Support for Farmers' Cooperatives

European Commission

1 The issue and the project

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

First, to provide a comprehensive description of the current level of development of cooperatives in the European Union. This description pays special attention to the following drivers and constraints for the development of cooperatives:

- Economic and fiscal incentives or disincentives and other public support measures at regional and national levels;
- Legal aspects, including those related to competition law and tax law;
- Historical, cultural and sociologically relevant aspects;
- The relationship between cooperatives and the other actors of the food chain;
- Internal governance of the cooperatives.

Second, to identify laws and regulations that enable or constrain cooperative development.
Third, to identify specific support measures and initiatives which have proved to be effective and efficient for promoting cooperatives and other forms of producer organisations in the agricultural sector in the European Union.

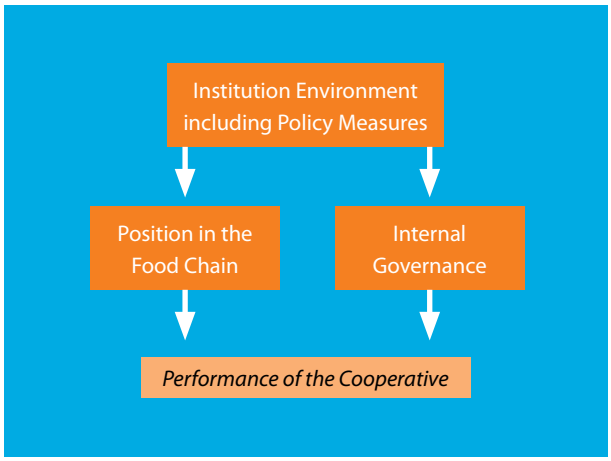
The study was carried out by a European research consortium (see back page) during 2011 and 2012. Data gathered in all 27 Member States have been presented and analysed in individual country reports, and in eight sector reports, focusing on the role of cooperatives in each of these sectors. At the EU level a number of analyses have been performed, studying aspects such as the institutional environment, internal governance, and the position of cooperatives in food supply chains (see Figure 1). In addition, 33 cases studies have been carried out, and the situation in selected non-EU OECD countries has been investigated. These background reports on countries, sectors and cases, as well as the EU-wide analysis, provide farmers, cooperatives and policy makers with useful insights into the market orientation and organisation as cooperatives and producer organisations.

There are at least three main factors that determine the success of cooperatives in food chains. These factors relate to (a) the position in the food supply chain, (b) internal governance, and (c) the institutional environment. The position of cooperatives in the food supply chain refers to the competitiveness of cooperatives in relation to their partners, such as processors, wholesalers and retailers, as well as to the strategies that the cooperatives follow.

Internal governance refers to the decision-making processes adopted, the role of the different governing bodies, and the allocation of control rights to members and professional management (and the associated agency problems). Further, the internal governance refers to issues such as the organisational structure of the cooperative enterprise (e.g. the formation of holding and daughter companies).

The institutional environment refers to the social, cultural, political and legal context in which cooperatives operate, and which may have a supporting or constraining effect on the cooperatives' performance. History is an important ingredient of the institutional environment. Positive past experiences of cooperative development usually result in the generation of social capital, necessary for efficient operation of the cooperative and in forming new cooperatives. Legal aspects of the institutional environment, such as taxation and competition laws, are also crucial in fostering or deterring cooperative development.

Figure 1: Core concepts in the approach



2 The role and types of cooperatives

In this SFC study we follow what Dunn (1988) has called "the three basic cooperative principles":

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

These are simple and flexible principles, still encompassing a latitude of practices such as open or defined membership and one vote per member or proportional voting. There are many organisations that follow cooperative principles in their structure and operations but are not cooperatives as defined by national cooperative legislation. The group of cooperatives in this study generally includes producer organisations, as these are economic organisations of agricultural producers with characteristics similar to those of cooperatives. A common definition is the following: a producer organisation is a rural business, owned and controlled by producers, and engaged in collective marketing activities. Often the legal form is not a cooperative and it does not necessarily own the products that it markets.

Farmers' cooperatives play an important role in helping farmers to capture a higher share of the value added in the food supply chain in all Member States. Cooperatives create markets or give farmers better market access and improve overall efficiency. The different motives for cooperation have led to many types of cooperatives (Table 1).

The role of cooperatives is changing. Marketing cooperatives are nowadays operating in tightly coordinated food chains. Their main functions are now to realise countervailing power, economies of scale, a reduction of transaction costs, pooling market risks and product or marketing innovation. The focus on innovation leads to quality control systems and support to members as well as to the need for more marketing expertise in boards and management. Some cooperatives have become international or transnational cooperatives. Cooperatives also obtain hybrid organisational structures and give more room for managerial entrepreneurship. In order to attract additional equity capital, cooperatives change their ownership structures. They also have or will have a more product-based and less region-based member representation.

1 Dunn, 1988, "Basic cooperative Principles and their Relationship to Selected Practices." Journal of Agricultural Corporation, 3:83-93.

