POLICY BRIEF N°.4

RESOLVING THE CHALLENGES OF COLLECTIVE MARKETING

INCENTIVE STRUCTURES THAT REDUCE THE TENSIONS BETWEEN MEMBERS AND THEIR GROUP

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Collective marketing and competition

Smallholder farmers are -by definition- scattered and, therefore, generally there is a need to bulk their produce in order to access urban markets or the processing industry. Bulking can be done through different modalities and by different type of actors, like middle-men and traders, processing companies, state marketing boards or collective marketing arrangements. This bulking has a strong logistic component and a need for working capital (trade finance), and requires a cost-efficient way of organisation and control of transactions.

Supporting collective marketing arrangements

The present research wants to improve the capacities of collective marketing arrangements, like cooperatives, producer associations, village enterprises, etc. to resolve the challenges of collective marketing in face of competition. It want to document strategies and practices that organisation have developed in time and that have been effective in empowering smallholders in markets.

Best practice solutions to common problems in different contexts

Successful collective marketing experiences have been 'build' organisational assets that make their life easier. They regularly fine-tune their internal management and transaction modalities with members and non-members e.g. related with pricing, payments, and quantity or quality requirements. The research will focus on these internal rules, contract conditions and control systems that have developed in transactions with farmers and clients and that have proven effective and feasible in prevailing market conditions. As these 'solutions' will always be somewhat context specific (e.g. different according to the product, the support of institutions, the scale of the organization, etc.), we present a comparative framework that helps to find solutions or lessons learnt around the same type of challenge.

Challenging the tensions that tend to break organisations

There are several 'basic tensions' (or, *agency dilemmas*) that characterize collective marketing. All organisations will be affected by some of these tensions, though they will not necessarily feel them as problematic. Typically, a farmers' organisations will only become aware of them when in situations of change or crisis, when decisions have to be made to resolve problems. to prevent damage, to mediate conflicts, or alike, that forces to re-define internal regulations.

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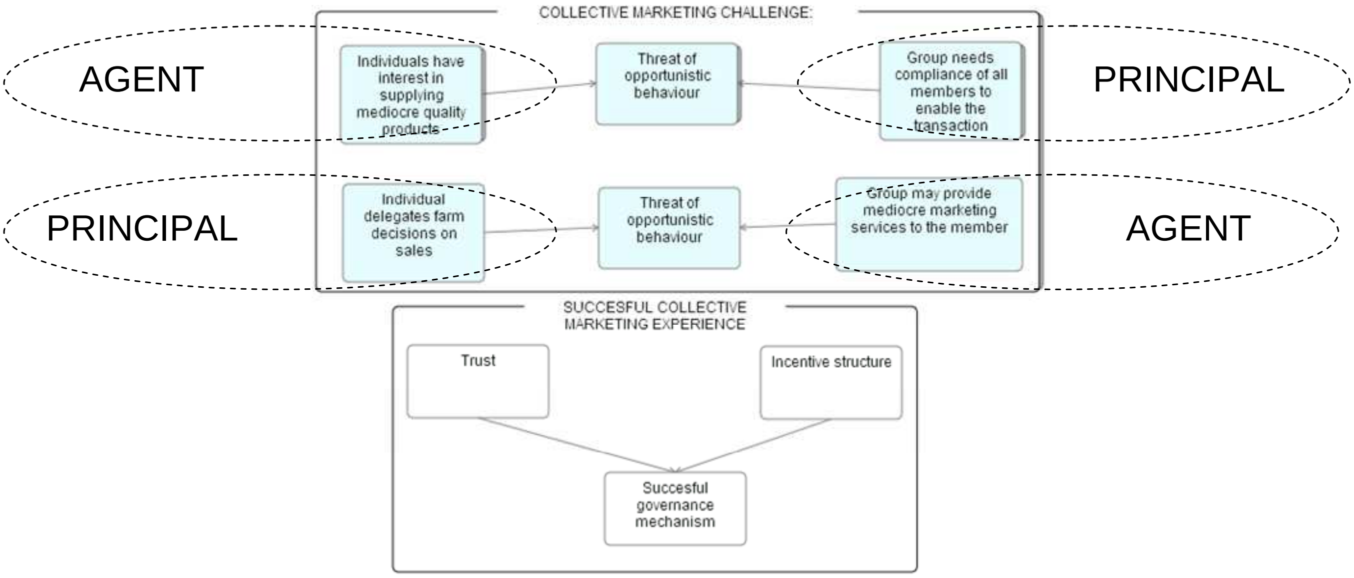
By organizing the experiences of organisations in defining the internal 'rules of the game' (or *institutional arrangements*), according to the type of tension, we facilitate that the users can find relevant lessons learnt on the tension that, at that point of time, is most relevant to them. By double-clicking on the experience that seem interesting to them, more detailed information will appear, with the reference to the document or source that presents the experience.

