comment

Able to supply customers with exact specification requires trust.

Significant costs and duplication can be removed. We are getting twice the tonnage utilization to what was happening before. Our members’ crops are being fully valued realized through proper presentation to the market. Duplication of grain storage and primary processing has been removed from the supply chain, particularly in the malting barley sector. Substitution of imports of malting wheat has been secured.

Pea Groups could not operate at the current cost structure without a cooperative structure.

None of these efforts or initiatives have been for marketing group but only works because there are still a range of outlets for potatoes which in essence is not the case for the rest of fresh produce. It has raised member competitiveness. Berry world appears to work well as does Opuntia in the arable sector.
From Stakeholders

Sorry, despite being a keen advocate for cooperatives and collaborative activity the only examples that spring to mind are the grain cooperatives which have managed to secure vertical integration for their members grain by sheer size.

Co-op storage and marketing of grain - we need to get bigger as all our customers continue to merge and drive us and rule

It is not just the quality of members' produce, but the degree to which they are able to sell it in the market, that determines the success of such collaborations. The ability to aggregate, blend, and assemble large quantities of specific product can create significant economies of scale.

PO's are able to support quality and continuity of supply which enables supermarkets to better plan supply and demand so supermarkets are more likely to work with PO's than individuals.

In the grain sector the ability to aggregate, blend, assemble & more large quantities of specific product creates an increase in value to the producer. Individual farmers cannot achieve the same standards. The facilities offered by the co-op e.g. drying, storage, etc reduce the need for investment & skilled labour at the peak harvest time on the farm.

The lettuce company Ltd forced out of the food chain by the restructuring of an failing salad growing business

Quite the opposite

Anglia Farmers Partnerships Anglia farmers / Waitrose North Norfolk potato growers / Walkers Nelson County potatoes / Kettle Anglia pea growers / Ardoallysham growers / Pingrin

Soft fruit production and marketing. Salad crop production and marketing. Potato production and marketing.

In my sector top fruit our PO enables us to trade with reasonable success with multiples not possible on ones own.

KGF fruits enabling the opportunity to invest in growers production infrastructure.
From co-ops/POs

Incentivise farmers supply chain directly to collaborate
8/15/2013 9:41 AM View Responses

Greater focus on R&D collaboration and adoption of scientific knowledge and technology translation
7/17/2013 11:41 PM View Responses

The removal of taxation on revenue derived from non-member trade. Often additional volume can be secured to increase total supply to customers from non-members alongside members supply that will benefit the customer and ultimately the members and the organisation. But often the taxes are a burden to the co-op.
7/17/2013 11:51 AM View Responses

A flexible and proactive approach from DEFRA/RPA in the handling of the EU regulations with respect to the UK. The situation is improving but the implementation of the regulations must aid competitiveness, not stifle it. Some protection against draconian penalties which severely disrupt cash flow of businesses
7/18/2013 11:41 AM View Responses

1. Fund research to show conferences as co-op's and PO's can learn from other co-op's and PO's. Could be sector-specific or wide-ranging as long as learnings are transportable to other sectors. 2. Give priority to co-op's and PO's when on export opportunities
7/18/2013 3:26 PM View Responses

I have too little experience to comment
7/15/2013 10:49 AM View Responses

Reducing red tape
7/4/2013 3:32 PM View Responses

Consolidation within sectors of Co-op's.
7/3/2013 3:26 PM View Responses

Appointing external management and Directors who can bring a wide experience of business management to the organization. Creating a structure that provides for nomination and remuneration to be dealt with outside the Board - also to monitor Board performance.
6/30/2013 12:57 AM View Responses

the retail sector showing genuine interest and support for farmer collaboration
8/29/2013 12:54 AM View Responses

Create management training as Co Ops are very difficult to manage, there are some very good practitioners in the industry who have created different ways of solving not only the commercial pressures of developing and running such a business, they have developed techniques to deal with the scenario where the suppliers are also the share holders, this creates further management dimensions which are generally overlooked, but is fundamentally why Co Op's struggle at some stage.
8/26/2013 12:07 AM View Responses

I think that more clear support from Government to the Farming Industry as a whole, not necessarily in financial forms, would inspire confidence within the industry and encourage more investment from outside of the industry into developing farming techniques and increases in production of food etc.
8/27/2013 2:40 PM View Responses
Q – Do you have any recommendations as to how government should support cooperatives / producer organisations and collaboration more widely in the future?