Table 1: Motives for farmers to cooperate

Motives	Examples
Countervailing power	Bargaining association
Economies of scale	Processing cooperative (including second-tier cooperatives)
Sharing of risk	Marketing cooperative with pool
Reduction of transaction costs	Cooperative auction
Access to resources	Credit cooperative
Access to markets	Marketing cooperative (including second-tier cooperatives)
Product innovation/quality control	Niche cooperative

As a result of these developments, in a number of cases cooperatives have adopted hybrid organisational structures, converted into IOFs (investors-owned firms), or operate their foreign subsidiaries as IOFs. Conversions from an IOF to a cooperative status hardly exist, but there are several examples of IOFs divesting and an existing or new cooperative taking over these operations.

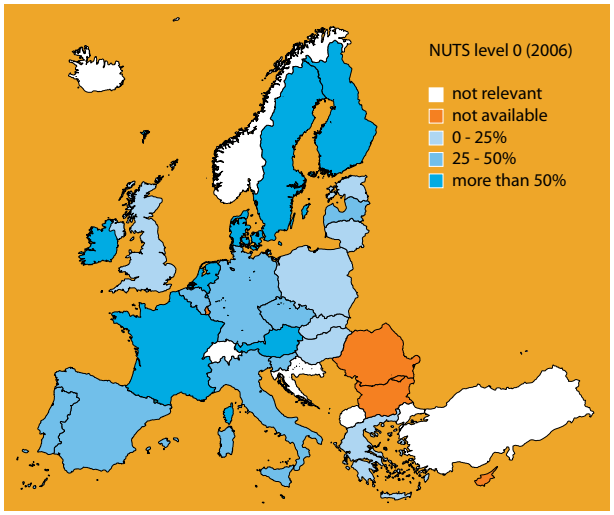
Farmers have also used their farmers' organisations to form various hybrid business entities which adopt organisational structures similar to those of IOFs. These hybrids are not user-controlled, but wholly or majority owned by farmers' organisations.

It should be realised that cooperatives do not always represent the optimal organisational form in a food chain; the choice between cooperatives and IOFs is not a dogmatic but a practical one. It depends, among other things, on product and market characteristics, technology, social aspects and human capital.

3 Cooperatives in Member States and Sectors

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

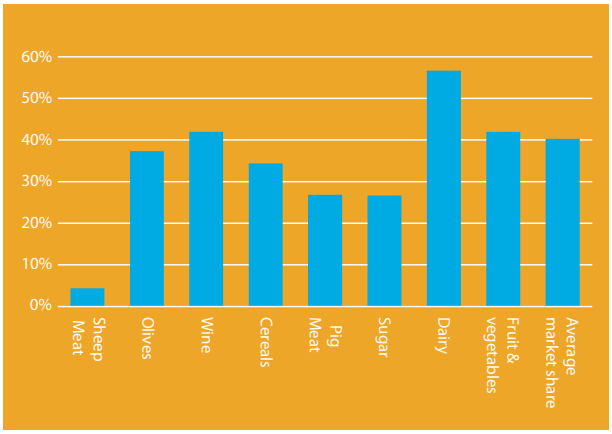
Figure 2: Share (%) of farmers' produce marketed through cooperatives, 2010



The map shows the relative importance of cooperatives in all Member States, based on the "SFC Cooperative Index": the estimated market share of all cooperatives at farm gate sales level, weighted for eight sectors. Farm gate sales handled by a foreign IOF owned by an international or transnational cooperative have not been included, nor have been hybrids.

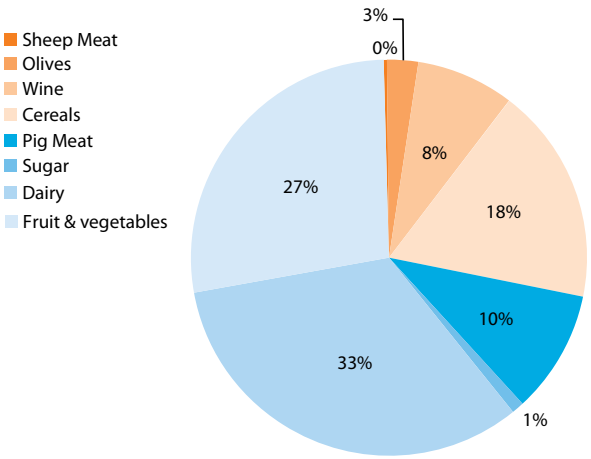
The map shows that there are large differences between Member States. Cooperatives have a high market share in countries like Denmark and Finland, but much lower shares in countries like Estonia or Spain. For the UK, Romania, Bulgaria, Luxembourg and Cyprus data are sketchy or not available. The average market share of all agricultural cooperatives in the EU is 40% (see Figure 3).

