FARMER ORGANISATIONS FOR MARKET ACCESS:

BRIEFING PAPER:

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1 Introduction
This paper draws on a range of theoretical approaches relevant to farmer organisations and on international experience with farmer organisations to identify critical issues affecting farmer organisations’ formation, management, activities, and success. The paper has been written as an initial output of the research and networking project “Farmer organisations for market access”1 to provide a summary of the main theoretical and empirical literature on farmer organisations, as a base from which to develop research and networking on farmer organisations’ roles and activities in Malawi. Subsequent activities will involve first reviewing these issues in the context of historical and current experience with farmer organisations in Malawi, and then, taking account of that review, the development of research and networking activities to promote more effective and, where appropriate, wider activity by farmer organisations in promoting farmers’ interests in improving market access and in meeting other objectives.

2 Farmer organisations: what are they and what do they do?
Farmer organisations (FOs) take many different forms, varying in both size (of membership) and the services they provide. According to the definition used by the International Federation of Agricultural Producers (IFAP 1992, p.4) farmer organisations include any of the following:

- farmer groups and pre-cooperatives2
- farmers’ associations, federations and unions
- agricultural cooperatives owned and controlled by their members
- chambers of agriculture having a general assembly elected by farmers

Most definitions of an FO stress the importance of membership, with the function of an FO being to provide services to its members: access to these services is the key incentive for becoming a member. An important distinction is therefore made between FOs and NGOs (non-governmental organisations), the latter may also provide

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1 This project is financed by the Crop Post Harvest Research Programme of the Natural Resources Research Programme of the UK Department of International Development. It commenced activities in January 2003, and is managed by a coalition consisting of Imperial College London, Agricultural Policy Research Unit (APRU, Bunda College, University of Malawi), National Smallholder Farmers Association of Malawi (NASFAM), CARE Malawi, and the Malawi Rural Finance Company (MRFC). See www.wye.imperial.ac.uk/AgEcon/ADU/research/projects/farmorg.

2 Pre-cooperatives are usually informal associations that are not formally registered as cooperatives but which may be in the process of becoming cooperatives. In some countries pre-cooperatives are officially registered as “pre-cooperatives”.
services to rural producers, but they are not membership organisations. (Collion and Rondot 2001). Collion and Rondot also distinguish between FOs (RPOs) and traditional organisations with FOs having a formally defined membership and generally existing to organise members’ relations with the outside world. Traditional organisations, by contrast, tend to be more concerned with the task of managing relations amongst the de facto members of the organisation (such as a kinship group, a religious grouping or a village).

An FO is an organisation that requires its members to meet certain formal criteria, such as payment of regular membership fees and participation in certain activities. For example, a cotton farmers association may limit its membership to farmers whose annual cotton production exceeds a minimum level. There may also be informal membership criteria, such as those based on ethnicity, religion or gender.

FOs operate at many different levels, such as clubs (with a small number of individual producers, often living near to each other), local associations (of clubs), and higher level (for example regional or national) associations. The opportunities and constraints faced at different levels of organisation vary. In general, larger organisations offer the potential for economies of scale, but these benefits need to be balanced against the costs and difficulties associated with organising larger numbers of people.

FOs provide a wide range of different services including:

- marketing services (input supply, output marketing and processing, market information)
- facilitation of collective production activities
- financial services (savings, loans and other forms of credit)
- technology services (education, extension, research)
- education services (business skills, health, general)
- welfare services, (health, safety nets)
- policy advocacy
- managing common property resources (water, pasture, fisheries, forests)

These services can be classified according to their function. Rondot and Collion (1999) divide the functions of FOs into three broad categories: advocacy; economic and technical; and local development. Certain types of service or activity, such as those associated with economic and technical functions are more effective when confined to local level organisations. Other types of activity, such as policy advocacy, are more effective when carried out at the regional or national level (Rondot and Collion 1999).

The success or failure of an FO needs to be measured in relation to certain goals and objectives. FO members represent the most important group of stakeholders, but others include employees, government, donors, NGOs and elements of the private sector wishing to do business with FOs. The objectives of these stakeholders in the formation and development of FOs are summarised in table 2.1
Table 2.1. Stakeholder Objectives in Supporting Farmer Organisations

<table>
<thead>
<tr>
<th></th>
<th>Farmers</th>
<th>Private sector</th>
<th>Government</th>
<th>NGOs</th>
</tr>
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<tbody>
<tr>
<td><strong>Overall objectives</strong></td>
<td><strong>Improved livelihood opportunities and security</strong></td>
<td><strong>Improved rural service delivery, economic growth, welfare &amp; poverty reduction</strong></td>
<td><strong>Improved rural service delivery, economic growth, welfare &amp; poverty reduction</strong></td>
<td><strong>Improved rural service delivery, economic growth, welfare &amp; poverty reduction</strong></td>
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<tr>
<td><strong>Specific objectives</strong></td>
<td><strong>Improved access to markets (inputs &amp; outputs)</strong></td>
<td><strong>Reduced costs, (transaction costs, transport costs, etc)</strong></td>
<td><strong>Improved efficiency of private sector &amp; NGO services</strong></td>
<td><strong>Improving cost effective logistics in service delivery (eg marketing, extension)</strong></td>
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<tr>
<td></td>
<td><strong>Access to financial services (mainly credit)</strong></td>
<td><strong>Lower cost, improved credit recovery</strong></td>
<td><strong>Vehicle for channelling &amp; distributing resources to rural people</strong></td>
<td><strong>Vehicle for channelling &amp; distributing resources to rural people</strong></td>
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<td></td>
<td><strong>Technology services (eg agric. research &amp; extension, veterinary, small machinery)</strong></td>
<td><strong>Lower cost; higher &amp; more reliable volumes &amp; quality (in supply of goods &amp; services, sourcing farm produce, payments, and transport)</strong></td>
<td><strong>Means to encourage better distribution of opportunities, income and wealth in the rural economy</strong></td>
<td><strong>Technology services (eg agric. research &amp; extension, veterinary, small machinery)</strong></td>
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<tr>
<td><strong>Business support &amp; skills</strong></td>
<td><strong>Higher levels of trust with farmers</strong></td>
<td><strong>Improved market coordination</strong></td>
<td><strong>Capacity building</strong></td>
<td><strong>Improved market coordination</strong></td>
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<td><strong>Improved access to information</strong></td>
<td><strong>Better communication with suppliers</strong></td>
<td><strong>Improved market coordination</strong></td>
<td><strong>Improved market coordination</strong></td>
<td><strong>Improved market coordination</strong></td>
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<td><strong>Advocacy &amp; voice</strong></td>
<td><strong>Sharing information to improve coordination</strong></td>
<td><strong>Advocacy &amp; voice, articulating demand for services etc.</strong></td>
<td><strong>Advocacy &amp; voice, articulating demand for services etc.</strong></td>
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<td><strong>Improved access to other services (eg health, education)</strong></td>
<td><strong>Delivery of other services (eg health, education)</strong></td>
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There is a significant overlap between these different objectives, but there may also be conflicts. FOs often exclude poorer and more vulnerable groups in society. If the livelihoods of these groups are either unaffected or worsened by the existence of the FO, development agencies will not achieve one of their key objectives.

Two additional criteria for success can be mentioned, relating to FO ‘expansion’ and...
‘survival’. An FO that expands to include new members is often viewed as being a successful one. However, expansion may dilute the benefits to existing members and in the process threaten the sustainability of the organisation. This need not be the case; expansion may also create economies of scale and greater benefits to new and old members alike.

‘Sustainability’ is commonly cited as necessary condition for judging something to be a success. Hence, an FO that survives the test of time is more likely to be deemed a success than one which does not. However, there may be cases of FOs that survive for a long time without ever achieving very much. There may also be FOs that in a short period of time achieve a considerable amount and are then terminated because they have fulfilled the role for which they were established (e.g. their role as a stop gap to link farmers with markets until such a time as markets become more developed or farmers have the capacity to act independently).

It is helpful to compare FOs with two other types of organisation with whom they are most similar, in order to consider the strengths and weaknesses that they share with other types of organisation, and the specific strengths and weaknesses specific to FOs. Table 2.2 compares the relations FO, NGO and private company relations with stakeholders with whom they interact. The involvement of FO members as both owners of capital and clients, together with the different relations between investment, voting rights and returns to investment in FOs as compared with private companies, presents particularly challenges, and opportunities, to FOs. We now turn to consider, therefore, roles of FOs, issues in FO establishment and operation, and particular questions these pose to FOs and to other stakeholders interested in working with them and supporting them.

<table>
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<th></th>
<th>Farmer Organisations</th>
<th>Private companies</th>
<th>NGOs</th>
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</table>
| **Suppliers of capital** | Equity: members, donors  
Loans: banks, trading partners | Equity: shareholders  
Loans: banks | Donors |
| **Clients** | Members and non-members | Customers | Beneficiaries |
| **Employees** | Members as well as non-members | Not generally owners | Not owners |
| **Government** | Specific regulations, taxes and subsidies | Specific regulations, taxes and subsidies | Specific regulations, taxes and subsidies |

3 **Theoretical perspectives on Farmer Organisations**
A large amount of literature has been written about experiences and performance of FOs. In this section we link the conclusions of this literature to various theoretical approaches to highlight common and important issues in FO formation and operation. Our theoretical review includes various strands in the literature on New Institutional
Economics (NIE) and on theories of organisations and business management.