The creation of a government and NFU backed initiative to promote the benefits of collaboration. A specific investment fund which incentivises the whole supply chain. For example, there are many SMEs in grain transport who would benefit from being in a collaborative entity but they need some incentive and help to take the first steps.

Increase flexibility of measures and actions in OPs and also increase flexibility within Environmental Frameworks.

Provide clear guidance as to how the rules can be met within a commercial context. The regulations are too open to interpretation and no clear guidance is offered by government. Historically rules have changed and POs are found to be at fault despite following the rules set out by UK government and are held accountable. Government must be held accountable for their mistakes.

1. recognition that Retailers are the gatekeepers to the consumer 2. the supply chain is dominated by organisations whose priorities include margin enhancement, volume throughout and shareholders’ returns rather than farmgate prices 2. well run cooperatives can outline some of this balance.

I have too little experience to comment.
Long term policy support in UK Agriculture.
7/4/2013 9:02 PM  View Responses

Make sure CAP support is channelled through to collaborative initiatives as this will help make British agriculture more competitive and guarantee the long term flow of income back to the farm level and thereby allow industry investment crucial for the long term competitiveness of agriculture. Break the monopoly of British Sugar.
7/13/2013 3:32 PM  View Responses

Support the continuation of the PO structure but understand the issues that businesses find difficult to implement because of the nature of the UK Supply/Retail sector and today’s EU for changes
6/30/2013 12:57 AM  View Responses

Not through capital grants! Creation of a supply chain environment which helps collaborative ventures to thrive. Encouraging very capable business leaders, Facilitating financial support from lenders, Financial support for R and D undertaken by collaborative ventures. Retaining present ability to hold retentions without being taxed until they are repaid. Use of portion of Pillar 2 money for applied research and giving priority for this to collaborative ventures. Allowing flexible structures for co-ops as long as there is 100% commitment from the relevant product(s). Helping Co-ops to advertise themselves.
9/29/2013 12:54 AM  View Responses

Create focus benefits which usually means some money, the efficiency and benefits will grow with the right management.
6/23/2013 12:57 AM  View Responses

Government should recognise more clearly the efforts of co-operatives / producer organisations in making collaboration work and be seen to support the industry more whole than is currently perceived by the industry and public alike.
6/22/2013 3:20 PM  View Responses

Market is dominated UK by one company with 35% market share aggressively acquiring market share. Government appears weak where companies have become too dominant, applicable to retailers too.
6/23/2013 3:10 PM  View Responses

As most of many cooperatives are not for profit organisations, finances for promotion of the sector and their impact are often low. A mechanism to promote the concept rather than the individual companies involved that has government backing is necessary.
6/27/2013 1:18 PM  View Responses

Very difficult! On one hand support in the form of subsidies is bad for business but on the other funding has become more difficult!
6/23/2013 9:47 AM  View Responses

The RDPE programme has been very beneficial and a new post 2015 scheme is a priority. It would be helpful to allow a phasing in for development over a period of years rather than just one off expenditure. An inducement for new membership would be useful to encourage those outside the co-op movement to take the first step in joining.
6/27/2013 8:54 AM  View Responses

From Stakeholders

Possibly tax breaks or other investment incentives for the initial start up capital requirements. Risk underwriting, i.e. like the Government guarantees for securitization, to reduce the risk factors for farmers whose business do not have the capacity for withstand failure of a co-operative or PO. Credit underwriting to assist start up collaborative ventures access capital.
7/23/2013 5:27 PM  View Responses

Commission reports into likely areas for P. O. activities and to identify where P.O.’s could deliver benefits for farmers and growers with those benefits fully costed to grab the attention of the target audience. The provision of a facilitator to help with the start up would also be useful until the growers could elect their own Chairman.
7/23/2013 5:03 PM  View Responses

The EU system of PO support helps, but the typical British over indulgence in red tape makes it less useful than it could be. Growers are not always able to invest what is available in their own money where they think best. Despite a near 50% financial contribution to the purchase of assets for use on their holdings this is not recognised and the assets remain totally in the ownership of the PO. This is a major disincentive to PO membership and needs to be resolved.
7/19/2013 7:02 PM  View Responses

