Are Farmers in the Transitional Economies Likely to Benefit from Forming Collaborative Marketing Groups?

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Abstract

Trade liberalization has opened up the food market in many transitional economies. This has created an opportunity for smallholder farmers to access higher-value markets, but it has also exposed them to competition from trading partners. Key issues in linking smallholder producers to higher-value markets are overcoming the diseconomies of size, poor infrastructure, lack of market signals for quality, high transaction costs, and the poor quality associated with traditional supply chains. A common suggestion made by many development workers and politicians to overcome these problems is to encourage farmers to form collaborative marketing groups. Furthermore, there is a common misperception that market intermediaries are taking advantage of the farmers and are the primary cause of poor farm-gate prices. Some schemes which aim to help smallholder producers access higher prices (e.g., Fairtrade) insist that farmers be part of a cooperative that delivers the product to market. Unfortunately, there is abundant evidence from the experience of smallholder farmers in the transitional economies that collaborative marketing groups are seldom competitive in either the traditional market or the emerging market. This paper will look at the question of if and under what conditions smallholder farmers in the transitional economies are likely to benefit from forming collaborative marketing groups. It will use evidence from the literature and the author's experiences in researching the success of marketing groups in the Philippines and Papua New Guinea. The main finding is that most are doomed to fail unless key prerequisites exist: a comparative advantage for the group and a sufficient level of social capital and trust in the community. A lack of social capital and trust in PNG and the Philippines means that collaborative structures need to incorporate mechanisms that prevail over this problem.

Keywords: comparative advantage; cooperative; institutional structure; social capital; trust

Abbreviations:

CMG - collaborative marketing groups
IOF - investor-owned firm
NGO - nongovernment organization
PNG - Papua New Guinea

Introduction

In a review of the role of collaborative marketing groups (CMG) in developing countries, Murray-Prior (2007, p. 7) concluded that two factors were critical to the successful establishment of a CMG: "a comparative advantage . . . generally arising from a market failure; and a reasonable level of trust amongst the members of the community seeking to establish the CMG." In this paper, these issues are discussed with particular reference to the Philippines and Papua New Guinea using evidence from the literature and the author's experience with groups in these countries.

Murray-Prior (2007, p. 2) defines a CMG as "a group of farmers who have organized to collectively market their produce." This definition includes structures such as cooperatives, growers associations, cluster marketing groups, and bargaining cooperatives. The reason for the broader definition beyond the normal focus on cooperatives is that, in many cases, less-formally organized structures enable farmers to overcome some of the deficiencies of cooperative structures, particularly as they are legislated in some countries.

Recent multilateral trade agreements through the activities of the World Trade Organization and bilateral free trade agreements have opened up the food markets in many transitional economies. In theory, this has created the potential for smallholder farmers in these economies to access higher-value markets, but it has also exposed the smallholder farmers to competition from their trading partners in two main forms: higher quality and lower price. Shifts in consumer preferences and technological and institutional developments have accentuated the problems for smallholder farmers with the increase in value chains dominated by large international retailers. These chains deliver a large range of products and require vertical coordination (Kirsten and Sartorius, 2002) to provide traceability and quality assurance (Brennan, 2004).

To overcome these problems, many development agencies and experts encourage collective or collaborative efforts by smallholders to enable them to compete in these markets (Manalili and Ellson, 2003; Shigetomi, 2006). However, CMGs have a history of failure in many transitional economies.

Key issues in linking smallholder producers to value chains are overcoming the diseconomies of size, poor infrastructure, lack of market signals for quality, high transaction costs, and poor quality associated with traditional supply chains (Murray-Prior, 2007). Two key issues which make it more difficult for smallholder farmers to achieve market share in high-value chains are the characteristics of small farmers themselves (e.g., poverty, illiteracy, low status, and power) and their external environment (e.g., poor transport infrastructure and poor access to inputs, credit, and information). Smallholder farmers cannot compete in these markets on their own. Therefore, they must collaborate, but their characteristics and external environment make it more difficult for them to collaborate successfully.

In discussing the question of if and under what conditions smallholder farmers in the Philippines and PNG are likely to benefit from forming collaborative marketing groups, this paper will draw heavily on the review by Murray-Prior (2007). It will summarize the discussion on the following: reasons for the formation of CMGs, reasons for the success and failure of CMGs in the transitional economies, and its implications for the conditions under which small farmers might benefit from establishing a CMG. Additional information will be introduced with particular relevance to PNG and the Philippines.