Anticipating risks of opportunistic behaviour

In theoretical literature, most of these tensions are termed "agency dilemma's", where 'principals' want 'agents' to do something without having full control on the agents' performance.

Organisations deal with the member from different positions. The members want the organisation to do some things for them (e.g. selling their produce for a good price), and need to have some assurance that the organisation does this well. The organization wants the member to do something (e.g. provide good quality products) and, in these situations, a workable 'middle-way' has to be found to make the deal acceptable both for the member and for the organisation.



Trust and incentive structures

This middle-way will involve two components that together make a successful governance mechanism: trust between the members and the organisation on the issue at hand, and incentives have been defined. These incentives are often economic, e.g. price levels defined for specific qualities, but generally also involve other things that need to be 'agreed upon' between members and collective marketing arrangement, e.g. quality control procedures, grading and package requirements, weight standards, etc.

Solutions to collective action problems

The following lists ten areas where the tensions between members and the organisation tend to be located, and for which organisations have found (often quite innovative) solutions that may inspire other organisations to implement similar solutions in their specific conditions. The web-site presents real life experiences and gives examples of ways that economic farmers' organisations have found to resolve these tensions. The web-site has a search function to distil experiences according to context, like the commodity, the geographical location and the membership characteristics.

‘Regulating Member Supply’

Collective marketing organizations usually uphold the principle of unrestricted procurement of members’ produce. Whatever volume of product at acceptable standards will be marketed for the members. And, as long as the market for produce can absorb the volumes supplied by members, there is no problem when one member supplies more produce than another. The situation becomes different when the market for the specific produce is saturated, processing capacity is exceeded, or sales are constrained, e.g. in cases where there are periods of overproduction in a bulk commodity market. In these cases, tensions can emerge when individual members increase their supply to the marketing organization, and, doing so, negatively affect the possibilities of other members to supply. Quotas systems are common solution to this situation. And, especially when this context prevails over a longer period, there is a need to develop systems to adjust or trade these delivery rights between members an generations.

‘Quality Assurance Systems’

In collective marketing, the group functions as an intermediary between buyers and members. In economic transactions with buyers, the organisations will define terms of trade based on certain qualities and quantities it can offer. When the deal is made, the quality that the organisations has promised will have to be controlled for. This is a source of tensions: individual members may tend to deposit lower quality and the organisations needs a system to maintain minimum quality requirements. The organisation will have to use grades, standards, logistic procedures and (internal) control systems that are cost-efficient, both for farmers and the organisation, and transparent enough for the procuring party (trader, exporter, etc.).

‘Coping with Working Capital Constraints’

Many smallholder farmers, especially in developing countries, tend to face cash constraints; they need money to cover expenses and they generally have limited or no access to credit lines. Therefore, they will ask for fast payment, while the organisations need time to finish transactions with the ultimate buyer. And, especially in case of processing, exporting or supplying governments, the period organisations have to wait for payment used to be several months. For the organisation it would be far better to pay its members only after all the financial transactions with buyers had finished. What’s a fair deal; how have organisations resolved this tension?

‘Anticipating Side-Selling”

Farmers need inputs to enable production, and they need production to enable the collective marketing endeavour. In absence of alternative sources of credit, the cooperative might establish a credit service or advance payment system to resolve this problem. However, immediately they will be facing the risk of opportunistic behaviour of the member; there is a serious risk that farmers “side-sell” their product to competing traders or processors, to which they have no repayment obligation. Most organisations, therefore, have developed mechanisms to prevent side-selling or ways toe recover the costs incurred in providing these services to the farmers.