Provide IT knowledge and support Reduce red tape
7/19/2013 2:38 PM  View Responses

Insist they sell produce to businesses that are not commercially related to specific producers.
7/19/2013 9:43 AM  View Responses

Reduce the red tape to enable po’s to reduce admin effort redirecting funds to useful solutions
7/19/2013 4:07 PM  View Responses
If you took away the grant funding for POs, how many would still be in existence in 5 years time? They exist purely for free money. Create a level playing field with support for the whole industry or no support.

Support EFFP and other organisations which facilitate cooperation.

Whilst providing support to establish these structures, they need to avoid imposing unnecessary bureaucracy in the day to day operation of these businesses.

To show support for the PO regime so that members and potential members can have confidence in the future of these organisations. Not the case at present.

My recommendation is that the UK Government should agree with the EU that all subsidies from the taxpayer to co-operatives or POs should either be available to all or be stopped. At present, the subsidies distort the market and give unfair advantage to those who can, for whatever reason, set up a structure that meets the regulatory criteria.

One of the barriers to the creation of co-operatives/POs is the lack of administrative/technical support to begin the process of establishment of the PO. A central PO Admin company would foster farmers coming together and establish a timeline of steps to be taken for the creation of the PO.

PO/COOP are NOT the total answer, just a part of it. They might produce a good average price but often fall short of the best price (purchase or selling). It is not possible to be all things to all men. Free markets and price volatility can and do out perform and therefore must remain part of the solution.

Grants to existing cooperatives to help support new ones so that experiences get shared.
### 13.3 Interviews

**Telephone interviews**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Retail</td>
</tr>
<tr>
<td>2</td>
<td>Dairy</td>
</tr>
<tr>
<td>3</td>
<td>Dairy</td>
</tr>
<tr>
<td>4</td>
<td>Dairy</td>
</tr>
<tr>
<td>5</td>
<td>Arable</td>
</tr>
<tr>
<td>6</td>
<td>Arable</td>
</tr>
<tr>
<td>7</td>
<td>Fresh produce</td>
</tr>
<tr>
<td>8</td>
<td>Fresh produce</td>
</tr>
<tr>
<td>9</td>
<td>Fresh produce</td>
</tr>
<tr>
<td>10</td>
<td>Potatoes</td>
</tr>
<tr>
<td>11</td>
<td>Inputs</td>
</tr>
<tr>
<td>12</td>
<td>NGOs</td>
</tr>
<tr>
<td></td>
<td>ASDA</td>
</tr>
<tr>
<td></td>
<td>First Milk</td>
</tr>
<tr>
<td></td>
<td>Barbers</td>
</tr>
<tr>
<td></td>
<td>Fonterra (NZ)</td>
</tr>
<tr>
<td></td>
<td>Openfield</td>
</tr>
<tr>
<td></td>
<td>Wessex</td>
</tr>
<tr>
<td></td>
<td>Freshgro</td>
</tr>
<tr>
<td></td>
<td>James Hallett BGA</td>
</tr>
<tr>
<td></td>
<td>Green Pea Co</td>
</tr>
<tr>
<td></td>
<td>Nene Potatoes</td>
</tr>
<tr>
<td></td>
<td>Anglia Farmers</td>
</tr>
<tr>
<td></td>
<td>Young Farmers</td>
</tr>
</tbody>
</table>

**Face to face interviews**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Retail</td>
</tr>
<tr>
<td>2</td>
<td>Dairy</td>
</tr>
<tr>
<td>3</td>
<td>Arable</td>
</tr>
<tr>
<td>4</td>
<td>Fruit</td>
</tr>
<tr>
<td>5</td>
<td>Fruit</td>
</tr>
<tr>
<td></td>
<td>Retail</td>
</tr>
<tr>
<td></td>
<td>Dairy</td>
</tr>
<tr>
<td></td>
<td>Arable</td>
</tr>
<tr>
<td></td>
<td>Fruit</td>
</tr>
<tr>
<td></td>
<td>GMOs</td>
</tr>
<tr>
<td></td>
<td>Morrisons</td>
</tr>
<tr>
<td></td>
<td>Dairy Crest</td>
</tr>
<tr>
<td></td>
<td>Camgrain</td>
</tr>
<tr>
<td></td>
<td>Berry Gardens</td>
</tr>
<tr>
<td></td>
<td>Worldwide</td>
</tr>
</tbody>
</table>
13.4 Workshop