3.1 Contractual arrangements and transactions costs

Much of what is termed new institutional economics is concerned with the organisational and institutional implications of information deficiencies and the associated risks and transaction costs facing parties to a contract or an agreement. Transaction costs include the costs of obtaining information about parties to a contract and the goods or services being exchanged, and the costs of negotiating, monitoring and enforcing agreements. Economic agents incur transaction costs in order to evaluate the returns and risks attached to particular transactions and to structure contractual/institutional arrangements to reduce risks and raise net returns. Three broad contractual forms are recognised by Williamson (1975, 1985, 1991):

- Market forms (spot-market contracts)
- Hierarchy (within vertically integrated firms)
- hybrid forms (bilateral contracts between autonomous parties, enduring beyond a single transaction)

According to Williamson, choice of these forms by the parties to a contract depends upon the information that these parties require in order to enter into the contract, and the cost of obtaining that information under different contractual arrangements. Where information requirements are high, hierarchy or hybrid forms are likely to be preferred to markets.

‘Asset specificity’ is also an influential factor. Where investment in ‘specific’ assets with a limited range of alternative uses is envisaged, the choice of contractual arrangement will be influenced by its ability to provide an assured return on the investment. Again, hierarchy or hybrid forms may be preferable in the context of high asset specificity.

Other factors influencing contractual form are the frequency of transactions (less frequent transactions favouring market forms), the scale of transaction, the social, technical and economic characteristics of the commodity or service transacted, the socio-economic and institutional environment, and power relations between different parties (Dorward, 2001).

In decentralised economies the transactions of farmer organisations with outside parties may involve either market or hybrid contractual forms. On the other hand, the internal relationships\(^1\) of an FO have much in common with the firm, in that both forms consist of a number of people united in a single organisation in pursuit of ostensibly, common objectives. In centralised, state-controlled economies both the internal and external relationships of an FO may exhibit the characteristics of hierarchical forms.

One of the rationales for FOs is that when farmers transact with third parties as a unit, the transaction costs and risks facing both parties may be reduced, especially where investment in ‘specific’ assets is involved. The role of FOs in reducing transaction

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\(^1\) Internal relationships refers to the relationships between members, whereas external relationships are those between the organisation and outside parties.
and information costs will be examined further in the section on collective action.

3.2 Institutional environment

Theories concerning the institutional environment are associated with North (1990) and earlier work by Davis and North (1971). The institutional environment consists of the fundamental set of rules that govern and constrain production, exchange and distribution within a society. These rules/institutions include the formal institutions of the state as well as the informal ones based on custom, tradition, convention and ideology. North distinguishes between institutions which he refers to as the ‘rules of the game’ and organisations which are the ‘players’. The latter include political bodies, economic bodies, social bodies and education bodies, and are groups of people bound by some common purpose.

The institutional environment has considerable influence on FOs, in terms of both their internal and external relations. The formal laws of the state, as well as local institutions based on custom and tradition, determine whether the environment for FO development is an enabling or a disabling one.

Getting from an institutional environment that is associated with economic stagnation to one which promotes economic growth and development poses a considerable challenge. The challenge is made harder by the fact that powerful people and organisations often have a vested interest in maintaining the institutional status quo. The processes by which institutional change takes place and the factors that influence the direction of change are examined in the following section.

3.3 Processes of institutional change

According to North “the agent of change is the individual entrepreneur responding to the incentives embodied in the institutional framework. The sources of change are changing relative prices or preferences. The process of change is overwhelmingly an incremental one.” (1990, p.83).

Entrepreneurs create organisations in order to take advantage of opportunities/incentives, which are a function of technology, relative prices and preferences. The opportunities that are available to entrepreneurs at any given time are constrained by the current state of the institutional environment. The interaction between self-seeking or ‘maximising’ organisations and the institutional environment brings about institutional change. This can take place in a variety of ways, the most easily recognised of which, involves explicit efforts by organisations to change the rules.

Change occurs when organisations can generate a greater return by investing resources in changing the rules than they can from investments within the current institutional framework. Clearly, though, the relative bargaining power of different organisations in society is an important determinant of which interests rule-changes are most likely to favour. According to Olson small interest groups are usually more successful than large ones. This is for a number of reasons. The transaction costs of organising them are lower; there is less temptation for members to free-ride on the efforts of others; and their interests can be more clearly represented in the political arena than is the case with large heterogeneous groups with less unified objectives.
The institutional changes induced by organisations will not necessarily be socially efficient and may change without explicit efforts on the parts of organised interest groups. Institutional changes brought about by interest groups influence developments in knowledge and technology. However, these developments can gain a momentum of their own as people respond to technological change and the incentives it creates. New technology requires new rules and, thus, creates its own pressure for institutional change.

All institutions, are nested within deeper levels of institutions that determine how they can be changed and the deepest levels are the hardest and most costly to change, (Ostrom 1990, North 1990). Institutional change can therefore take place at many levels, but is likely to begin with institutions that can be changed at least cost.

To summarise the implications for the role of FOs in fostering economic development:
• Firstly, there is the risk that they will be used by powerful organisations to pursue socially inefficient institutional and technological change.
• Secondly, even if they are controlled by farmers whose interests coincide with socially efficient change, any change that they are likely to achieve will involve a gradual process of small, incremental steps.

3.4 Organisation theory
This section highlights a few key areas of organisation theory that contribute towards a larger framework for understanding FOs, based on Handy (1999), Mullins (2002) and Pugh and Hickson (1989).

Organisation theory is concerned with the factors that determine whether or not an organisation is effective in meeting its objectives. Handy (1999) divides these factors into three broad categories: individuals, the organisation and the environment (see Figure 3.1).

3.4.1 Individuals
The bulk of the literature on organisational theory is concerned with the management of private organisations within which the key participants are managers and employees. In farmers’ organisations managers, and to a certain extent employees, are also important, depending upon the size and function of the organisation. However in FOs the most important category of participant aside from the manager is the member. In some ways the members are akin to shareholders in a private company. They are the owners of the organisation and the people to which management is ultimately accountable. The difference, though, is that an FO usually requires much greater participation by its members than private firms require of their shareholders. FOs with an inactive membership inevitably fail. In many respects the role of the member in FOs is a blend between that of owner, manager, client and employee.
3.4.1.1 Ability and role

Clearly the ability of individuals to carry out their role in the organisation will have a significant effect on the organisations capacity to meet objectives. Matching roles to abilities is therefore important. For example, FO leaders should have good communication skills, treasurers need good numeracy skills, and secretaries should possess minimum levels of literacy. Improving the abilities of managers and members of an FO is an area in which the capacity building initiatives of donors and others can be very valuable. It is important that individuals should not experience ‘role overload’ where they are expected to perform too many roles simultaneously. Management responsibilities should be distributed effectively not concentrated in the hands of too few as this can impair performance and affect motivation. ‘Role underload’ should also be avoided – this too will affect motivation and a member’s sense of belonging to an organisation.

3.4.1.2 Motivation

Motivation or what in the economics literature is usually referred to as incentives is a key factor in an organisation’s performance. Organisation theories usually consider a far wider range of motivations than merely financial/economic incentives, and usually focus on needs, and the relationship that exists between an individual’s effort in pursuit of the organisation’s objectives, and the resulting satisfaction of these needs.

Within these needs, non-financial needs are often very important. The importance of belonging to a community and, therefore, of not breaching accepted norms of behaviour can have a significant influence on the participation of individuals in FOs, especially where the latter’s principles seem to conflict with traditional values. The
need for power and its relationship with customary rules on who should hold it also impinges greatly on the development of FOs.

An individual’s motivation to contribute effort towards the organisation’s objectives depends on the perceived link between this contribution and the satisfaction of particular needs. Organisations with a motivated membership or workforce are those in which organisational structure, leadership and group relations ensure that this perceived link is strong and positive. (Group relations refers to the relationships between the members of sub-groups within the organisation as well as inter-group relations).

### 3.4.2 The organisation

Any organisation, including FOs, consists of leadership, various groups of individuals working together on specific tasks and activities, and the structures and systems which coordinate activities, define roles and facilitate decision-making.

#### 3.4.2.1 Leadership

The literature on leadership explores, amongst other things, the types or styles of leadership that are required to achieve the organisation’s objectives. A variety of styles are identified, ranging from those that are hierarchical and relatively autocratic or structured (to put it euphemistically) on the one hand to more democratic forms of leadership on the other. Since democratic control is usually considered to be one of the pre-requisites of well functioning FOs, the leadership style in FOs should ideally reflect this, although, again, in many parts of the world this may sit awkwardly with traditional norms regarding leadership roles.

Handy (1999) advocates a “best-fit” approach to leadership style in which leaders adopt a style that accords both with the style preferences of those they lead and with the nature of the activity being led. Organisations in which leaders do not match their style with these two variables are likely to fail. This suggests that although ultimate control of an FO must remain with members, there may, within that broad framework, be scope for a variety of different leadership styles. In some social settings members may be willing to entrust leaders with considerable power to make decisions on their behalf. Providing there is sufficient transparency within the organisation for them to be able to monitor the performance of leaders they may be content to accept their dictates without the consultation and participation that members in more democratically orientated societies would expect. Expectations vary from one culture to another (Hofstede 1980).

They will also vary according to the tasks involved and the sorts of decisions that need to be made. For example long term investment or policy decisions require wider consultation than short-term buy or sell decisions. Establishing the right balance between the need for democratic control and member participation on the one hand and the need for swift commercial decisions on the other, is one of the key challenges facing relatively democratic organisations such as FOs. In a commercial environment too much membership participation hampers decision making, resulting in missed opportunities. Too little participation can alienate members from the leadership, leading to a loss of motivation and ultimately to organisational failure. This challenge needs to be met with appropriate systems and structures.
3.4.2.2 Systems and structures

Wherever the balance lies between member participation and leadership flexibility in decision making, it is important for the purposes of transparency to ensure that FOs have a clear set of constitutionally defined rules governing how different types of decisions are made. This should clearly identify the division of responsibility between executive managers charged with the day to day running of the organisation, the board of directors who represent the interests of members, and members themselves. Voting procedures and consultation processes for different types of issues need to be clearly defined. Details such as whether certain types of decisions require a majority or a unanimous vote can be critical to whether an organisation is able to respond rapidly to a changing environment.