‘Ways to Dispose of Profits

When the organisation makes profit, the organisation will tend to invest or increase capital reserves, while the member will have a tendency to prefer more short-term benefits, e.g. better prices. In most countries there are three options available for allocation of profits in collective marketing arrangements: topping up the price paid to the member, paying out the surplus a kind of dividend, or adding the surplus to the organization’s capital reserves. The allocation decision is usually made during the Annual General Meeting (AGM) of the organization. To prevent hot and lengthy debates on this issue, many organisations have developed routines to distribute gains and losses of the organisation. The following will provide insights into particular arrangements, developed by organisations to facilitate decision making on these three allocation options.

‘Free-riding on Member Investments’

Most economic organisations need contributions form members to realize their business opportunities or start-up service provisioning. However, members face a number of disincentives to do so. The most common one, especially in developing countries, is the free-riding. This occurs when benefits which flow from investment, accrue to investors and non-investors alike. For instance non-members of the collective organization may benefit from the services provided as a result of the investment, e.g. price information from a marketing information system, or increased marketing opportunities as a result of a lobby of the organisation to open up government procurement. This room for free-riding discourages investment from members, and explains the tendency to look for external funding of investments instead of internal funding by members. The dependency of external sources of investment (donors, development banks, etc.) a major constraint for dynamic collective entrepreneurship.

These tensions occur especially in organizations with open membership policies. Limited entry fees combined with easy exit options create room for non-loyal members to have the same level of access to the benefits of the collective organization, as loyal

members. Resolving these tensions requires introduction of membership policies or incentive systems that differentiates between member and non-members in access t services and benefits of the collective action.

‘Different Risk Preferences and Time Horizons’

Often there is a divergence between the members’ preferences for investment, and the preferences of the collective organization’s management. This divergence may occur when the type of investment is so commodity or region specific that it is not likely to benefit all members Investment decisions that seem economically optimal from the perspective of the management are not necessarily desirable from the standpoint of (sub-groups of) members.

Similar problems occur when members differ in the preferred time-span in which to redeem their investment. Some members that are at the end of their business cycle would be less willing to make long term investment commitments, than members that are just starting. And, in a context of smallholder agriculture in developing countries, where households make a living by multiple income generating activities, often including off-farm employment, there is a context of easy ‘exit’ and where investments that have a return on investment in the future, are constrained by the decision making power of members that feel that the investment may not be in their individual interest.

Organizations that are successful in seizing business opportunities by timely investments will have found ways to cope with these constraints. Often, the dead-lock on investment decisions is broken by recurring to bundles of incentives that compensate for these disincentives.

‘Supervision of Professional Staff’

The characteristics of member-based organisations prescribe that member are elected to supervise and support the management. However, the limited technical knowledge of board members and the lack of transparency of information disclosed by the management often limits the effectiveness of this governing structure. A successful organisation will necessarily combine two elements needed to manage this inherent tension between staff and board: mutual trust and loyalty, and clear rules and incentives

Some organisations have found a solution to the ‘lay-board-members-problem’, by specifying minimum criteria for board members, like a threshold educational level or training, or they complement the board with external professional expertise. Also, the reporting requirements to the board also tend to evolve, often with a tendency of the board to delegate decision making on details to the management, together with a more transparent way of monitoring, presenting and explaining the main economic indicators by the professional staff.

‘Individual Liability for Group Actions”

Other companies often feel uncomfortable when contracting member-based organisations. They want clear responsibilities in case of breach of contract, default on payment, etc., and are afraid that the organisation try to avoid their contractual responsibility. This issue is especially manifest in case of bank loans. In some countries, the financial institutions ask for additional securities. In South America, board members often have to put part of their personal belongings as collateral for the group loan. This limits their economic activities as an individual. In other countries, like most European countries, different legal formats are available that differ in the financial liability of individual members for losses of the group. There is an inherent tension between members that want to limit their liability for group actions and the need of the group as a whole to generate as much collateral as possible when negotiating loan rates with banks or conditions with buyers. In response to these external demands, organisations use to define and refine the regulations on liability of individual members, board and management, and specify procedures for decision making when the board is contracting on behalf of the group.

‘Managing Political Aspirations’

Especially in developing countries, where rural needs are high and political parties are often unstable, economic farmers’ organisations tend to take up a broader representative role next to their economic service provisioning to members. Even when members support a political role for their organisation, there use to be a tension because the members delegate their political voice to the organisation while the representative of the organisation can never fully discuss all political decisions with them. This tension creates the need to define rules in the organisation on the extent to which leaders or staff can participate in (party) politics. Especially in and after election periods, the draw-back of explicit political action on the organisation can be quite big.