Producer Organisations and their Future Role in the UK Agricultural Industry

Thursday 17th October 10.30am – 4.00pm held at NFU Conference Centre, Stoneleigh

13.4.a Introduction

The final stage in the project was to hold a workshop involving a mix of industry stakeholders and senior cooperative and PO personnel. A total of 22 delegates attended from NFU (including Deputy President), Agricultural and Horticultural Development Board, Coops UK, Defra plus representatives from 6 co-ops and POs. The event was led by Sion Roberts and two colleagues from EFFP.

The workshop commenced by outlining the project and stating the aims of the day which were to explore the views of participants on the following…

- Can farmer collaboration improve the competitiveness of UK agriculture?
- Is there a role for government to support collaboration?
- Should government promote and support the establishment of POs across other agricultural sectors and how?

Key findings from the earlier research and interviews were described. Most of the participants had completed the on line survey and/or had been interviewed in person so possessed a good understanding of Defra’s purpose in undertaking the work to inform policy decisions.

Feedback and ideas from the participants were sought both in discussion during the presentation and in two subsequent break-out sessions which posed the following questions:

- What should the role of Government be in supporting collaborative development?  
  random 3 groups

- What is the impact of collaboration and the potential introduction of POs on agricultural competitiveness?  
  Participants asked to choose sector specific group – arable, livestock and dairy

13.4.b Discussion of report findings

In setting the scene the change in market dynamics was described. Over recent decades we have seen significant changes in both the organisation of transactions within the food chain and the growing intensity of competition. This has led to a fundamental shift in the behaviour and structure of cooperatives (and POs in the fruit and vegetable sector) as they have reacted to this.

Traditionally cooperatives were set up to deal with market failure, often providing a basic service for their members at least cost. More recently we have seen POs and cooperatives adapt to the market by investing into assets and capabilities to add value to their members’ production. This leads to a whole different dynamic requiring financial investment, greater management expertise, improved member communication and awareness of membership issues.
Participant discussion particularly focused on a number of questions:

- **Are there differences between coops and POs?**

The data from the industry survey indicated the two main aims of cooperatives/POs were to achieve a better price for members and to provide a service that would otherwise not exist. This posed the question of whether there is any difference between coops and POs and therefore does a PO offer any benefits that cannot already be delivered by cooperatives?

The workshop participants held varying perceptions of the differences between coops and POs – there was a view from some dairy sector participants that the introduction of POs would clarify the position around competition law by allowing collective negotiation by dairy producers who in theory could have, between them, up to a 33 per cent share of the market. Definition of ‘the market’ however would be open to challenge. In comparison it was thought that cooperatives had less clear guidance in this area of potential competition infringements.

Views were also expressed suggesting that…

- POs were concerned with marketing whereas cooperatives increasingly involve processing investment (e.g. in stainless steel) as exemplified by the dairy and grain storage cooperatives;
- POs would generally act as agent rather than principal in product marketing;
- The role of POs is likely to focus on price negotiation whereas coops have a wider role;
- POs may be able to enforce regional standards by imposing rules and conditions on all producers for a designated product from a geographical area.

It was, however, concluded in discussion that whilst the first three points may appear to be valid perceptions from our experiences with the fruit and vegetable PO sector and the milk cooperative sector, participants could identify clear exceptions to each. On the fourth point, regarding wider enforcement of PO standards, Defra attendees clarified that the reform proposals leave discretion in applying this option to the member state which is unlikely to be pursued in the UK.

Overall it was concluded that the differences between a cooperative and a PO were not obvious or material and in reality the proposed new regulation would not bring anything that could not in theory be undertaken already. Furthermore there are no business structure differences; POs have to be registered as a cooperative, either in the form of a Limited Company or an Industrial and Provident Society.

However there may still be benefits from the wider introduction of POs which the participants explored later in the breakout sessions.