Reasons for the Formation of CMGs

The most recognized form of CMG is the cooperative, which is derived from the Rochdale cooperative of 1844 that was established to buy cheaper food. The International Cooperative Alliance (1995) outlines seven principles that define a cooperative and differentiate it from an investor-owned firm (IOF): voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training, and information; cooperation among cooperatives; and concern for community.

The key difference that distinguishes CMGs from IOFs is that members have two roles in CMGs: as patrons and as investors (Nilsson, 2001). Historically, CMGs have been formed for three main reasons: to increase bargaining power (a defensive reason), in response to government policy, and as an entrepreneurial activity (an offensive reason).

Increase bargaining power—defensive reasons

Farmers have established many successful cooperatives to protect themselves from situations of market power when faced with monopoly sellers or monopsony buyers (Murray-Prior, 2007). In the case of downstream processing, an additional factor has been the opportunity to take advantage of the economic rents associated with scope and size economies. It is important however to distinguish genuine monopoly or monopsony market power situations from the widespread perceptions in transitional economies that market intermediaries are the cause of low prices (Lele, 1981; Milford, 2004; Murray-Prior, 2007). The reality is often quite different, with low prices being due to other causes such as poor infrastructure, law and order issues, and a lack of enforceable legal contracts, which make it difficult to develop marketing arrangements that reward quality (Murray-Prior et al., 2009).

While cooperatives have a long history in the Philippines (Sibal, n.d.) and take many forms, they have a high failure rate. However, it is interesting to note that three of the top four cooperatives in Region IV of the Philippines selected by Castillo et al. (2003) have feed milling as their main line of business. While it is not clear whether they were established initially to compete with a monopoly seller, they are definitely in an industry that has considerable economies of size. In PNG, smallholder coffee farmers are often encouraged to get into owning and managing wet and dry processing mills (CIC, 2002). However, while there are economies of size inherent in these mills, in most cases, there are other mills available and competition is fierce, so market failure is generally not present.

Response to government policy

In many developed and developing countries, governments have promoted cooperatives, either through legislating legal and taxation advantages or as an element of government development policy (Nilsson, 2001; Milford, 2004). In the Philippines, there has been a long history of government promotion and initiation of cooperatives for development and political reasons (Sibal, n.d.; Briones, 2003). These reasons have included improving agricultural development, distributing subsidized inputs and credit, and the pacification of revolutionary activities. There is general agreement that most cooperatives formed for these reasons have not been sustainable.

In PNG, their history has been shorter, but colonial and independent governments have promoted their use. Colonial governments promoted both cooperatives and Rural Progress Societies, with the latter seen as forerunners to Cooperative Societies (Goldbold, 2006). Cooperatives were established throughout PNG in the 1970s and 1980s, but most have failed (Gustafsson, 2002) and very few remain today. More recently, the Coffee Industry Corporation adopted an eight-point plan, one point being "to promote and coordinate grower-owned systems of marketing" (CIC, 2002, p. 5). However, in practice there has been little government support for cooperatives.

Entrepreneurial cooperatives—offensive reasons

Entrepreneurial cooperatives have emerged following the development of new structures for cooperatives (such as New Generation cooperatives) arising from the work of New Institutional economists and their critiques of traditional cooperative forms (Cook and Plunkett, 2006). In these forms, the investor role receives much greater emphasis and the objective is to create structures that make them more efficient than IOFs. Most of these cooperatives occur in the developed world, particularly in the USA, but these structures have not been widely adopted in the transitional economies. They generally occur in processing industries and require high levels of management and capital, which make them generally unsuitable for smallholder farmers in transitional economies.

Reasons for Success and Failure of CMGs in Transitional Economies

The cooperative sector in the Philippines is substantial, with around 60,000 registered cooperatives in 2001, of which approximately 55% were multipurpose agricultural cooperatives and around 1% were marketing cooperatives (Briones, 2003). However, over 40% of these were nonoperational or dissolved and only around 3% submitted annual financial reports required under law (Briones, 2003; Castillo et al., 2003). No recent statistics were obtained on the number and status of cooperatives in PNG, but some authors (Gustafsson, 2002; Goldbold, 2006) and anecdotal evidence suggest that there are very few successful cooperatives remaining.