Writers on organisations often refer to the ‘culture’ of an organisation and the associated systems and structures. Handy (1999) refers to four such culture/structure pairs:

- power/web
- role/temple
- task/net
- person/cluster

He describes these as follows. The power/web model is a very centralised one, usually characterised by a fairly autocratic and hierarchical leadership style, in which the leader or leaders sit at the centre of a web of command and enjoy considerable flexibility. The role/temple model is strongly associated with bureaucratic organisations in which roles are clearly defined and activities are governed by rules and procedures rather than by the ad hoc decisions of the organisation’s leadership. The task/net model revolves around a network of relatively autonomous teams working on specific tasks or projects. The teams are fairly fluid and are created, reformed or abandoned in response to changes in the organisation’s current portfolio of projects. The person/cluster model is the one with least structure. It involves a cluster of often relatively independent individuals who see practical benefits in joining together with others for specific purposes.

Which of these models is adopted by an organisation depends upon a number of factors including: its history and ownership; its size; the technology it uses; its goals and objectives; the social, economic and geographical environment; and the character of the people in the organisation. For example, small, young, family-owned firms are likely to reflect the power/web model. As they expand and search for economies of scale, the structure may become more bureaucratic and role orientated, especially if the technology permits a clear and fairly fixed division of roles. Factory production lines epitomise this model. However, in a highly competitive, and rapidly changing technological and economic environment bureaucratic organisations may be too unwieldy and unresponsive. In this setting, task/net models of organisations are more appropriate, although they are unlikely to enjoy the same economies of scale as large bureaucratic organisations. Person/cluster models are primarily suited to small groups of people.

Each of these models is relevant to the study of FOs. Where the power/web model dominates FOs, there is a risk of member alienation. Although a strong charismatic leader with a fairly domineering leadership style may be responsible for an FO’s
initial success, the organisation’s long-term viability may be compromised as soon as such a leader departs. Rules and procedures provide transparency and clarity, which may be helpful for FOs with a large, dispersed membership and associated communication problems. As with other types of organisation there may be a trade-off between these benefits and the scope for innovation and flexibility in response to changing market conditions. The task/net may have relevance to certain types of FO activity as when a group of members takes on the task of exploring new market opportunities or undertaking on-farm research trials. The person/cluster model seems particularly relevant to small organisations at the local level. The most appropriate model would seem to depend on the level of organisation, the activities being undertaken as well as on the external culture.

3.4.2.3 The effect of national cultures on organisational culture

National, regional and even local culture can have a significant effect on the culture of an organisation. What is an acceptable organisational culture in one society is not acceptable to the members of an organisation in a different society. The most notable research into the relationship between national cultures and organisational culture is associated with Hofstede (1980) and his survey of IBM employees in over 40 different countries. He classified national cultures according to where they were positioned along four dimensions:

- power-distance
- uncertainty-avoidance
- individualism
- masculinity

In cultures that score highly on the power-distance scale (e.g. India, Philippines, Mexico) it is acceptable for leaders to exert far more power over their subordinates than is the case in cultures that have a low score on this scale (e.g. Denmark, Israel, Austria) In the latter subordinates expect much greater consultation and participation to take place. High uncertainty avoidance cultures (e.g. Greece, Japan, Belgium) are more risk-averse than low uncertainty avoidance cultures (e.g Singapore, Denmark, UK) and prefer stability and regularity in the work place and the rules that govern it. A high score on the individualism scale (e.g. USA, UK, Australia) contrasts with more collectivist cultures that receive a low score on this scale (Pakistan, Columbia, Thailand). The former values individual achievement and privacy, whilst in the latter loyalty and commitment to a wider group is often considered more important. Masculine cultures (e.g. Australia, Venezuela, Japan) value performance and material standards. They contrasts with feminine cultures (e.g. Norway, Sweden, Denmark) that place a high value on ‘quality of life’, inter-personal relationships, the environment and gender equality. Whilst the countries mentioned above lie at the extreme ends of these scales, many do not. Nevertheless, what Hofstede demonstrates is that the way a country scores in these four dimensions has a significant effect on the types of leadership style and organisational structure that can be successfully employed in that country.

In relation to the development of FOs, Delion (2000, p.10) sums this issue up as
follows: “In many cases, imported PO\(^1\) models carry with them values and norms that are not accepted by all members … while local producers might welcome such "imported models," for their immediate benefits (i.e., access to credit or fertilizers), they do not necessarily "internalize" the models. Organizations developed with the support of external powers are like grafts: they look healthy and successful as long as they receive outside support. However, like all grafts, they must be compatible with the host's organism, or they will be rejected as soon as the external support ends.”

3.4.3 Agricultural cooperative theory
The theoretical literature on farmer cooperation is relatively scarce. Le Vay (1983) provides a review of some of this literature, providing some theoretical insights into the complexities of successfully managing farmer cooperatives. The chief difficulties, according to Le Vay, relate to the particular problems a cooperative has in a) raising and managing capital and in b) choosing from one of a number of competing and essentially rational objectives when deciding on the level of service provision.

Cooperatives and similar organisations are based on the premise that profits are distributed to members according to the level at which they patronise cooperative services, rather than in proportion to their capital contribution. Capital contributions do receive a payment, but it is usually a fixed interest rate, rather than a return linked to the profitability of the cooperative. Additionally cooperative law usually sets a maximum limit to this payment. This contrasts with private sector firms where an individual’s capital contribution determines not only their share of profits, but also their voting power. The incentives to contribute capital to cooperative ventures are small in relation to traditional firms.

The implications for a cooperative’s ability to raise capital are obvious. This issue also has implications for the objectives a cooperative sets for itself. The choice of objective is not as obvious as it is for private sector firms. The long term objective of a private firm is to maximise profits, or in other words, to maximise the return on capital. In a cooperative this is not so clear-cut. Profitability is still important if cooperatives are too survive in a competitive environment. However, the principles that govern cooperatives (e.g. the Rochdale principles\(^2\)) define cooperatives as service- rather than profit-orientated organisations. Moreover, members of cooperatives usually expect their reward for patronising the cooperative to take the form of low cost services – which translates to low input prices in the case of input supply and high farmgate prices in the case of output marketing. In practice this is facilitated through a dividend (‘divi’) or service rebate that is paid to members on a regular basis in proportion to their volume of input or output transactions with the cooperative.

All this creates a dilemma for cooperative managers as can be seen from Figure 3.2, which assumes the cooperative faces a u-shaped average cost curve (AC) and a downward sloping demand curve (D) for its services. D is equivalent to the average revenue curve (AR).

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\(^1\) Producer Organisations
\(^2\) Own capital; guaranteed quality/quantity/margin – ie fair trading; cash-only trading; dividend distributed in proportion to trading; savings encouraged; democratic principle of one member-one vote.
Given the difficulties involved in raising capital from members, capital for investment needs to come from retained profits. However the strategy that maximises profits (point c, where MR=MC) may differ from the strategy that meets the demand of members for low cost services.

Figure 3.2 A cooperative’s service options

Indeed, even the objective of minimising the cost of service provision is not without ambiguity. There will be various possible solutions to the cost minimisation problem, depending on how one defines cost minimisation. A conventional approach to cost minimisation involves operating at the lowest point on the average cost curve (point b). However, if the price of service provision to members is set at this level, there will be excess demand for the service creating a pressure to allow in new members. This may be resisted by existing members, because accepting new members would raise the cost of service provision. Cost minimisation whilst also meeting excess demand moves the cooperative beyond the lowest point on the average cost curve. A cooperative could continue to expand until the average cost curve meets the demand curve. At this point (d) the cooperative would be just breaking even and there would be no dividends to distribute to members.

There is in addition to the two already mentioned a third cost minimisation solution. This is the one that maximises the dividend per unit of service bought (i.e. per unit of input or output transacted with the cooperative). It exists at the point (a) where the distance between AC and AR is greatest. Dividends will be maximised at a lower level of service provision and at a higher average cost than would be the case at the

lowest point on the average cost curve.

The above discussion illustrates the difficulties of cooperative leaders face in resolving the tensions generated by competing objectives and stakeholders. Outside pressures to expand membership (including pressure from government, donors and NGOs in pursuit of social objectives) needs to be balanced against the interests of existing members. The financial management of cooperatives requires considerable skill and organisational sophistication.

Leaders themselves may side with either group. As members they may share similar interests to those of other members. As leaders they may favour expansion in order to benefit from the prestige and influence that is attached to leading a large organisation.

From a government perspective the main role of cooperatives is to help meet, or even create, the demand for rural services, not to maximise the dividends of a limited number of existing members. Legislation may be used to encourage expansion and prevent cooperatives from being excessively restrictive with regards to membership. However, excessive legislation may also be counterproductive if it encourages expansion beyond that which is financially sustainable and organisationally viable. Legislators clearly need to tread with care.

3.5 Economic coordination

The discussion in this section follows Hall and Soskice (2001) and Hoff (2001) and their analysis of coordination problems and potential solutions. Hall and Soskice focus on the solution to coordination problems in OECD countries, whilst Hoff is concerned with coordination problems in transitional and less advanced economies.

3.5.1 Economic coordination and institutions

Economic development does not result from the sum of isolated actions of individuals. Instead it is the synergistic outcome of coordinated action in which the returns to one party’s actions depends upon the actions of others. To use a simple example, if one party decides to invest in rural infrastructure, another in farm production, another in food processing and distribution, and another in agricultural technology development, then each party clearly benefits from the actions of the other. However, if one or more of these actions is missing then the returns to the other parties’ investments will be reduced.