- **What are the key ingredients to achieve PO / cooperative success?**

The survey data led to the conclusion that whilst it is difficult to put financial measures on the benefits POs/cooperatives bring (internally and externally), it is the long-term improvement in member returns, member satisfaction and financial sustainability that really matter. There are a number of ingredients that influence the
success of a PO or cooperative, of which management, leadership and member commitment are seen as most crucial.

The workshop participants largely agreed with these findings but emphasised that a focus on the market place was vital with many coops and POs proven in enabling a planned route to market, continuity of supply, and market discipline achieved through farmers collaborating. For example Camgrain’s (a leading co-operative grain storage business) success in its supply agreement with Sainsbury’s is achieved by understanding the needs of its customer and being able to offer all the benefits of exact product quality, reliable service and continuity of supply. The ability to fulfil supplies of quality wheat to the retailer in 2012-13 was an incredible achievement, in one of the worst seasons in history. Farmers operating independently could not do this.

Coops do have to face both ways and achieving member satisfaction and therefore commitment is vital. Considerable communication resource is necessary, particularly as the coop grows, to ensure members remain aligned to the objectives of the coop. High levels of service are a given with the ultimate test being success in the market over a long period.

- Are farmers more willing to join cooperatives / POs?

The survey results suggested that farmers are more likely to join a PO/cooperative now than they were five years ago for a number of reasons, major ones being; farmers need to gain more strength in the market place, POs and coops in the UK are proving they can be successful and collaboration is helping farmers to meet customer demands.

The workshop participants generally concurred with these findings but some important points were added:

a) The new generation of farmers were much more positive, having had less influence of government/EU protection and as a result are developing much greater focus on the marketplace for their return;

b) Attitudes are changing in the retail sector, which wants to find ways of getting closer to its farmer suppliers – working with coops / POs might facilitate this for some;

c) There is a social dimension – farming is becoming an increasing lonely job – the cooperative or PO can provide a social and communication bridge.

- So what are the barriers to joining cooperatives/POs?

There are still acknowledged barriers, the survey indicated that well publicised failures have tarnished the reputation of coops and farmers believe they lose autonomy when they commit to a cooperative. This was emphasised by participants who made a number of points:

a) There has been a collective ‘bad’ experience in dairying with DFB. One milk supply group, which has applied for PO status, see themselves as consciously moving away from being a cooperative, viewing a PO as having a different purpose of purely supply agreement and price negotiation without the need to commit to off farm investment. Furthermore some farmers might take the view that sharing risk is actually increasing the risk on their own business.
b) In contrast to point 1.3b above, there may be a fear factor that processors, manufacturers and retailers will not like the potential shift in the power balance and make life difficult for those who try to form new POs or coops.

c) Some farmers remain fearful of order and external control which might prevent them from taking potential personal advantage. There have been no new POs in the fruit and vegetable sector of recent, possibly due to the fact that large more powerful farm businesses would rather do their own thing.

d) Some farmers see the overhead cost associated with the coop/PO as excessive.

13.4.c What should the role of Government be in supporting collaborative development? (break out group findings)?

This question was targeted at collaboration generally but most of the thinking can be applied to the wider introduction of POs. All the three groups started by stating that Government has a role to act as an enabler but not to seek to ‘buck market forces’. Any initiatives to undertake collaborative ventures must come from farmers.

Having stated this, however, the groups were unanimous in wanting to see certain stimuli, including continuation of capital funding, which had been proven to aid cooperative development by stimulating investment to facilitate added value initiatives. Strong evidence of success exists in fresh produce (processing and packing), cereals (storage and processing) and to a lesser extent in smaller dairies (processing). There was a view expressed that funding should be available to joint venture arrangements in the supply chain (involving investment from both farmers and food companies) which was difficult to achieve in previous grant aid schemes. This would be more likely to result in innovation and added value initiatives embracing and committing more of the supply chain.

One group suggested that a more favourable tax regime could provide an alternative or complimentary method to stimulate off farm investment.