Figure 3: Market share of cooperatives in the EU per sector, 2010



The market share of cooperatives is high in some sectors but low in others. This is mainly due to the characteristics of the product and the production process. In the dairy and fruit & vegetables sectors, cooperatives have an important market share due to product perishability (and consequently high transaction costs of trading these products). In sectors like cattle, pigs and sheep, the animals are often sold under contracts to traders or non-cooperative slaughterhouses, but several cooperatives and hybrids have substantial market shares in these sectors, too. Given also the importance of the dairy and fruit & vegetable sectors in Europe, this implies that these two sectors dominate the value of products marketed by cooperatives (see Figure 4).

Figure 4: Share of different types of products in the total produce marketed by cooperatives in the EU, 2010



4 Internal governance

Farmers have many options to organise the internal governance of their cooperative. There is a wealth of quite different cooperative organisational models. Internal governance is about the allocation of decision rights among the various stakeholders in the cooperatives, such as members, directors and management. Who may decide on the strategies and policies to be adopted by the cooperatives? While a cooperative has a democratic decision-making structure, giving each member at least one vote, in practice, particularly in large cooperatives, an individual member has very little influence. Members have delegated decision-rights to a Board of Directors (BoD), which is the primary body to decide on the strategy and policies of the cooperative. In most countries cooperatives have a board of supervisors that has the formal task of control over the BoD, on behalf of the General Assembly.

A further element in the internal governance is that in most cooperatives the actual management of the cooperative firm is left to professional managers. Boards can consist of either only members or members and outside experts.

Another internal governance issue relates to the formal separation between the cooperative as an association and the cooperative as a firm. In several countries a legal separation is quite common, which has the advantage of reducing liability and giving the professional managers more room for entrepreneurship. But it can make member control over the cooperative firm more complicated.

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

As regards professionalisation, also proper remuneration of managers is important. Managerial compensation is very diverse and often related to the size of the cooperative. Small cooperatives seem to have trouble attracting professional management.

In many cooperatives there is room for strengthening management and supervision capacities, in short: further professionalisation. Most national laws provide sufficient flexibility for cooperatives to choose an internal governance model that fits the strategy of the cooperative, although such flexibility may not always be accompanied with the often much-needed guidance. In some countries cooperatives and national legislators need to pay more attention to the ability of farmer-members to monitor effectively both the board of directors and professional management (e.g., by using supervisory boards or realising professionalisation with non-member experts in boards, where appropriate).

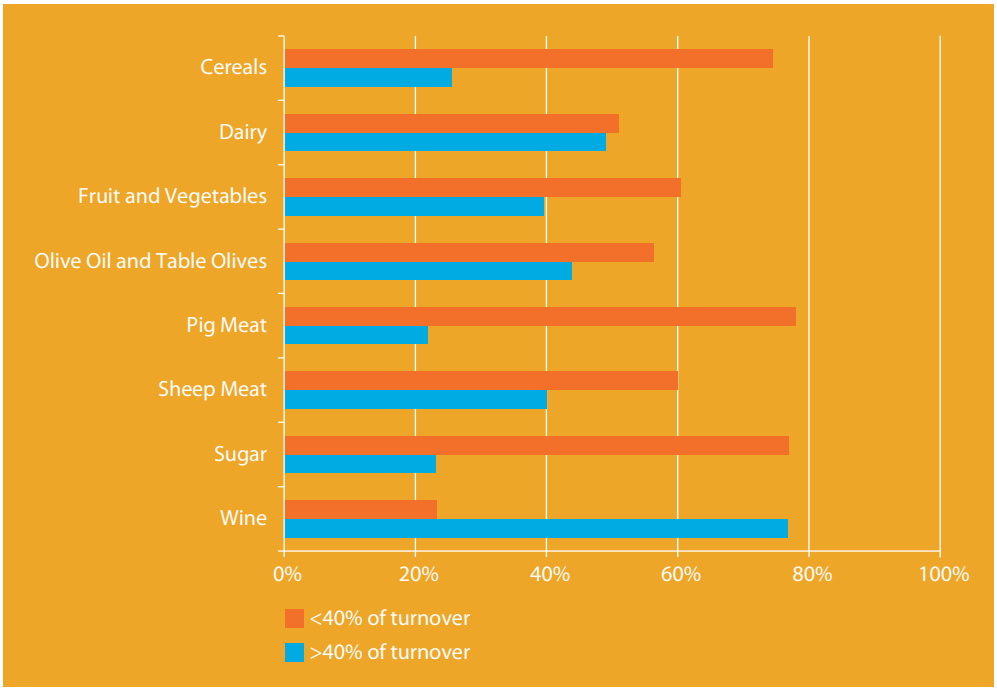
5 Position in the food chain

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

Unlike marketing cooperatives, bargaining associations do not own assets and, usually, do not assume ownership of their members' produce at any stage of production or marketing. These associations are mainly active in the dairy and fruit & vegetable sector. In Germany, producer associations are also active in selling cattle and pigs on behalf of the members.