This is precisely the problem in many developing countries. Investments in one area are not viable because complementary investments have not been made elsewhere. Investments in rural infrastructure produce low rates of return because of low levels of farm productivity and a lack of investment in agricultural technology, whilst investments in farm production or marketing are not viable as long as rural infrastructure is poor or non-existent. A catch–22 situation exists where no party will act until the other has done so or makes a credible commitment to do so. The result is what Hoff (2001) refers to as an equilibrium of underdevelopment.

The success of an economy depends, therefore, to a large extent on the ability of it’s institutions to coordinate complementary investments. Appropriate institutions allow different parties to make credible commitments to act in ways that are necessary for other parties to make their investments.
Hall and Soskice point out that there are no universal set of institutions for achieving economic coordination. Culture and history have considerable bearing on which institutions are effective in coordinating economic activity in any particular country. What works in one country will not be the same as what works in another.

Firms are the key actors in achieving economic coordination, but the state, too, plays an important role. One of its main roles is to provide a supportive framework for the dominant coordinating institutions. More is known about how a state can enhance and support market institutions than about the ways it can improve coordination via strategic interaction. History has shown that when the state takes a centralised role in coordinating economic activity it is usually thwarted by insufficient knowledge and information, and by poor incentives and a lack of trust on the part of those the state is seeking to control. As Hall and Soskice (2001, p.46) point out, “states may establish agencies, but what agencies can do is limited. In many cases effective strategic coordination depends on the presence of appropriately organized social organizations, such as trade unions and employer associations, that governments can encourage but not create.” The institutions of strategic interaction evolve over a considerable period of time and are the result of an extended learning experience. They cannot be created overnight.

Some evidence exists to suggest that effective institutions for strategic interaction are most likely to evolve in countries in which state power is more dispersed and less concentrated and where government by consensus is a guiding principle. (Hall and Soskice 2001). States where power is excessively concentrated in the hands of the political executive do not seem to receive the trust of employers organisations, trade unions and similar organisations. This appears hinder effective cooperation with the government and therefore undermines the development of strategic interaction.

3.5.2 Coordination problems in development

Much of the literature on coordination problems in developing countries builds on the work of Rosenstein-Rodan (1943) who was concerned “that an economy with all the preconditions for industrialization would fail to industrialize because of a failure to coordinate complementary investments.” (Hoff 2001, p.25). What follows draws on Hoff’s examination of this and related issues which focuses on the existence of diffuse externalities or ‘spillovers’ which causes poor countries to be trapped in an equilibrium of underdevelopment and poverty.

Diffuse externalities arise from the fact that the actions of any given actor within an economy can have spillover effects (externalities) that affect the returns to the activities of other actors in the economy. The problem is that unlike conventional externalities, which are often fairly localised and readily identified, diffuse externalities often involve large numbers of dispersed actors. Individually the impact of their behaviour is negligible, but added together it can be very significant.

Examples of spillover effects include knowledge spillovers, externalities from innovative behaviour, externalities from rent-seeking and externalities from enforcement mechanisms.
For example, corrupt behaviour and rent-seeking by many limits the benefits any individual may gain from not being corrupt. However, as the number of people who reject corrupt practice increases the benefit each enjoys from such a strategy increases.

Likewise, the contract enforcement mechanism that any individual party chooses to adopt will depend on the one chosen by others. Thus the dominant mechanism for enforcing contracts in an economy may not be the most efficient one, but it persists because as long as everyone uses it there is little incentive for anyone to adopt or lobby for an alternative system. Systems involving personal networks of exchange seem to exemplify this. They are rational from the individual’s point of view because they reduce transaction costs associated with contracting. However, the very fact that within certain boundaries, they do work, reduces the likelihood that governments will take on the role of contract enforcement. Yet, the latter is required in order to expand the range of contracting and with it the level of market development and economic growth.

3.5.3 The role of FOs
In developing countries, by contrast, institutional development at the national level is far less advanced. National institutions are often weak in relation to traditional institutions which have a longer history and a greater hold on the individuals associated with them.

If developing countries are to break free from the low income equilibriums they currently occupy, they need new institutions capable of coordinating economic activity beyond local boundaries. Since neither state planning, nor unfettered markets seem capable of achieving this, it is pertinent to ask whether the sorts of institutions that are characterised by CMEs have a role to play. FOs are an obvious candidate for solving the sorts of coordinating problems that developing countries are faced with. Well organised FOs may be able to build up the internal and external relationships of trust that are required to secure credible commitments from diffuse parties to cooperate on mutually beneficial actions and investments.

Rondot and Collion (1999, p.13) summarise the potential role of FO’s in this capacity as follows: “POs are part of a new mode of economic and social regulation. The coordination hierarchy imposed by government in a number of countries is slowly disappearing. As a consequence, new forms of coordination among actors, including POs, have to be invented, whether these modes of regulation are sectoral or territorial, or at local, regional, or international levels. Producers, through their organization, participate in the negotiation of institutionalized agreements, such as the setting up of supply or marketing services, the structuring of a production/processing industry, the definition and implementation of local development plans, or the formulation of public agricultural policies…..The recent interest in POs displayed by certain institutions is connected with the rediscovery of the importance of networks, and of the role of institutional capacity in the management of prevailing economic opportunities and constraints.”

3.6 Collective Action
Collective action occurs when individuals cooperate as a group in order to solve a shared problem. It involves establishment by the group of a mutually recognised set of rules, that, if followed, allow the group to achieve a common objective.
3.6.1 Collective action and CPRs
Collective action is, according to Ostrom (1990, 1999) and others (e.g. Feeny et al 1989), an institutional mechanism that has been overly neglected by policy makers in their attempts to find solutions to the problems associated with the management of natural resources. This she attributes to the excessive influence of conventional theories of collective action based on Hardin’s ‘Tragedy of the Commons’ (Hardin 1968) and the ‘Prisoner’s Dilemma’ game. These predict that common pool resources will be eventually be destroyed by the people who use them unless outsiders intervene to prevent it. Policy makers have therefore tended to focus on solutions that are based either on centralised regulation by the state, or on the creation of private property rights and the mediation of markets. Ostrom objects to the theories on which these policies are based because they do not match with much of the empirical evidence, which demonstrates that users frequently do find ways of avoiding the ‘tragedy of the commons’.

Whilst advocating cooperative solutions to CPR problems, Ostrom does not deny the role of private sector property rights or public sector intervention. Indeed, she contends that institutions are rarely either private or public, but a mixture of “private-like” or “public-like” institutions. Thus, the implementation of collective agreements to protect a CPR may require the support of private or public sector institutions, whilst private property rights or state regulations may depend on collective action for their enforcement. These three institutional types are often inseparably intertwined.

3.6.2 Challenges and obstacles
Endeavours to organise collective action, in whatever sphere, are confronted with a common set of problems. These include how to arrive at the rules/institutions on which collective action is based; how to obtain credible commitments on the part of the group members to abide by collectively agreed rules and abstain from free-riding; and how to monitor and enforce compliance with the rules. Collective action incurs transaction costs, which if too high, may prevent it from successfully taking place. However, the transaction costs (negotiation costs, information costs, monitoring and enforcement costs) associated with collective action are often less than those associated with institutional alternatives, in which case it can lead to a more efficient allocation of resources than could be brought about, either by privatisation and markets, or by direct state regulation, which may both involve very high transaction costs.

This review is concerned with the circumstances under which people, through their own initiative, manage to overcome the problems outlined above; why they sometimes fail; and the situations where outside assistance can make the difference between success or failure.

Ostrom’s work describes many success stories – incidences where people, recognising a need, have created institutions that overcome the problems of collective action and allow them to organise successfully for the collective benefit. But there are also many failures which Ostrom attributes to factors that are either internal or external to the group. The internal factors are summarised as follows:
“The participants may simply have no capacity to communicate with one another, no way to develop trust, and no sense that they must share a common future. Alternatively, powerful individuals who stand to gain from the current situation, while others lose, may block efforts by the less powerful to change the rules of the game. Such groups may need some form of external assistance to break out of the perverse logic of their situation” (Ostrom 1990, p.21).

The external factors relate to the following:

“Some participants do not have the autonomy to change their own institutional structures and are prevented from making constructive changes by external authorities who are indifferent to the perversities of the commons dilemma, or may even stand to gain from it. Also, there is the possibility that external changes may sweep rapidly over a group, giving them insufficient time to adjust their internal structures to avoid sub-optimal outcomes. Some groups suffer from perverse incentive systems that are themselves the results of policies pursued by central authorities” (ibid).

3.6.3 Recipes for success
An understanding of the causes of failure helps clarify recipes for success. Good communication, a sense of common purpose and cohesion, socio-economic homogeneity, as well as autonomy and freedom from harmful outside interference are all factors that typically contribute towards successful collective action. They are amongst the factors that have been consistently identified as ingredients of success in the generic literature on FOs that was reviewed in the first part of this review.

Ostrom’s empirical work has led her to identify a number of ‘design principles’ that seem to characterise institutions which are associated with the sustainable management of common pool resources (CPRs). Although CPRs are not the same as Fos, with due care some important lessons for Fos can be derived from this literature. In the successful cases each of these principles appear to apply, whereas in the less successful examples, they do not. The principles are outlined in Box 3.1.
Most of these principles are self-explanatory. However, it is worth looking at them in a little more detail to see whether they might apply more generally to collective action outside the CPR scenario.

The first principle links a clearly defined group of people to a clearly defined source of natural resources. The natural resources from this source are for the exclusive use of the group, and each member of the group has some rights over the natural resources from that source. One could perhaps draw parallels here with the relationship between an FO and the services it provides to its members, whatever these may be. Where the boundaries of the group/FO and the CPR/services do not coincide, the incentives for members to cooperate effectively may be diminished.