The early stages in establishing a collaborative venture, cooperative or PO can be costly and involve a leap of faith by those involved. Funding to support this stage to include business advice (as is proposed in the dairy PO scheme) would help bridge that uncertain period as farmers get together but may lack the skills, knowledge and organisation to get the initiative off the ground. Indeed, one group was of the view there must be a conditional link between grant aid and the development of skills to avoid some of the failures that have occurred, for instance in the red meat sector, where farmers were simply not up to the job of leading a downstream venture.

A further area in which the groups felt Government support is necessary is around awareness, knowledge and education. There are excellent case studies demonstrating success of collaboration and the industry should promote these to demonstrate where and how benefits can be achieved. Having a knowledge base allows such dissemination, SAOS is supported for this very purpose in Scotland but in England, despite relatively short term initiatives, there has been no long term commitment to provide any extension service. It was also felt that there is no academic focus as is prevalent in many other countries within Europe and around the world. If a University could be encouraged to develop a specialism in agri-food collaboration and cooperation it would lead to better knowledge and understanding for the supply chain as a whole. Such initiatives would ultimately result in better education, both for the decision makers of today and for the next generation.
The final role of Government, where all groups were unanimous, would be to minimise the legislative and administrative burden for any schemes and to speed up the process as a whole. As an example a dairy group has been waiting since March 2013 for its PO application to be progressed. It is important that the PO recognition process for new POs is less onerous that that for the Fruit and Vegetable regime, particularly as it is not proposed to have on-going financial support.

13.4.d What is the impact of collaboration and the potential introduction of POs on agricultural competitiveness? (Sector specific breakout groups)?

Each group was asked to consider, in relation to specific sectors, a number of questions to determine the impact of collaboration on competitiveness, the factors that limit collaboration within that sector and the benefits of introducing POs into the sector. The sectors covered were dairy, red meat and arable (combinable crops and potatoes) and the views below are those of the respective group participants.

<table>
<thead>
<tr>
<th>Dairy</th>
<th>Red meat</th>
<th>Arable (incl. potatoes)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Would more collaboration in the sector drive greater agricultural competitiveness and how?</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Currently limited horizontal (farmer level) production collaboration. Some horizontal collaboration in input buying.</td>
<td>The pig sector has a significant level of horizontal collaboration through the pig marketing cooperatives but farmers have no significant collaborative activity in processing. This is now in the hands of very few large processors, other than niche markets (e.g. specialist sausages or organic). Whilst this downstream structure is unlikely to change there is a strong need for farmer coops to get nearer the market place to improve what they do (their competitiveness) but communication is currently blocked by processors. ‘Greater transparency will lead to greater competitiveness’. There are also supply groups (not cooperatives) linked to processors such as BQP for Waitrose</td>
<td>Collaboration in arable farming is both vertical – to allow the value opportunity e.g. long term supply agreements for grain of a specified quality and; horizontal – often needed to achieve the vertical objectives e.g. volume storage and primary processing. Vertical collaboration can optimise efficiency and reduce waste over the whole chain which is not possible in a pure trading relationship. Failure to address the efficiencies along the whole chain will ultimately result in import substitution. Participants felt that the benefits are greatest where vertical (supply chain) and horizontal (farmer level) collaboration are</td>
</tr>
</tbody>
</table>
It was felt that those farmers that are not marketing through cooperatives or groups are generally large and/or independent minded so the likelihood of further collaboration driving competitiveness is limited.

For the beef and sheep sector the view was that there was a need for a more collaborative approach but producers have always resisted any formal structures to their marketing other than ‘loose’ retailer producer groups.