Apart from situations where there is a comparative advantage for cooperatives because of market failure problems, Murray-Prior (2007) identifies several other success factors. In the case of milk marketing cooperatives, access to market opportunities, a clear marketing strategy, a competitive advantage, and matching supply to demand were important (Raju, 2004). Certification schemes such as Fairtrade offer some advantages to small farmers, but they do not guarantee success and they still rely on a cooperative that has genuine commitment and participation of its members (Pirotte, Pleyers, and Poncelet, 2006), along with the usual factors such as good management. While outside support also seems to contribute to success in many smallholder cooperatives, it is not sufficient (Holloway et al., 2000; Raju, 2004; Gonzales and Nigh, 2005; Murray-Prior, 2007), and sustainability is a problem once the support organization withdraws (Shigetomi, 2006).

Government support can be beneficial, but in many cases, it becomes more of a hindrance because the group becomes dependent on government and is subject to political interference and often corrupt and incompetent management (Milford, 2004; Gonzales and Nigh, 2005; Pirotte, Pleyers, and Poncelet, 2006). The situation in the Philippines seems to mirror that in other developing countries (Sibal, n.d.; Castillo et al., 2003). When a cooperative is formed in response to a government initiative, it tends to collapse once this support is removed.

According to Murray-Prior (2007), key factors associated with the success of CMGs are social factors such as the level of trust and social capital in the community. The level of trust within the community and between the CMG members and its managers and leaders has a positive effect on performance. This relates to social homogeneity within the community, with higher levels leading to lower transaction costs and an increased advantage over alternative structures for selling their produce. The size of the group is also negatively related to the level of trust and social homogeneity.

Social capital and trust in the Philippines

Both the literature (Sibal, n.d.; Briones, 2003; Castillo et al., 2003) and anecdotal evidence from the Philippines of high failure rates in cooperatives, often due to corruption, incompetence, and mismanagement, corroborate the contention of low levels of trust between CMG members and their leaders and managers. Observations of cooperatives in the Kapatagan area support this notion; for example, one cooperative experienced trouble when the manager was away and the second in command absconded with the cooperative's funds. However, while it is not clear whether trust is the foundation of social capital or the process of generating social capital improves levels of trust (Fox and Gershman, 2000), there is some evidence that the Philippines has lower levels of social capital than Thailand (Shigetomi, 2006). This latter study of microfinance organizations in Thailand and the Philippines found that Thailand had savings groups with an average of 80 members, whereas the Philippines requires much smaller numbers for success. The Grameen Bank model of a five-member group was found to be suitable. Shigetomi (p. 14) attributes this to the more individualistic and unorganized nature of Philippine communities where "social ties among rural people depend more on dyadic relationships rather than the affiliation to collectively formed groups" and the communal spirit is weak.

An additional problem in the Philippines is the political and economic power structures that dominate the rural landscape (Lara and Morales, 1990). The exercise of power by a rural oligarchy through patron-client relationships, backed up by the military, police, and paramilitary forces, limits the ability of the numerically larger rural poor to exercise electoral and economic influence. Consequently, small farmers may have difficulty organizing collaborative marketing groups because of interventions by the rural elite who feels threatened by such developments (Briones, 2003).

Social capital and trust in PNG

Levels of social capital and trust in PNG may also be low, although no direct comparison has been made or found with the Philippines. PNG has over 850 separate languages with some scholars claiming there are more than 10,000 microsocieties (Reilly and Phillpot, 2002). Particularly in the highlands, which are characterized by a highly dissected landscape, there exist the most fluid, aggressive, and competitive microsocieties, who engage in intermittent class warfare. The clans are horizontally structured, because the "big men" achieve status through competition rather than inheritance, with thousands of house lines, clans, and tribal groupings competing with one another for resources and public goods. Each group attempts to monopolize access to resources leading to the absence of beneficial horizontal social relations.

Reilly and Phillpot (2002) related the number of social groupings to measures of social capital and found a high negative correlation and a consequent negative correlation with the level of provincial development. They hypothesized that this same heterogeneity negatively affected the development of norms of trust, cooperation, and reciprocity. Cooter (1991) suggests that kinsmen do not feel bound by bad decisions of "big men," which may have negative effects on social cohesion. He further suggests that clan organizations have little in common with Western concepts of cooperative or corporate forms of organization.

Table 1 provides some insight into the relationships within the farm communities associated with various types of coffee chains in PNG. It suggests that the communities have some problems with social cohesion and trust. Only one-third believe that the members of their community can be trusted, while less than one-quarter strongly believe that their views will be considered or that people make a fair contribution to community activities. On the positive side, most people have confidence in the village leadership.