Appropriation and provision rules in the second principle relate, respectively, to the rules governing an individual appropriator’s access to CPR resources and their

### Box 3.1 Design principles illustrated by long-enduring CPR institutions

1. **Clearly defined boundaries** – Individuals or households who have rights to withdraw resource units from the CPR must be clearly defined, as must the boundaries of the CPR itself.
2. **Congruence between appropriation and provision rules and local conditions** – Appropriation rules restricting time, place, technology, and/or quantity of resource units are related to local conditions and to provision rules requiring labor, material, and/or money.
3. **Collective-choice arrangements** – Most individuals affected by the operational rules can participate in modifying the operational rules.
4. **Monitoring** – Monitors, who actively audit CPR conditions and appropriator behavior, are accountable to the appropriators or are the appropriators.
5. **Graduated sanctions** – Appropriators who violate operational rules are likely to be assessed graduated sanctions (depending on the seriousness and context of the offense) by other appropriators, by officials accountable to these appropriators or by both.
6. **Conflict-resolution mechanisms** – Appropriators and their officials have rapid access to low-cost local arenas to resolve conflicts among appropriators or between appropriators and officials.
7. **Minimal recognition of rights to organize** – The rights of appropriators to devise their own institutions are not challenged by external governmental authorities.

For CPRs that are parts of larger systems:

8. **Nested enterprises** – Appropriation, provision, monitoring enforcement, conflict resolution, and governance activities are organized in multiple layers of nested enterprises.

contribution to maintaining the supply of CPR resources. These rules need to reflect what are often subtle but significant variations in the nature CPRs. For example, the rules that are appropriate for governing one irrigation system may not be the same as those that are needed in another, similar, but different system. Local people have better information about the subtle nuances of their environment than outsiders do, which is why they are often best placed to ensure congruence between rules and local conditions. The same can be said for the rules governing many types of FO activity, not just CPR management. The third principle, therefore, follows from the second and conforms with the principles of democratic control and participation that have frequently been highlighted in this review.

The fourth principle relates to monitoring. Good rules made and agreed upon by those affected by them only work if they are effectively monitored. To avoid the opportunistic behaviour of ‘the prisoner’s dilemma’ and ensure continued cooperation by individual parties to an agreement, each party needs assurance that others are meeting their side of their bargain. In the model/game represented by the prisoner’s dilemma the optimal strategy for each party is to defect from an agreement. However, the conditions of this game do not necessarily reflect those of the real world, because the game is played only once and there is no scope for participants to monitor each other’s behaviour and build up trust. In a repeated playing of a game information about the behaviour of others is revealed through monitoring. Since each participant’s optimal strategy depends upon the strategy of others (as is also highlighted in the economic coordination literature), information about the behaviour of others is crucial. Once a certain level of cooperation has been achieved the incentives to defect are greatly reduced. The optimal strategy for each individual is to cooperate providing others do the same. Individuals have an incentive to bear some of the costs of monitoring because it provides the information they need to ensure that their own strategy remains an optimal one. In successful CPRs the rules are usually designed in such a way that monitoring costs are kept to a minimum. When monitoring is an inevitable by-product of the routine activities of appropriators (i.e. when it would be difficult not to see an incident of rule-breaking), it may be achieved at a very low cost.

The fifth principle states that if rule-breaking is discovered, sanctions need to reflect the severity of the offence. Occasional and minor infractions are inevitable and, if punished too severely, can lead to more serious defections on the part of those being punished, which can in turn escalate into mass defections by others. Severe and regular rule-breaking, on the other hand, needs to be deterred with harsher sanctions. Without these the incentives of others to continue cooperating is diminished and the whole cooperative venture is threatened.

Principles six and seven are self-evident and need not be discussed further. The final principle relates to larger CPRs. Collective management of these must be based upon a multi-tiered organisational structure consisting of small primary units at the base, secondary units of associated primary units, and if necessary, higher level units of organisation. Organising individuals into a large group without a tiered structure of this sort does not work. Moreover, the structure must be built from the bottom-up, rather than the top-down. In other words, small groups at the base must be organised and working effectively before larger organisations can be built out of these units.

Each of the above principles would seem to apply in some degree to all FOs and not
just to those concerned with CPR management.

4 Lessons for success - the empirical evidence

So far this review has concentrated on theoretical issues. We now turn our attention to some of the empirical evidence relating to FOs. The literature reviewed in this section is not couched within any particular theoretical framework, but instead provides an overview of the various factors that seem to be associated with viable FOs. It is based upon international experience over many years.

4.1 Meeting the objectives of members

The objectives of members of an FO are unlikely to be identical. Different members may have different priorities with regards to the sort of services the organisation should provide and the finer details of how they should be provided. Nevertheless, there must be sufficient consensus on broad objectives for members to agree to cooperate with each other as an organisation.

On its own, however, an agreement to participate in collective activities is clearly not a sufficient condition for successful cooperation. Many factors are identified in the literature as having an effect on whether or not an FO is likely to achieve the objectives of its members. Below is a list of factors are commonly associated with successful cooperation.

1. Homogeneity – people engaged in collective activities are relatively homogeneous in terms of their socio-economic status and cultural values.
2. Size – the size of the FO matches the organisational abilities of its members and is appropriate for the type and scale of activities being collectively undertaken.
3. Choice of services – the services provided by the FO reflect the demands of its members and are matched by the ability of the FO to deliver them.
4. Commercial activities – the FO is able to identify and undertake activities that make good business and commercial sense.
5. Self-reliance and autonomy – the FO is not dominated by outsiders (e.g. government, donors and NGOs) in pursuit of their own respective agendas and in the long run is not overly dependent upon outsiders for support and guidance.
6. Finance – the FO has the financial capacity to support its own activities and is not heavily dependent upon subsidies.
7. Skills and education – a minimum level of skills and education are represented amongst the FO’s membership.
8. Participation – strong incentives exist for active participation by members in decision-making and in the use and/or provision of services.
9. Organisational structure and governance – the structure of the organisation facilitates good governance and effective day to day management of the organisation and ensures that the leadership is accountable to members.
10. Legislation – the legislative framework within which FOs operate promotes good governance whilst at the same time avoiding excessive regulation and the harm this can do to the autonomous development of FOs.
11. Focus – resources are focused on undertaking a limited number of activities effectively rather than a larger number of activities less effectively.

It should be noted that the factors listed above are not necessarily requisites for
success, but they are frequently associated with success.

4.1.1 Activities, capability and scale—achieving an appropriate match

Stringfellow et al (1997) identify three key factors that determine whether or not successful farmer cooperation is likely to take place. Broadly speaking, these relate to the following requirements: a match between the existing skills/experience of members and what is required to undertake joint activities; internal cohesion and a membership driven agenda; and successful, commercially oriented, integration of the organisation into the wider economy. We explore the first of these in this section and the others in following sections.

One of the commonly cited explanations for why FOs fail lies in their attempts to undertake activities that they do not have the experience or skills to undertake collectively (Stringfellow et al 1997, FAO 1994 & 2001). Frequently these attempts are encouraged and supported by development agencies wishing to expand farmers’ incomes, but failing to fully recognise the constraints to achieving this through collective action.

Developing the capacity for collective undertakings takes time, especially where farmers are not used to working together. Any expansion in the range and scale of collective activities should be a gradual process, in which competence in relatively simple collective ventures is developed before attempts are made to undertake more complex activities on a collective basis.

<table>
<thead>
<tr>
<th>Box 4.1 Attributes required by small farmer groups wishing to form associations with other groups</th>
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<tbody>
<tr>
<td>• good leadership, and active participation of members in group meetings and activities</td>
</tr>
<tr>
<td>• a high degree of solidarity among members</td>
</tr>
<tr>
<td>• well-defined group income-generating activities and a high level of self-reliance (e.g. they no longer need continuous support from their group promoter)</td>
</tr>
<tr>
<td>• the capacity to deliver valued benefits or services to their members</td>
</tr>
<tr>
<td>• the ability to manage their financial affairs efficiently and to repay debts promptly</td>
</tr>
<tr>
<td>• sufficient group savings to cover their own needs and any risks or costs associated with forming and developing their SFGA</td>
</tr>
<tr>
<td>• a demonstrated interest in inter-group cooperation to solve common problems that affect neighboring groups</td>
</tr>
<tr>
<td>• confidence that inter-group cooperation will bring them concrete economic and social benefits</td>
</tr>
</tbody>
</table>

Similarly, a small group at the local level is more likely to participate effectively in a larger organisation if its members have already demonstrated an ability to cooperate successfully amongst themselves. In a guide to building small farmer group associations and networks, the FAO suggests that small groups wishing to build larger organisations by associating themselves with other groups should have the attributes listed in Box 4.1.¹

**Box 4.2   Solar fruit drying in Uganda**

The Kyeirumba Women’s Association and the Nakatundu Young Farmer’s Group both supply the private trading company, the Fruits of the Nile, with sun-dried fruit for export to the UK. Initially both centred their production activities around large group-owned driers which, in the case of the Kyeirumba group, was financed by an NGO. Over time both groups have moved away from group production as they have encountered difficulties in managing the assets efficiently. In place of this members have used their own savings to purchase small, individually operated driers. However, group arrangements have been retained for marketing, as the benefits (lower transport costs, regular deliveries to the trading company, payments by the company into a group account at the bank) outweigh the costs involved. An indication of the success of both groups has been their ability to find a sustainable balance between individual and joint activities.


Generally speaking the management of jointly owned assets is considered to be the most complex form of collective action, especially for those who have little experience of this. Less complex and therefore more likely to succeed are collective coordination of marketing and procurement activities involving dealings with intermediaries further up the marketing chain (Stringfellow et al 1997). This is illustrated in Box 4.2. Stringfellow et al recognise that joint management of collectively owned assets can sometimes be successful, but usually only when people have a strong tradition of cooperation in such activities. They also point to the problems that occur when donors supply FOs with free or subsidised equipment. Donations of this sort confront FOs with managerial challenges that they may be unable to meet and undermine the principle of self-reliance that is commonly recognised as an essential ingredient for successful cooperation. Box 4.3 illustrates some of these problems.