<table>
<thead>
<tr>
<th>Can you provide good examples of collaboration improving competitiveness?</th>
<th>(Note as opposed to purely strength in price negotiation)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arla Milk Link is now a multinational coop, processing and adding value to members' milk, achieving value returns reflecting considerable off farm investment by farmers.</td>
<td>Within the pig sector there are established marketing cooperatives such as Scotlean and TVC. Some of these provide other services such as input purchasing and technical support.</td>
</tr>
<tr>
<td>Arlagarden (assurance standard) enables product quality / animal welfare assurance. By farmers implementing the production standards Arla can create products in the knowledge that raw material is safe / meets expected standards.</td>
<td>The BQP supply group for Tulip outdoor bred pork for Waitrose offers a committed route to market to give producers confidence to increase pigs reared, coupled with group performance benchmarking.</td>
</tr>
<tr>
<td>First Milk – is undertaking added value processing. First Milk also offers input buying through Anglia Farmers.</td>
<td>Tesco is attempting to develop a direct supply group with the purpose of increasing producer confidence through more assured returns, which will hopefully in turn lead to committed supply and growth in production.</td>
</tr>
<tr>
<td>Other retail pooling groups achieve coordination of combined in a particular chain, with a discipline, efficiency and scale created at production level.</td>
<td>Collaboration can take different forms and the centre of power / influence will dictate where value is captured i.e. at the farmer end or with others further down the chain.</td>
</tr>
<tr>
<td>The group were strongly of the view that there was scope at both levels for greater collaboration – for example central grain storage accounts for less than 10% of the total and cooperative marketing less than 25%. Horizontal collaboration on farm (field operations) has demonstrated significant cost savings and whilst increasing in popularity will still account for a small proportion of production.</td>
<td>Very good cereal cooperative examples include Camgrain. In comparison a strong non coop example is the Molson Coors Group of malting barley producers which is successful but driven by the brewer.</td>
</tr>
<tr>
<td>Grower led organisations in potatoes include Wholecrop Marketing, a company owned by farmers but with a cooperative ethos.</td>
<td>In the PepsiCo group, growers are more vertically aligned in supply.</td>
</tr>
</tbody>
</table>
supply and assured markets (e.g. OMSCo, DCD) and as such assist competitiveness by reducing marketing risk which leads to confidence to increase on farm investment and production. (They also exist for negotiation purposes).

levels.

For beef and sheep the examples are very limited. There are producer groups linked to abattoirs such as ABP but limited real commitment or collaboration.

Blade (part of ABP) is not a coop but provides a range of forward price contracts for quality beef and would argue that it collaborates with its suppliers.

management for crisping potatoes.

In comparison a more ‘hybrid’ example is McCain which is instrumental in encouraging grower groups for supply management but also for the purpose of achieving production efficiency through horizontal collaboration

| Why do farmers / growers not collaborate more than they do in your sector? | Farm level (horizontal) collaboration is very limited; contract farming / JVs are rare due to lack of proven commercial templates and difficulty in sharing capital investment (e.g. dairy parlour facilities / infrastructure). Some labour sharing and ‘arable’ operations e.g. silage making do take place. The Dairy sector has an uncomfortable history with a notable failure (DFB) and low prices in comparison to direct supply contracts with commercial processors. Collaboration is restrained by milk buyers, preferring to form groups under their control (e.g. Muller Wiseman) | Overall the pig sector is fairly collaboratively minded in its marketing. Pig producers that do not market through coops are usually of a significant scale to be dealt with directly by an abattoir or processor. Abattoirs and processors tend to act as a block to further downstream collaboration. Beef and sheep producers think in a different way! They are generally independent and not collaboratively minded. They have a range of routes to market and will consider these at the time of selling, reluctant to enter into long term committed contracts for risk of missing the best prices somewhere else. The whole chain tends to be dominated by a short term trading mentality which is unlikely to change. | Arable farmers may have a strong loyalty to commercial buyers – and are happy to stick with those relationships, often moving if the buyer moves. Cereals are dictated by a world market so very much a traded commodity without Government intervention. Many farmers are of the view that the market dictates so collaborative marketing can offer little benefit. Producers may also be ignorant of the value being lost, particularly as this can be difficult to determine with the complexities of crop type, quality, time of sale etc. Potato growers in particular have confidence in the few key players such as Greenvale, Branston and McCain and see less need for cooperative marketing |
## Should Government actively encourage the introduction of POs in this sector and why?