Cooperatives are important for reducing market risks for farmers, notably the risk of receiving payment for the deliveries. The capitalisation of cooperatives is a major constraint in some regions, where risk capital and other forms of equity are not readily available or cooperatives fail to provide their members with adequate incentives. However, capitalisation is not the only or even the main barrier to cooperative development and often the business model - or the lack of a profitable one - is a much more binding constraint.

Figure 5: Percentage of cooperatives per sector that has a low (<40%) or high (>40%) percentage of its turnover in branded products, 2011



In agrifood supply chains, which are generally characterised by bargaining imbalances between farmers and their upstream and downstream partners, cooperatives can, and in many cases do, play a key role in strengthening bargaining power and thus obtaining a better price for members' products. However, the countervailing power of cooperatives is limited, as even the largest transnational cooperatives are relatively small compared with their retail customers (or suppliers of farm inputs), and do not have any real market power. The need for further building of countervailing power will most likely lead to more international mergers among cooperatives.

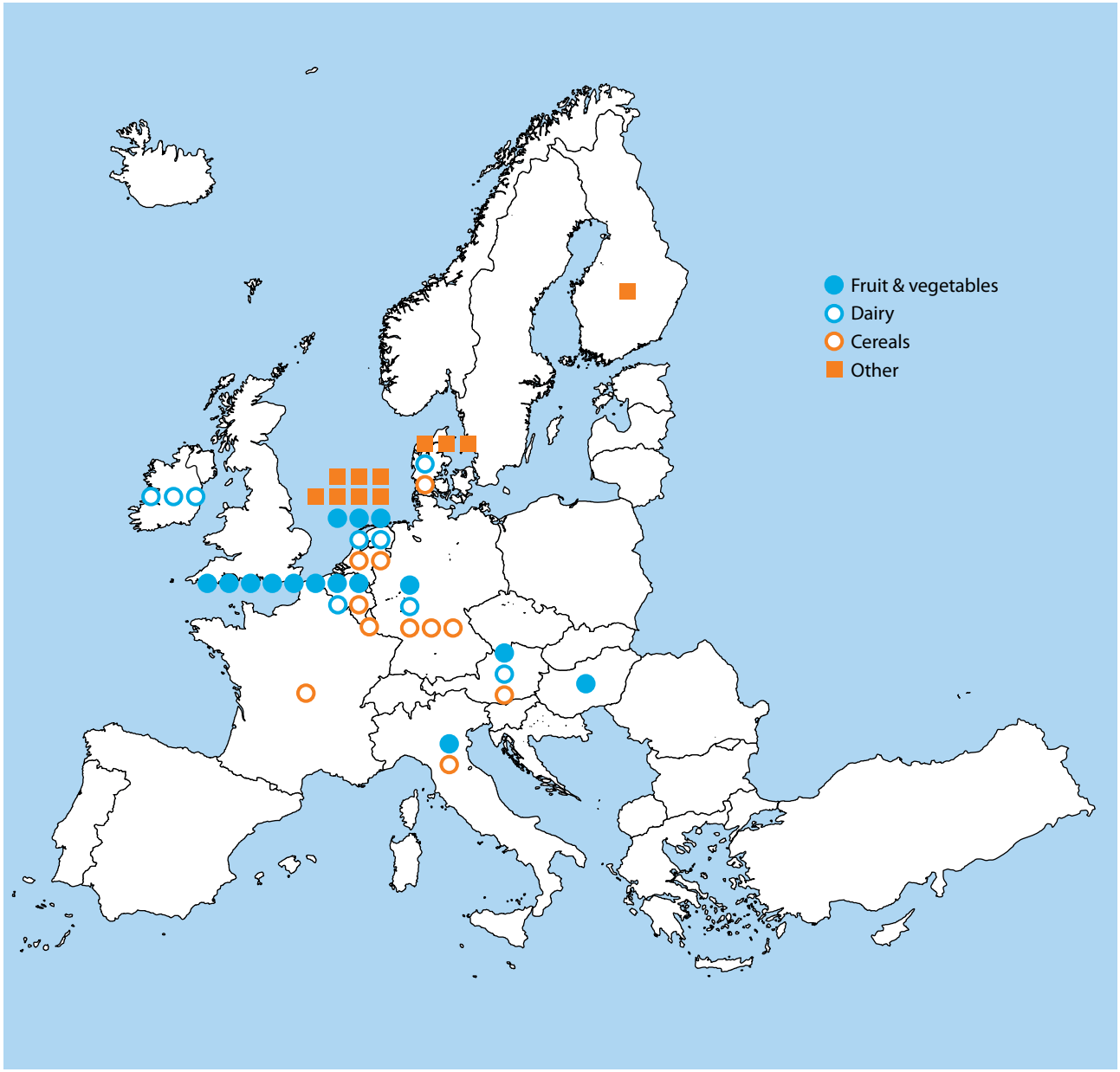
To support farmers in this trend, legal definitions of producer organisations and support measures should not discriminate against large cooperatives. The disadvantage of this (international) growth process, however, is a potential loss of member control, especially if cooperatives increasingly mimic IOFs in choosing their organisational structures.