Group borrowing based on joint liability for the loans of individual members is an activity that is less demanding in managerial terms than some other activities. It is more likely to be successful if groups are self-selecting (this enhances the effectiveness of peer pressure) and if the group is producing a relatively high value commodity (Stringfellow et al 1997).

¹ SFGA stands for Small Farmer Group Association
The EU has been involved since 1988 with a major project to assist smallholders involved in horticultural production in Mashonaland East. Though the project initially focused on improving production and productivity, a second phase emphasised marketing and institutional development.

The lack of transport facilities had been identified as a major constraint, leading to the project strategy of forming farmer associations to operate donated trucks.

In practice the operation of the associations has been disappointing. Membership of the associations was perceived by farmers simply as a means to receive a free truck. Once acquired, members had little interest in the association and, with no resources of their own invested in the new equipment, viewed it as the responsibility of the donor. This attitude was compounded by the poor performance of the association committees, elected by members to manage the association’s marketing activities. These received little training and guidance from the project, despite the complexities of the operations they were involved in. An evaluation of the associations in May 1995 found them to be neither profitable nor sustainable.


Policy advocacy is an area of activity that usually dominates the agenda of national or regional FOs. Often the main focus of lobbying activities has been on farm prices and related terms and conditions. This is particularly the case where government intervention in marketing and pricing is a major feature of agricultural policy. However, as agricultural markets in developing countries become increasingly liberalised the nature of FO advocacy work needs to change.

Increasingly FOs are being invited to sit on committees to represent the interests of farmers in the design of development strategies, the allocation of associated funding or in setting the agenda for agricultural research and technology policy. It is also common for them to be recruited as partners in the implementation of rural development projects. How appropriate these activities are depends on whether FO participation in these activities genuinely represents the interests of members. For this to be the case, the FO requires representatives with the skills and influence to ensure that FO representation is more than just a token gesture. The FO also requires sufficient organisational capacity to ensure that its representatives in these activities carry out the wishes of the membership rather than pursuing their own agenda (Delion 2000).

The delivery of research and extension services is an area in which FOs may have either a direct or indirect involvement. The latter involves collaboration with existing institutions to ensure that research and extension activities reflect the needs of FO members. This can take the form of advocacy and lobbying, participation in consultative processes or contracting providers to undertake specific kinds of research or extension. A more direct involvement may entail FOs shouldering some of the responsibilities associated with research and extension themselves. Advocacy work in
the technology arena is usually carried out by national level organisations reflecting the
centralised nature of most national research and extension programmes. On the
other hand, small groups at the local level can play a useful role in technology transfer
(Bebbington et al 1994; Arnaiz et al 1995). By working with groups of farmers rather
than individuals extension agents are able to reach a larger number of farmers than
would otherwise be the case.

Selecting the appropriate level of organisation for any given activity is critical for
successful cooperation. As organisations get larger the benefits of scale economies are
increasingly offset by the problems of coordinating the activities of large numbers of
members, and reconciling what are often a very diverse set of interests. Services
involving input or output marketing, rural credit, management of natural resources or
jointly owned assets, are usually better when provided by local or regional level
organisations. National level organisations, on the other hand, can play a strong role
in the area of policy advocacy (Collion and Rondot 2000).

Some evidence also points to the need for FOs to concentrate their attention on a
relatively limited number of activities. According to Stringfellow et al (1997),
“Donors wishing to promote farmer cooperation should refrain from …overburdening
groups with too many or too complex functions.” Those that perform too many
functions are less likely to be successful (Delion 2000). IFAD (cited in Delion, p.2)
emphasize the need "to avoid mixing different kinds of functions: economic functions
(inputs, marketing), community functions (equipment, public services) and financial
intermediation functions (savings and loans) must be provided by different
institutions. Input and marketing will be better provided by Producer Organizations,
such as Economic Interest Groups (EIGs) that can federate into national federations or
associations. Funding of community investments and services can stay with village
associations and be supported by new local institutions or Local Investment Funds.
Financial intermediation services must be provided by autonomous, specialized
institutions."

Whilst the above may be true, there is also a question to what extent it is preferable to
have a large number of different FOs, each with their own organisational structure,
own meetings etc, providing different services to broadly the same group of members.
Where there is a large overlap in terms of membership, it might be more economical
for one organisation to provide a variety of different services, especially if it reduces
the number of meetings that need to be held, the amount of travel required and other
managerial expenses.

In summarising the characteristics of successful FO enterprises, Coulter et al (1999)
suggest that such enterprises “tend to begin with a single activity”, are “generally
involved in relatively simple marketing, input supply and credit operations involving
liaison with market intermediaries higher up the marketing chain”, and “tend to
concentrate on relatively high value produce (e.g. seed-maize, dried fruit, oil palm and
cotton) rather than low-value staples”.

4.1.2 Internal relations and organisational viability
To conduct activities on behalf of its members an FO needs to demonstrate
organisational viability. A number of organisational characteristics determine whether
or not collective action by an FO is likely to be viable. They are closely related to the
criteria listed in Box 1 and according to Collion and Rondot (2000, p.11) include the following:

- legitimate leadership
- functioning governing bodies
- cohesion among members
- existence of an efficient system of information
- existence of an appropriate system of financing
- existence of a transparent and efficient financial management and accounting system.

4.1.2.1 Leadership and democratic structures

Leadership is a subject that has already been discussed in relation to the theoretical literature on organisations (see Section 3.4.2.1). For an FO to operate effectively, it needs good leadership. Indeed, the success of many organisations appears to stem from the skills and charisma of individual leaders (e.g. Poole et al. 2000).

Whilst good leadership is a function of the personal qualities and skills of individual leaders, it also a function of its perceived legitimacy from the perspective of members. Legitimacy in leadership comes from various sources, including traditional customs and values. However, in voluntary, membership-based organisations legitimacy should also be derived from democratic processes in which leaders are elected by members, decision-making is open and transparent, and governing bodies have a clearly defined and well understood mandate. Unless this is the case members may be unable to identify sufficiently with the organisation and its aims, and may cease to participate actively in the organisation and its undertakings.

4.1.2.2 Other sources of cohesion

Internal cohesion, characterised by a common sense of purpose and accountability amongst members, is clearly important for successful cooperation amongst farmers. In addition to good leadership, various other factors can contribute to such cohesion, including homogeneity, kinship, traditional group activities, small group sizes that permit regular face-to-face contact between members, transparent rules and record keeping, regular meetings and elections, and a written constitution designed and agreed upon by all members.

Much of the literature on collective action highlights small group size and homogeneity as pre-requisites for success. Ostrom, on the other hand, downplays the importance of size and homogeneity per se, placing greater emphasis on the role of other variables (see Box 4.1 and 4.2). Large group size and heterogeneity may reduce the value of some of these variables (especially those relating to user attributes) but need not do so. (Ostrom 1990, Varughese and Ostrom 2001)

Nevertheless is it probably fair to say that larger groups face greater organisational problems than smaller ones. Leadership and decision-making in large organisations are typically remote from the grassroots membership, which can cause problems with regards to perceptions of legitimacy. As organisations become bigger cohesion amongst members weakens due to increasing heterogeneity, information flows between leaders and members become increasingly difficult to facilitate, and financial
management and accounting becomes more complex and therefore less transparent and more prone to abuse. These problems are well documented in the literature on national level organisations (e.g. Bingen et al 1995; and Arnaiz et al 1995) and on agricultural cooperative theory (Levay 1983). These authors highlight the difficulties multi-tiered organisations face in maintaining the interest, support and participation of organisations and members at the primary, grassroots level.

In their review of FOs and technology transfer in Mali, Senegal, Burkina Faso and Guinea Collion and Rondot (1998) point to a number of problems associated with organising on a large scale. These can be divided into those relating to the internal relations within FOs themselves and those relating to the agricultural research establishment. The latter typically finds it difficult to shift from a culture of centralised control to a more client-orientated approach involving greater participation by farmers. This attitude combined with a lack of political influence on the part of FOs often means that FO representation on consultative committees is token rather than effective.

FOs, on the other hand, find it difficult to analyse and articulate their members’ needs, which at the regional and national levels are often very diverse. The member organisations of national or regional level associations are very varied in terms of size and orientation. Many are multi-purpose community based organisations with a social and political orientation rather than a strictly commercial one. Where they are involved in commercial activities they tend to concentrate on activities with relatively short-term benefits, such as marketing, credit and input supply. In summary, Collion and Rondot highlight the point that those FOs that have been most successful in delivering technology services for their members are those with a strong market orientation and sufficient financial resources to fund research of their own choosing. FOs focused on the production and marketing of cash crops have clearly met with greater success than the less focused, multi-purpose FOs.

4.1.2.3 Traditional organisations

At grassroots level kinship and local neighbourhood ties can form the basis for small cohesive groups. Self-selection is also important and usually leads to more cohesive groups than is the case when outsiders exert too much influence on the selection of members. Traditional group activities can provide a valuable foundation for the development of more formal organisations. Examples include traditional labour-sharing groups, group processing activities, savings clubs, petty trading, and activities revolving around a shared religious identity (Stringfellow 1997).