<table>
<thead>
<tr>
<th>Should Government actively encourage the introduction of POs in this sector and why?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>As earlier Government should ‘enable’ rather than encourage collaboration generally by providing information and guidance.</strong> However there developed a view during discussion that the UK industry risked losing out if it did not develop its PO sector – for instance it is conceivable in the future that potential opportunities and benefits might be offered to those with a PO structure e.g. grant schemes. The group participants became in favour of more proactive support. A Government funded extension service to pump prime activity would help (could this be a role for DairyCo?). The Dairy Fund will go some way towards this when operational.</td>
</tr>
<tr>
<td><strong>This sector would improve its competitiveness through greater collaboration; pig industry through dissemination of information and beef / sheep by improved coordination of production.</strong> However it is felt that progress particularly for the beef and sheep industry will be difficult and slow. Some participants thought that whilst processors might be against the creation of POs, retailers may be more supportive, seeing it as a means of achieving more alignment amongst producers and hence supply continuity, whilst also providing traceability and shorter supply chains. Some more enlightened producers, particularly those that identify a specific market opportunity may see the creation of a PO as offering benefits. It is desirable for this sector to have the opportunity for PO creation.</td>
</tr>
<tr>
<td><strong>Whilst it is not clear that POs can achieve any more than a cooperative, there was a feeling within the group that the introduction of POs to this sector could stimulate more collaborative activity, possibly leading to more formalisation of some of the loose supply group arrangements.</strong> Whilst it is difficult to predict uptake of POs in this sector the group considered it very important that farmers were made aware and had the opportunity. [Like the dairy group] the participants became in favour of more proactive support, likewise conceiving that potential opportunities and benefits might be offered to those with a PO structure e.g. grant schemes or would at least strengthen an application under a future RDPE scheme.</td>
</tr>
</tbody>
</table>
13.4.e Workshop Conclusions – summary views of participants

The participants concluded that the differences between a cooperative and a PO were not obvious or material and in reality the proposed new regulation would not bring anything that could not in theory be undertaken already. However there may still be benefits from the wider introduction of POs which the participants explored later in the breakout sessions.

The survey identified a number of ingredients that influence the success of a PO or cooperative; of which management, leadership and member commitment are seen as most crucial. The workshop participants largely agreed with these findings but emphasised that a market focus was vital. Effective marketing cooperatives are proven to enable a planned route to market, continuity of supply, and market discipline.

The workshop participants generally agreed that farmers are more willing to join cooperatives now than five years ago, also feeling that the new generation of farmers, without the historic baggage of government/EU protection, are more positive towards cooperation and collaboration. Barriers still exist around the reputation of coops and their performance; coupled with a fear of loss of independence for some.

Government has a role to facilitate though not necessarily encourage collaboration. The drivers to collaborate must come from farmers and the industry. However grant support for infrastructure investment is seen as very important with long lasting benefits. General awareness raising and the provision of information and knowledge are important and new ventures should be supported in the early stages of formation with advice and skills development. Minimising the administrative burden in establishing new POs must be a priority.

Sector breakout sessions concluded that more collaboration will assist competitiveness, both at a horizontal (farmer) level and at vertical (supply chain) level. This is evidenced by the achievements of many good collaborative ventures both formal and informal. Indeed, for the cereal sector a failure to collaborate and address the efficiencies along the whole chain would risk import substitution of grain and manufactured products.

There are a number of reasons why farmers choose not to collaborate. Independence and a trading mentality for some still remain a key preference and driver. Within the beef and sheep sector in particular, farmers take a short view and are often reluctant to enter into long term commitments for risk of missing the best prices somewhere else. Likewise a significant proportion of cereal farmers will prefer to trade grain, rather than market it to specific customers. They are also confident in the relationships they have with trading businesses and personnel. For dairy producers it is not an issue of short term trading; they remain cautious given cooperative’ past failures, low prices and the requirement to invest off farm. Therefore the preference for many is to sell direct to a processor on a contractual basis.

When drawing an overall conclusion, the participants agreed that Government should actively encourage the introduction of POs to other sectors. This may appear a contradiction to the earlier point ‘Government has a role to facilitate though not necessarily encourage collaboration.’ Underlying this is the conclusion of the participants that collaboration does increase competitiveness and a view that a formal PO scheme may stimulate more collaborative activity, particularly in the arable and milk sectors. Some of the loose ‘group’ marketing arrangements might
over time become more formalised which could ultimately become beneficial, rather than a threat to others in the supply chain.

There was also a perceived risk that if farmers are not made aware of the opportunity or the UK remains outside the scheme the industry could be disadvantaged. It is conceivable that potential opportunities and benefits might be offered to those with a PO structure and such opportunities could be missed if the UK does not have the right structures to take advantage.