Table 1. Measures of social capital for coffee farmers in PNG highlands (n = 117)

Question	Strongly disagree	Neither agree nor disagree	Strongly agree
People in my village or community can be trusted	33%	66%	1%
People in my community are likely to steal cherry from my trees	0%	44%	56%
People who do not participate in village or community activities will be criticized or fined	59%	32%	9%
Views of local people are taken into account before important village or community decisions	27%	72%	1%
I have confidence in the local community leadership to manage conflict in the community	77%	22%	1%
People in my village or community make a fair contribution to communal activities	19%	80%	1%

Source: Survey of farmers carried out as part of ACIAR project ASEM-2003-053 in the Eastern Highlands, Simbu, and Western Highlands provinces of PNG in 2006.

The combination of this evidence and that on problems with cooperatives in the coffee industry and elsewhere suggest that CMGs are likely to struggle with trust issues in PNG.

Implications for the formation of CMGs in PNG and the Philippines

The objective of this paper is to address the question of "if and under what conditions smallholder farmers in the Philippines and Papua New Guinea are likely to benefit from forming collaborative marketing groups." The specific evidence for PNG and the Philippines is consistent with the contention by Murray-Prior (2007) that two factors are necessary for the successful establishment of CMGs: a comparative advantage and a reasonable level of trust. CMG structures in these countries will need to address these two factors effectively if they are to increase their chances of success.

In both countries, when CMGs attempt to compete in competitive market places, they are generally unsuccessful. For instance, CMGs who try to compete in the Philippines with middlemen supplying the wet market struggle because they are unlikely to be as efficient in an environment of poor infrastructure and related constraints. Similarly, in PNG, CMGs are unlikely to be competitive in supplying the traditional Y-grade coffee market. In both instances, the markets are competitive, and CMGs will need to be able to deliver advantages that are superior to existing marketing arrangements if they are to be successful.

Similarly, the evidence is that both countries do not have high levels of social capital and trust, which are essential for the effective and efficient operation of CMGs. This limits the size of CMGs that are likely to be successful. On the one hand, CMGs can be an advantage in trade and processing if there are economies of size and market failure in the delivery of these services. On the other, a large CMG will be likely to have governance and cooperation problems when its members are smallholder farmers who lack the literacy, numeracy, and management skills to govern a complex organization. In this case, it is likely to fail or be captured by elites who have these skills and who will direct the CMG towards their own interests.

The converse is that small CMGs may be successful in marketing their members' products provided the group's size and composition coincides with existing traditional social structures that can maintain social control. In PNG and the Philippines, this would appear to be small because of the lack of strong horizontal relationships in the community. In PNG, this may correspond with "house lines," while in the Philippines, around five members as in the Grameen Bank model. The problem is that a small group may be able to meet the needs of a small niche market, but will not be able to achieve economies of size or to participate in many of the institutional markets without joining other groups.

There are two possible solutions which appear to reduce this problem. One approach is the Normin Veggies model where small vegetable farmers sell their produce through a CMG, which, for a fee, facilitates the contracts but does not take possession of the product. This not only reduces the working capital requirement of the organization but also reduces the chance for corruption because they do not handle the money. However, most Normin farmers are commercial operators and have higher levels of literacy and management expertise than traditional semi-subsistence farmers.

The second approach is for a larger organization such as an NGO or a commercial company to link the small groups, supervise, and support the overarching organization. Catholic Relief Services in Maragusan is fulfilling this role with clusters of vegetable farmers. Similarly, Coffee Connections is supporting a number of Fairtrade and Organic cooperatives in PNG. The problem with this solution is that the overarching collaborative marketing organization would most likely collapse or decline significantly without the support of the NGO or commercial organization. In this case, finding a solution that overcomes the need for continued support from an outside organization is the key to resolving this issue, but this is not easy.

It appears to be as true in PNG and the Philippines as it is elsewhere in the developing world that state-sponsored cooperatives, which are set up as part of government development policy or to deliver input subsidies, will survive only as long as they receive government support. Furthermore, they are inherently susceptible to corruption and mismanagement. NGO-supported organizations will have the same problem of sustainability unless the NGO can build human and social capital through a truly participatory approach. This will not be a short-term problem. Shigetomi (2006, p. 3) says "such projects malfunction after the outside agencies retreat from the project site, suggesting that 'making organizations' is not the same as 'making a system of making organizations.' The latter is essential to make rural organizations self-reliant and sustainable."

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