One should not assume, however, that all traditional groupings are necessarily homogeneous. Whilst most exhibit a degree of cultural homogeneity, they can be fairly heterogeneous in terms of the distribution of economic and political power (Bebbington et al 1994). Cohesion may be based on cultural norms and values that bind members together by positioning them in a strict hierarchy in which some members are clearly subordinate to others. An FO based on this sort of cohesion may not be sufficiently democratic to allow equal participation by all of its members. The legitimacy of leadership and the nature of decision-making under traditional institutions may be in direct conflict with the principles of democracy and accountability that are usually considered to be pre-requisites for the success of formal membership-based organisations.
There is a risk that under these circumstances, the activities of FOs and the associated distribution of benefits will favour those at the top of the social hierarchy at the expense of those at the bottom. This suggests that if FOs are to be based on traditional organisations, democratic organisations are more likely to emerge in egalitarian societies than in those that are very hierarchical – although even in relatively egalitarian societies there may be strong hierarchies based upon age and gender.

To avoid the inequities enshrined in traditional institutions outsiders may seek to bypass such institutions when assisting in the development of FOs. There are clearly risks associated with this approach. It may cause harmful social divisions in a community. Local elites may view the introduction of formal organisations outside their control as a threat to their power base, and may seek to undermine such developments. Moreover, individuals who are lower down in the social hierarchy may be reluctant to participate in organisations that are opposed by local elites, especially if they are dependent on local elites for access to key resources such as land, employment or credit. Ideally an FO will gain the approval and support of local elites, without being dominated or controlled by them.

4.1.2.4 Subsidies, finance and sustainability
Outsiders seeking to promote FOs may try to work with local elites in order to gain their cooperation and facilitate mutually beneficial linkages. Alternatively they may adopt a less collaborative approach, in which they try to reduce economic dependency on local elites by using FO membership as a way for farmers to access alternative sources of resources. Apart from the social conflicts that this may cause, there is also attached to this strategy a risk that the promise of these resources, especially if heavily subsidised, will attract members who otherwise have little in common. Any cohesion that exists may evaporate as soon as the subsidies do (Kindness and Gordon 2001, Stringfellow 1997, Hussein 2001).

Cohesion and sustainability are more likely in groups that are able to mobilise their own savings in order to undertake cooperative activities, either through membership fees or through revenues generated through economic enterprise. Regular financial contributions by members to their FO demonstrates their commitment to the organisation and its future. Financial autonomy is important for FO development. If finance or funds are provided by outsiders FOs should be given responsibility for determining how they are used (Collion and Rondot 1999).

4.1.3 External relations
As was mentioned earlier, one of the main reasons for formal (as opposed to informal/traditional) cooperation between farmers is to manage the relations between farmers and the wider world. The rational is that the mediation of an organisation can a) provide farmers with better services and better terms of exchange in their transactions than would be the case if farmers acted individually and b) facilitate transactions and access to services that might not otherwise be available to many farmers.

Establishing appropriate relationships between FOs and the wider world is therefore crucial to their success. The external relations of an FO (as well as its internal
relations) determine its capacity to act as an autonomous self-sustaining unit. The importance of autonomy and self-reliance is something that has already been mentioned and is a common theme in the literature. A review of World Bank experience in the development of cooperatives and rural organisations (Hussi et al 1993) highlighted lack of autonomy and excessive political interference as the main reason for why these organisations have so often failed.

The relationships between an organisation and the wider world can be characterised in terms of the following:

- the sorts of goods and services that flow between FOs and outside parties
- the contractual arrangements that govern the flow of these goods and services between FOs and outside parties, and
- the formal and informal rules of the wider world (the institutional environment) that influence and constrain the activities of FOs

The first of these characteristics relates to the earlier discussion about matching activities, scale and capabilities: an FO should only transact with outsiders on behalf of its members for a particular good or service if it has the necessary skills to do so and the benefits from doing so exceed those that farmers could achieve by acting independently.

The second of the above characteristics (contractual arrangements) relates to theory discussed in Section 3.1. It concerns a number of different issues. Firstly, there is the broad question of whether the relationship of an FO with third parties is a largely a commercial one, similar to that of private sector firms, or whether the relationships are based upon the use of FOs as a vehicle for delivering public goods/services to the rural areas. Secondly there are questions concerning the detailed structure of FO relationships with third parties.

4.1.3.1 FOs as commercial enterprises

Stringfellow et al (1997) emphasise the importance of a strong business rationale for the transactions undertaken by FOs on behalf of their members. Integration of FOs into the wider economy should be based upon commercially viable activities, and not upon the social objectives of donors or the desire to channel public subsidies and services to the rural sector. This view concurs with the findings of the review by Hussi et al (1993), which concluded that “cooperatives must be treated as private sector enterprises, and that the government’s primary role should be to establish a conducive policy environment for their growth, not to control or regulate. Cooperatives function best when focused on commercial activities, and appear to be most sustainable when they have a high business turnover and multipurpose commercial activity” (Collion and Rondot 2001, p.5).

These views contrast with those that prevailed in development thinking during much of the 20th century which were often suspicious of private sector enterprise. Under centrally managed development planning farmer organisations, particularly cooperatives, were often created in order to replace commercial activity by the private sector. The failure of this approach to cooperative development has been well documented (e.g. Lele 1981), and there is now a recognition that FOs are more likely to meet the needs of their members when operating in partnership and/or in
competition with the private sector than as part of a state-sanctioned monopoly.

4.1.3.2 Relationships with the private sector
If one concedes that the success of an FO depends upon its ability to operate successfully as a commercial enterprise, there still remains the question about the sort of business relationships that are likely to be most conducive towards success – the nature of the contractual arrangements between FOs and the private sector is important.

Contract farming
Coulter et al (1997) argue the case for combining farmer cooperation with contract farming, which they argue, often work best in tandem. Under contract farming agribusiness firms provide farmers with agricultural services such as inputs, extension advice and output marketing in exchange for commitment by farmers to supply them with some or all of their output. Where these contracts are negotiated with FOs farmers gain from the additional bargaining power that membership of an FO bestows. Agribusiness benefits from economies of scale in service delivery and from a reduction in lending risk that may result if, as is often the case, FOs accept joint liability for the credit of their members. Both parties benefit from lower transaction costs than would be the case if agribusiness negotiated a separate contract with each farmer.

This model of contract farming combined with farmer cooperation is based upon the business relationship between relatively small grassroots FOs and their agribusiness partners. These partners operate at different levels of the same vertical marketing chain. Rather than competing with each other at the same level of the supply chain, they represent what Pickard (1975) refers to as a ‘vertical grouping’ that competes with other ‘vertical groupings’ to supply the consumer (cited in Levay 1983). The case for combining contract farming with farmer cooperation fits in with Levay’s suggestion that “governments wishing to promote agricultural cooperation should encourage those which seek, not to bypass the middleman, but to create the most advantageous form of partnership with him” (1983, p.34).

Multi-tiered national organisations
The view of farmer cooperation described above contrasts with the multi-tiered vertically integrated cooperative headed by a national body at its apex. It is a view that recognises the role of multi-tiered organisations in certain areas, such as policy advocacy or the dissemination of information, but which questions its value in the management of agricultural marketing activities. Studies of these sorts of organisations, such as the Zimbabwe Farmers’ Union (Arnaiz et al 1995) and the The Malian Union of Cotton and Food Crop Producers (Bingen et al 1995) seem to support this view. Both of these organisations have had some successes in the area of policy advocacy, yet neither play a very significant role in the direct provision of other types of service. For example, although, the Zimbabwe Farmers’ Union attempts to offer a range of different services (seed packs, transport, grain bags, group lending, cattle re-stocking) only a relatively small proportion members appear to actually use these services on a regular basis. Indeed a high proportion of members are unaware that these services even exist.
4.1.3.3 The relationship of FOs with government, donors and NGOs

As previous discussion has highlighted, the viability of FOs often depends upon the nature of their relationship with government and other development agencies. Most of the literature underlines the risks of excessive external intervention or subsidy and highlights the importance of basing FO activities upon a membership- rather than donor- or government-driven agenda. However, there is also acknowledgement of the positive contribution that development agencies can make in facilitating FO development, especially in the early stages. A facilitative role, as opposed to a more interventionist one, is more likely to promote organisations that are sustainable and, since it is less costly, allows a wider range of farmers to be reached (Kindness and Gordon 2001). The main features of such a role are:

- training and capacity building,
- facilitating FO linkages with the private sector, and
- creating a legal framework (part of the institutional environment) that enables FOs to operate successfully in a commercial setting whilst at the same time ensuring that they remain accountable to their members.

Capacity building

Capacity building and associated training are considered very important if FOs are to develop into autonomous, self-reliant entities. Past involvement by outsiders in the promotion of FOs has often been limited to the establishment of contact groups to facilitate technology transfer or as a means of channelling project benefits to rural people. In many cases little effort was put into developing the organisational capacity of these groups (Delion, 2000). More recently there has been an increasing move towards capacity building for its own sake, reflecting the view that once producers have the capacity to organise, they can play an increasingly prominent role in driving the rural development agenda. In this context FO development is means of empowerment, participation and self-help. It is an investment in social capital rather than a tool for agricultural service projects.

World Bank projects on FO development currently focus on strengthening FOs’ technical and strategic capacities. Other donors and NGOs are also supporting these sorts of initiatives. Strategic capacity is the ability to design strategies for meeting objectives. Technical capacities relate to the following skills: “(i) functional literacy and numeracy; (ii) accounting and financial management; (iii) ability to run and efficient information system; (iv) capacity to analyze constraints, synthesize members’ needs, set and articulate priorities; (v) undertake specific activities; and (vi) design, implement, and evaluate an activity” (Collion and Rondot 2001, p.12).

FOs need the capacity to analyse markets and assess opportunities. Whilst in the early stages of an FOs development outside agencies can assist in identifying market opportunities and constraints, in the longer term FOs need to acquire the capacity to do this by themselves (Kindness and Gordon 2001).