We found that a large market share for cooperatives in a region can increase the price level and reduce volatility, as is currently the case in the dairy sector. Moving from a cooperative market share in dairy below 20% to a share of 20-50% increases the milk price by roughly 4.5 to about 6 euros - a relative increase of more than 15%. Farmers who deliver to an IOF benefit from this effect, although they tend to receive an even higher price as the cooperative farmers, as IOF, often specialising in niche products like baby food, can and has to compensate them for the risk of moving out.

6 Transnationals

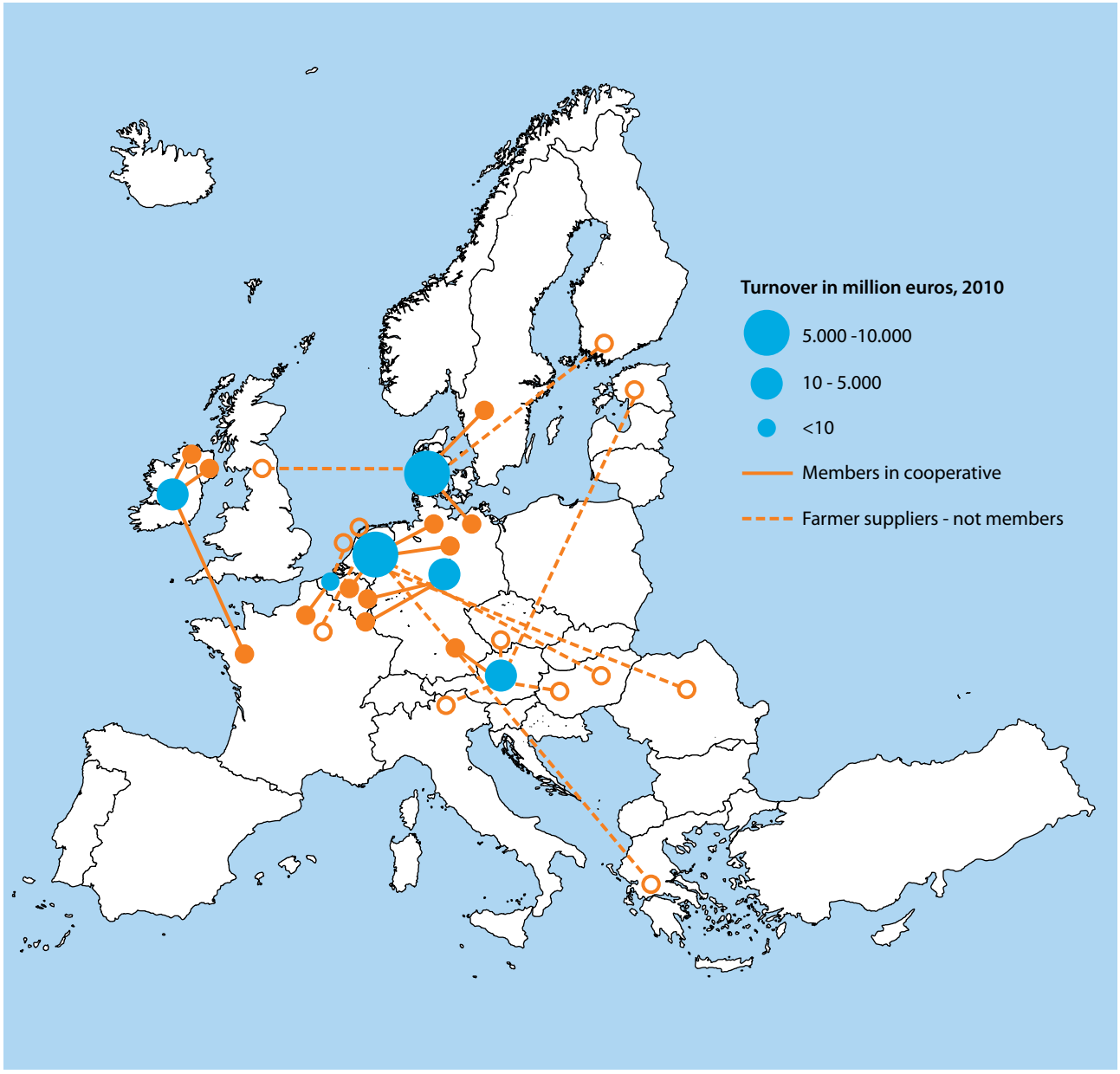
We found 46 transnational cooperatives (i.e., cooperatives with members in more than one Member State). They can be found mainly in the dairy and fruit & vegetables sectors in northwest Europe. They often have foreign subsidiaries that source from non-member suppliers, like the 45 international cooperatives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