To capitalise on the demands of the market FOs may need to focus efforts on both production and post-harvest activities. A capacity to assemble and distribute inputs or outputs and to negotiate contracts on behalf of members is important. However, it may be insufficient unless there is also a complementary capacity in activities aimed
at improving the volume and quality of members’ production. An FO’s success in facilitating market access is often enhanced if it can provide members with appropriate extension advice, either directly or by contracting with outside suppliers of technology services.

One area of capacity building not explicitly mentioned so far relates to the need for better internal coordination between different levels of an organisation. Delion (2000) points towards the tendency for donors to focus on just one level whilst ignoring others. Yet the linkages between different layers are as crucial to effective service provision as the linkages between the organisation and third parties. Units of organisation lower down in the organisational hierarchy need to be able to monitor and evaluate the performance of leaders higher up in the organisation; they need negotiation skills and an ability to represent the interests of their members within the larger organisation. At the same time, higher levels of the organisation need to communicate more effectively with lower levels; they need the skills to assess the needs of the grassroots membership and to be able to prioritise accordingly.

**Facilitating linkages with the private sector**

FO development initiatives may be more effective and sustainable if they concentrate on linking FOs with existing private sector marketing channels rather than trying to replace the latter with new ones.

**Providing an enabling environment**

An FO’s ability to function successfully will depend significantly on the institutional environment in which it operates. Informal rules based upon custom and tradition may be difficult and slow to change, however formal rules can be designed in such a way as increase the likelihood of FOs achieving their objectives.

In most countries there is legislation governing farmer cooperation. It is primarily targeted at formally registered cooperatives, but may affect other FOs if they too are legally registered. If well designed and properly enforced these laws can help promote good governance, protect the interests of members and encourage membership participation. However, if badly designed their effect can be to stifle cooperative development. Many cooperative laws were designed at a time when cooperatives were tools of state development planning and enjoyed very little autonomy. The position of cooperatives following market liberalisation and structural adjustment is now very different. Cooperatives are faced with greater competition and must be sufficiently flexible to respond to commercial pressures and changing market conditions. This calls for reforms in cooperative law, which have indeed been taking place in some countries.

Important elements of reform, according to Shah (1995), include provisions that give cooperatives greater autonomy from state regulation; permit and encourage the employment of professional managers; separate day-to-day managerial functions from the policy-making functions of the board of directors; strengthen democratic control and participation by members; and encourage internal capital mobilisation. Reforms also need to accommodate a large variety of different types of cooperatives or pre-cooperatives, so that small relatively simple organisations are not burdened with the same level of regulation as larger more complex organisations.
4.2 Meeting the objectives of governments, donors and NGOs

4.2.1 Poverty reduction

Poverty reduction is a key objective of governments, donors and NGOs. For many amongst this stakeholder group FOs are viewed as a potentially useful vehicle for achieving this objective. There are essentially two ways in which this might be achieved:

- In the first, the poor may benefit directly from being members of FOs. In other words FOs provide them with access to markets and to services which would otherwise be inaccessible.
- In the second they benefit indirectly from the rural economic growth that FOs might stimulate.

Much of the literature on FOs cautions about being overly optimistic with regards to the first of these (Lele 1981). The conditions for successful cooperation (minimum levels of education, skill, financial capacity etc) tend to mitigate against successful cooperation by the poor (especially the poorest of the poor). Because of the exclusive nature of formal membership organisations there is always a risk that the poor will be excluded from becoming members (Collion and Rondot 2000).

Even if the poor are not excluded from membership they may be excluded from the benefits of membership. Discussion earlier (see Section 4.1.2.3) highlighted the difficulties of establishing democratic FOs in environments that are characterised by rigid social hierarchies and unequal distributions of power and wealth. This is something outsiders need to consider carefully when seeking to use FOs as a vehicle for poverty reduction. Subsidies and resources aimed at supporting the development of FOs may be captured by relatively wealthy members of the community and further exacerbate social inequality. Careful monitoring is required if this is to be avoided.

New organisations can create social conflict, especially if they challenge the positions of traditional elites. Conflict is an inevitable part of the social change required to improve the position of those at the bottom of the social hierarchy (Delion 2000). However, well meaning outsiders need to ensure that such conflict works in favour of rather than against the interests of the poor. Organisations that sever traditional support mechanisms and then collapse as soon outside support is removed can do more harm than good.

Clearly there is a fine line to be trod by outsiders between, on the one hand, providing sufficient oversight and control to protect the interests of the poor, and on the other hand, allowing FOs the freedom to develop as autonomous entities.

Some members, often the very poorest members of the group, will be less reliable in terms of output quality or debt repayment. As a result they may harm the group’s reputation upon which access to services relies. The group’s response may be to exclude poor performers from the group or suffer the consequences of not doing so. Moreover, whilst cooperation may reduce transaction costs, members with very low
levels of output are still more costly to service per unit of output than members with higher output levels. If this additional cost is borne by the group this creates another incentive to exclude the smallest producers from group participation.

This is why homogeneity can be an important criteria for successful farmer cooperation. Where all members are of the same socio-economic status the benefits of FO membership are likely to be distributed more fairly. This is particularly noticeable in the case of gender. In societies where the participation by women in decision-making processes is limited by cultural norms, primary level groups and clubs often serve women’s interests better when membership is restricted to women.

Despite the difficulties, primary level cooperation within small homogeneous self-help groups does offer potential benefits to the most vulnerable in society. It may strengthen their organisational skills to the point at which in future they eventually have the capacity to participate effectively in more complex or larger scale collective activities. Above all, cooperation in small groups creates social capital that can make investments in other forms of capital more productive, reducing vulnerability and enhancing livelihoods. Moreover, even if the poorest of the poor are unable to participate directly in FOs, higher incomes amongst those that do participate is likely to generate demand for locally produced goods and services and, hence, better employment opportunities for the poorest of the poor.

4.2.2 Delivering public services

In most developing countries the fiscal discipline imposed by economic stabilisation and structural adjustment programmes have forced dramatic cuts in public service budgets. As a means of cutting costs government departments frequently recruit FOs as partners in service delivery. Donors, too, have sought to do the same, due to the weaknesses of public sector agencies and in recognition of the need to decentralise and engage people more fully in the development process.

The general consensus in the literature is that where FOs are used as a means of delivering public services to the rural areas there is a strong risk that their organisational viability will be undermined. FOs appear to be most effective when they act and are treated as an alternative form of business organisation rather than as an extension of the public sector or as a channel for donor aid to the rural sector.

“When projects invite POs to take part in project implementation, they often provide equipment, per diems, and other facilities. POs can hardly reject such proposals, which attract their best staff. This process, however, can divert the POs from providing the basic services requested by their members” (Delion 2000, p.9).

This does not mean that FO’s should not organise to gain better access to public services - a viable organisation can serve both the interests of the its members and outside service providers by reducing the transactions costs faced by both parties. What this does mean, however, is that the initiative should come from organisationally viable and democratically controlled FOs.

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1 Producer organisations
5 Conclusions
This review began by exploring a number of theoretical strands in the literature on institutions and organisations to see what insights these might offer into the workings of FOs. The review concluded with an examination of the empirical evidence relating to FOs and the factors which are likely to influence the success of collective action by farmers to access markets. Broadly speaking, the evidence is consistent with the theory.

The theories of transaction costs, contractual arrangements and the institutional environment are well known and their relevance to FOs is clear. Farmers and the agents with which they transact, whether they be private traders, donors, NGOs or public sector agencies, face high transaction costs. These can be reduced under contractual arrangements in which farmers transact as a unit. When they do this they internalise transaction costs. In other words the transaction costs of doing business with third parties are replaced in part by the transaction costs of organising themselves to act collectively. The more farmers internalise transaction costs (by expanding the size and scope of their organisation), the lower the external transaction costs become – external transaction costs are the costs of the transactions between the FO and a third party.

The benefits of internalising transaction costs are derived from reducing external transaction costs and from potential economies of scale. However, internal and external transaction costs are likely to be inversely related to each other, which suggests there may be a point where the marginal net benefit of any further internalisation of transaction costs falls to zero. Where exactly this point lies will depend on the institutional environment, the technology embedded within it, the physical environment and the nature of the activity being undertaken collectively. These factors are likely to affect both internal and external transaction costs. The relationships are illustrated in a rather stylised form in figure 5.1, where the concentric rings represent expanding levels of organisation and geographical space.
The shape of the institutional environment and the direction of institutional change is influenced by many factors. These factors have been examined from various theoretical perspectives, including those of North (1990) (sections 3.2 and 3.3), organisation theory (section 3.4), economic coordination theory (section 3.5), and Ostrom’s collective action theory (section 3.6). Each of these perspectives points to opportunities and constraints with respect to efficient institutional change.

The economic coordination literature highlights the importance of non-market institutions in overcoming diffuse externalities and in moving economies to higher equilibriums than could be achieved in their absence. It highlights the importance of
sequencing when undertaking institutional reform and the need to take advantage of windows of opportunity when they arise. It also points to the importance of institutional complementarities and, along with North (1990) and Hofstede (1980), draws attention to the difficulties of introducing formal institutions that are out of step with informal ones. This is consistent with much of the literature on institutional change which suggests that change is primarily incremental, involving small changes at the margin which lead only gradually to more fundamental changes in the institutional environment.

The work of North (1990) and Hoff (2000) identify the powerful forces that trap some countries in low-income equilibriums of poverty. It appears to caution against excessive optimism, but is useful in drawing to the attention of policy makers the potentially harmful and irreversible consequences of certain institutional changes. The work of Ostrom, by contrast, does seem to offer greater hope. Through rigorous analysis of the empirical data she has developed a coherent framework for analysing the problems of collective action. With this framework and with assistance from benevolent outsiders, people may be able to design better institutions – institutions that lift them from the low-income equilibriums of the real world to high-income equilibriums that at present exist only in theory.
6 Bibliography