Figure 6: Transnationals by sector and mother country

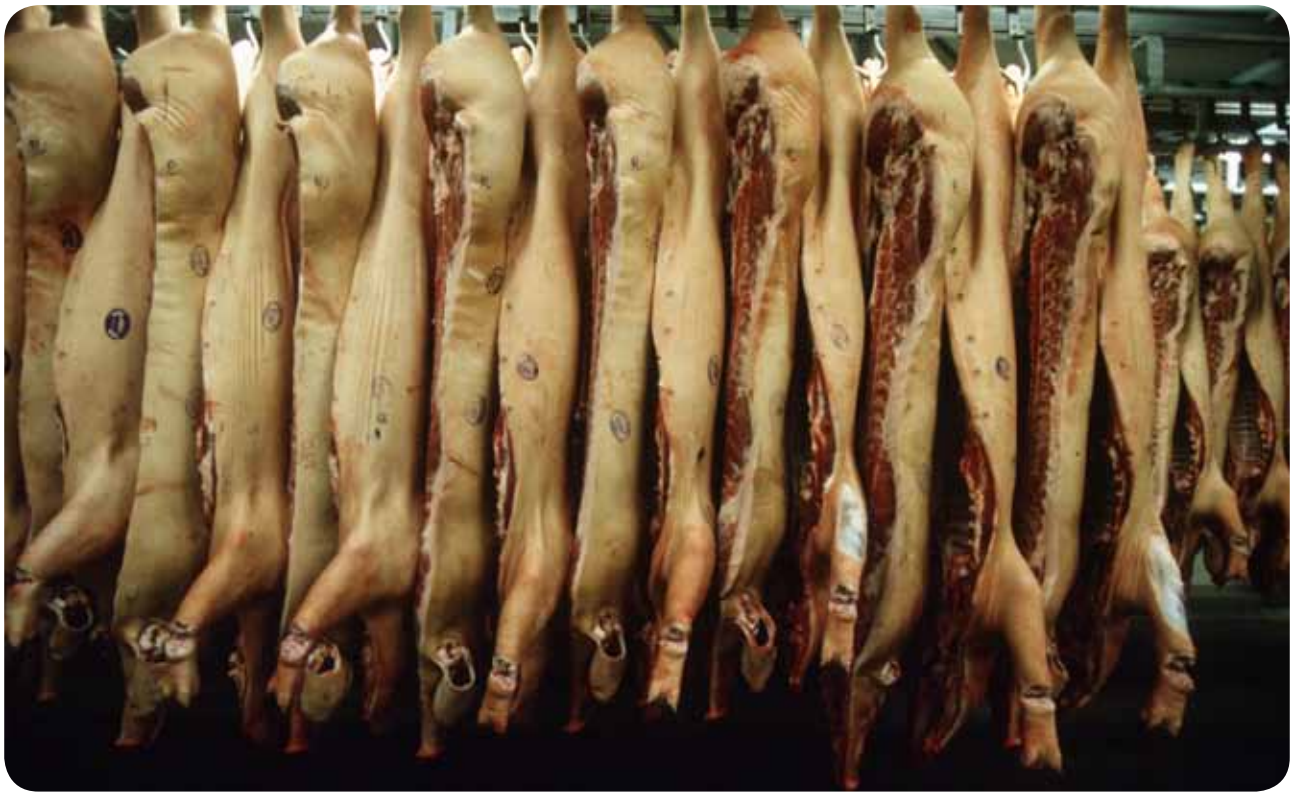


Farmers from two or more Member States could also establish a European Cooperative Society (SCE), but currently no SCE exists in agriculture.

Figure 7: Transnationals in the dairy sector



7 Cooperatives in the new Member States



The marginal role played by cooperatives in some countries (and especially in the Member States which joined the EU on 1 May 2004 or thereafter) has an important social background. The low level of self-organisation and networking is not only a barrier to cooperative development but represents a persisting societal characteristic.

The situation in the former socialist Member States is diverse and contrasting due to differences in historical backgrounds, pre-collectivisation land reforms, post-collectivisation transformation laws, cooperative traditions and collective memories, policy streams and social and cultural contexts. However, all cases have in common that the impact of the communist legacy persists, as lacking trust is an obstacle to cooperative development. Convincing members by building trust, coping with fundamental collective action problems, often in poor regions with vulnerable rural societies, reflects pioneer activities that resemble early stages of the cooperative movement in Western Europe. This is in the first place the task of trustworthy and skilful leaderships. Yet, leaders with such characteristics seem to be the scarcest resource and their absence represents a real obstacle to further cooperative development.

Several of our case studies reveal that cooperatives improve market efficiency in several ways: they challenge monopolistic markets and powerful international conglomerates in Poland and Hungary, deal with difficult access to the dairy market (including the organic market) and milk processing in Lithuania, provide market access to smallholders in Slovakia and Bulgaria, enter the farm and energy supply markets in East Germany, establish links to the land and labour markets both in Bulgaria and East Germany, and so on.

8 Rural development

Cooperatives are more likely to be set up in remote areas facing market access challenges (e.g., long distance transport to the market) and information asymmetry (dependence on traders for price information). Markets can and do fail in such regions. Cooperatives support income and employment in areas where rural development is a policy issue.

Cooperatives in remote areas are often important employers. In many cases the activities of these cooperatives go hand in hand with support for pursuing public objectives such as the development of human capital and environmental protection. Cooperatives promote and lobby for public programmes, including subsidies that favour the region. Further, in sharp contrast to their IOF counterparts, agricultural cooperatives are tied to a particular region because the farmers who own, control and are benefitted from the cooperative are also tied to the region through ownership of land.

In some cases cooperatives build their business strategy even on regional characteristics and social processes (resulting in, e.g., regional or fair-trade types of products and services). PDO and PDG-types of products and links with incoming tourism can be part of such a strategy. However, in the end, all cooperatives are business oriented. They are instruments of farmers to enhance their income, which can partly come from state support.

Cooperatives are economic organisations, and activities that do not fit in their business models are eventually not taken up or are discontinued. Like IOFs inside and outside agriculture, many cooperatives perform activities that are inspired by their corporate social responsibility policy. It is also clear that in some regions the cooperative is not only an important element in the life of the farming and rural community, but also an important social "place" to meet, to learn and socialise. However, it should not be expected that cooperatives pursue rural development as their primary objective. Also in the new Member States the cooperative is now, in this respect, business oriented and totally different from the situation under socialist rule. We came across one important exception: in some regions in Bulgaria public authority functions are carried out by agricultural production cooperatives and indirectly financed by the State, due to weak local government.

9 Legislation and support measures

Although most Member States do not actively promote the cooperative as a legal business form, the cooperative is commonly used in the EU and appears to be the "natural" legal form for agricultural producers to organise their joint business activities. In several East European countries the limited liability company is the dominant legal entity in which agricultural producers organised themselves. The cost of setting up as well as maintaining a cooperative does not seem to hamper the formation of cooperatives.

The way cooperatives are treated by the tax authorities seems to facilitate their growth. Cooperatives are treated as an extension of members' farms. Consequently, surpluses - money earned from selling members' products - return to members in cash or held in individual accounts by the cooperative are taxed only at the farm level (single taxation principle). Profits - i.e., money earned from selling non-members' products - are taxed at the cooperative level and, if distributed to the member, also at the farm level. In some countries, even cooperatives' profits are not taxed if they are kept in special reserves (e.g., for investments in R&D or education). Such provisions are particularly helpful for new and growing cooperatives.

With regard to domestic merger legislation, all Member States have legal provisions for cooperatives to merge with other cooperatives. The provisions for cross-border mergers between cooperatives remain fragmented. The SCE Regulation, the EU's legal statute for the European Cooperative Society, provides the necessary facilities for cross-border mergers, but the SCE is not used in practice by agricultural cooperatives. Transnational and international cooperatives maintain their internal governance structure based on national cooperative laws.
In total, more than 300 European, national and regional policy measures were identified. Cooperative legislation, competition rules, inducements (money transfers) and financial incentives were among those observed most often. There are considerable differences between Member States, in terms of policy measures adopted. There are no clearly established links between the current support measures for farmers' cooperatives and the market share of these organisations. Also in other OECD countries there is a lot of diversity in the level of support measures, and no unambiguous relationship between support measures and cooperative performance has been found

Cooperatives particularly benefit from a flexible cooperative law, single taxation, and clearly defined competition rules. In some sectors producer organisations and cooperatives benefit from the CAP and some of its reforms. But there is no clear conclusion as to which support measures have additional value. Nevertheless, we argue that governments at national and EU levels, recognising that cooperatives are essentially a form of self-organisation, have a role to play in capacity building and technical assistance, especially in supporting small and start-up cooperatives. This is even more true for the former socialist economies, where self-organisation is hampered by a lack of social and human capital. Subsidies for producer organisations should support such capacity building.

10 Competition issues

Cooperatives are not exempted from competition law. From a competition law point of view, the cooperative form seems irrelevant. As a result, the specific characteristics of cooperatives are not taken into account when applying competition rules.

The EU Court of Justice, has clearly recognised in several occasions the pro-competitive effect of cooperatives and has established that the prohibition principle (Article 101(1) TFEU) does not apply to agreements that contribute to the improvement of the competitive conditions of the markets. However, the interpretation of what constitutes competitive conditions of the markets differs substantially between farmers, who feel exploited by large retail customers, and competition authorities, who seem to be mainly concerned about consumer benefit.

Cooperatives and producer organisations perceive legal uncertainty in competition law and report high costs due to burden of proof. In the fruit and vegetable sector there seem to be conflicting policy objectives between the Common Market Organisation (bundling) and competition law. Some other OECD countries (e.g., the USA) have more exemptions for cooperatives – albeit under strict conditions – from competition law to rebalance market power. Such exemptions can be used to create more balance in the food chain (as a next best option to challenge market power of retail). Exemptions could be given under certain conditions (like level of membership influence and exit options) to ensure that farmers' interests prevail if there is a concern that cooperatives mimic IOFs too much.

At least in theory the upward pricing potential of cooperatives is rather low (although rulings should be made on a case-to-case basis with publication of rulings to build up case law). Not only do they play an important role in situations where markets do not work well - in addition to cases where they realise efficiency of scale or lower transaction costs and prevent a double mark-up - but they also take over the positions of IOFs that quit the market because the profitability is too low. As farmers have different marginal costs and, due to technological change, often have overcapacity in labour and fixed assets, cooperatives often have a strategy of cost reduction and bulk commodity production and are open to new members. They seldom restrict production of members over longer periods. This all has the effect that they tend to realise prices that equal long-term average costs.

11 Operational recommendations

Because this study is first of all a fact-finding investigation into the state of agricultural cooperatives in the imbalanced food supply chains and into relevant policy support measures, we will not provide detailed recommendations for farmers, cooperatives and policy makers. We do, however, address a number of issues for the agendas of the stakeholders that follow from our analysis.

Farmers interested in starting a producer organisation, bargaining association or cooperative are advised to pay sufficient attention to the issues of leadership and human capital. It requires social, economic and organisational skills and resources, and sufficient time and capacity for building the organisation. Once the organisation is established, members and directors are advised to pay sufficient attention to professionalisation. This includes developing and updating a good strategy with a business model that generates added value. It also applies to internal governance.
Professional associations of cooperatives could help their members, especially the smaller ones, by providing access to knowledge and best practices for professionalisation, especially in an international context, making use of support measures where available.

Regional and national governments responsible for cooperative legislation could use this study as well as recent special studies on the legal aspects of cooperatives to evaluate current legislation. Cooperatives are on the radar of competition authorities, and this will intensify with more mergers to come. Authorities could work on the reduction of legal uncertainty and judicial costs in competition law.

Agricultural cooperatives and producer organisations show positive externalities and produce public or semi-public goods. These merit the attention of policy makers and can be a basis for designing support measures. Besides enabling cooperative laws, supportive tax or single tax legislation, clear and fair competition rules, and additional policy support should focus on human capital building among members, directors and managers of cooperatives, but also among legislators and administrators dealing with agriculture and the food chain.

The Common Agricultural Policy, recognising the important role of agricultural cooperatives for the rural EU, has been supportive in several ways. The Common Market Organisation of particular agricultural products has been crucial in enabling a more efficient coordination of the respective supply chains, such as in fruit & vegetables and dairy. It is important that the national and especially the European institutions keep learning and adjusting their policy instruments. FEADER funds have been instrumental in agricultural cooperatives' attempt to build and expand their processing and distribution capacities. However, FEADER funds are only available for small and medium-sized firms, which entails a disincentive for mergers among small cooperatives into larger units.

Although many scholars emphasise that cooperatives, being based on self-organisation, should develop independently, our findings reveal that there is a strong role for a facilitating state to help farmers develop organisational skills, particularly in the New Member States. Notably young farmers as potential future board members in small and large cooperatives could benefit. Transnational and international cooperatives could be involved in cross-border human capital building programmes. Although they are not seeking to expand their membership beyond the national borders, in the long run they could benefit from well-functioning bargaining associations in their host countries to optimise the supply chain. In some regions also banks and policy makers as well as the agricultural education system could benefit from more know-how on cooperatives. Extension or advisory services and research could play a role too in such a programme for facilitating capacity building and technical assistance. Current European policies like the CAP 2nd Pillar, the proposed so-called Operational Groups in the European Innovation Partnership facility of the new CAP and other EU support measures seem to be close enough to incorporating these suggestions.

For **future studies** it would be helpful if more data on cooperatives are available. Many aspects of the food chain in general and cooperatives in particular are not well covered in statistics. For conducting further in-depth research on the interaction between cooperative performance and policies, a reliable database on agricultural cooperatives in the 27 Member States should be set up.

The 2011-2012 project "Support for Farmers' Cooperatives" has been commissioned and funded by the European Commission, DG Agriculture and Rural Development.

Contract Number
30-CE-0395921/00-42.

For the end report, visit
http://ec.europa.eu/agriculture/external-studies/index_en.htm

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

Other members of the consortium are
- Pellervo Economic Research PTT, Finland: Perttu Pyykkönen
- University of Helsinki, Finland: Petri Ollila
- Agricultural Economics Research Institute, Greece: Constantine Iliopoulos
- Justus Liebig University Giessen, Germany: Rainer Kühl
- Humboldt University Berlin, Germany: Konrad Hagedorn, Markus Hanisch and Renate Judis
- HIVA Katholieke Universiteit Leuven, Belgium: Caroline Gijselinckx
- Rotterdam School of Management, Erasmus University, the Netherlands: George Hendrikse and Tony Hak

Disclaimer
This study, financed by the European Commission, was carried out by a consortium under the management of LEI Wageningen UR. The conclusions and recommendations presented in this report are the sole responsibility of the research consortium and do not necessarily reflect the opinion of the Commission or anticipate its future policies.

The text of this publication is for information purposes only and is not legally binding.

© Photos: Marcel Bekken and Hollandse Hoogte.