Structural And Governance Challenges In Farmer Producer Companies

A Transaction Cost Economics Perspective

G. V. P. RAJAN

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Cooperatives

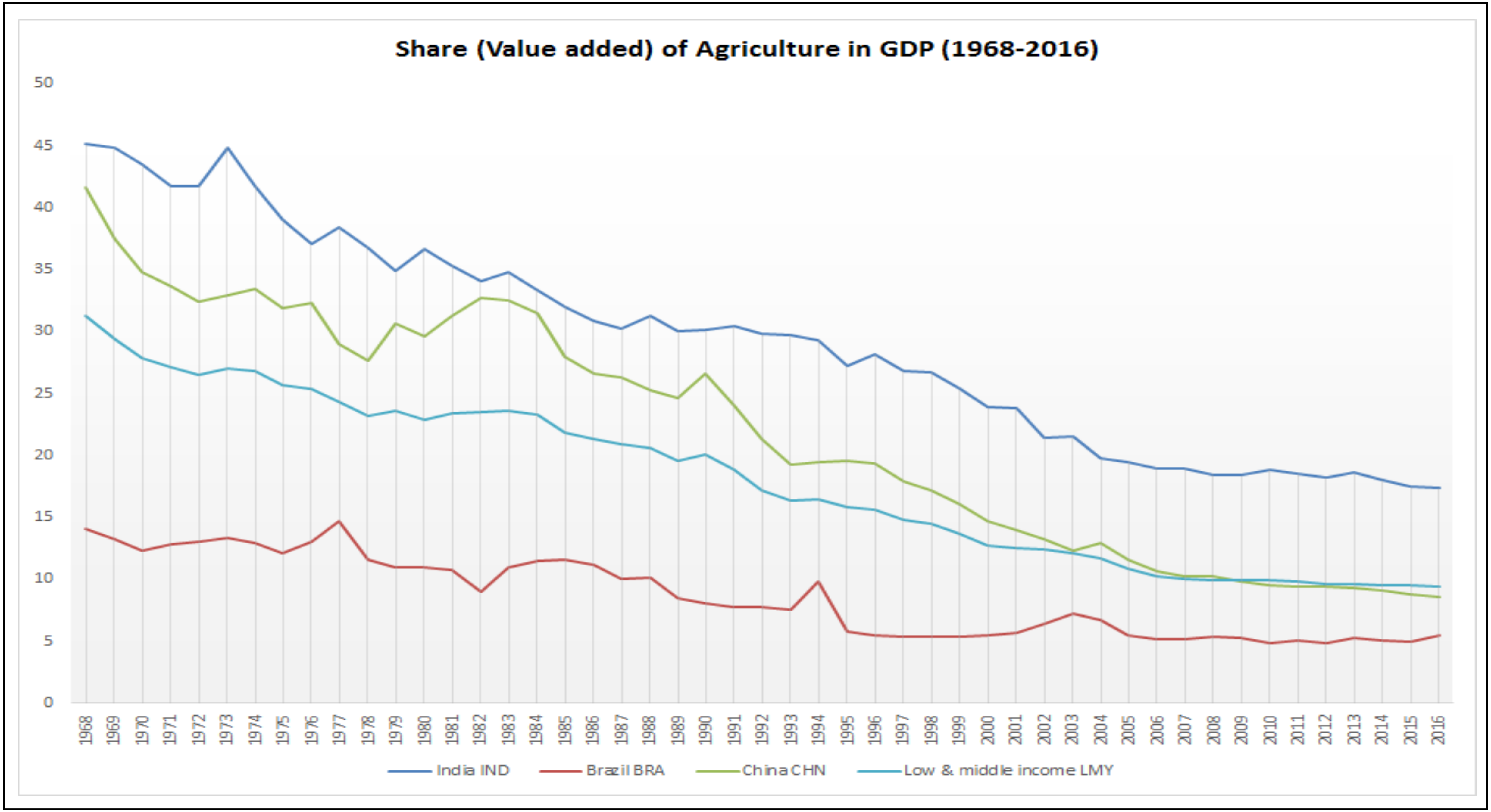
- Based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity
- Represent the *plural* sector which is not addressed by either the public or the private sector
- Reduce negative externalities and *improve positive externalities* which are not done by free markets
- Can be broadly classified as *user*, *worker*, *producer*, *social* and *community* cooperatives

Cooperatives in Rural India

- Rural Cooperative banks are responsible for improving access to rural credit.
- Issue – Penetration of rural credit in India is just about 2.6% which leaves out a sizeable population out of coverage

Country	Credit Unions	Members	Savings and Shares	Assets	Penetration
India	2,705	21,060,430	50,663,251,304	60,450,919,247	2.6%
Korea	910	5,752,000	53,272,682,478	56,111,667,320	16.0%
Thailand (c)	2,277	4,078,311	22,801,000,000	57,101,000,000	8.2%
Asia (Total)	**27,492**	**45,484,815**	**138,072,669,754**	**185,548,256,260**	**2.9%**
Brazil	582	6,339,462	29,503,166,850	28,239,614,354	4.5%
Australia	91	4,100,000	60,770,907,288	70,706,106,175	27.0%

Penetration rate is calculated by dividing the total number of reported credit union members by the economically active population age 15–64. (c) - Data from Association of Asian Confederation of Credit Unions. *Source : 2015 Annual Report of World Council of Credit Unions*



Share (Value added) of Agriculture in GDP (1968-2016)
50
45
40
35
30
25
20
15
10
5
0
1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016
India IND
Brazil BRA
China CHN
Low & middle income LMY

Cooperatives in Rural India

- Farmer cooperatives majorly flourished in dairy and sugarcane industry. Very few cooperatives have reached the size and stature of *Amul*.

Cooperative	Rank	Turnover in Billion Dollars (2015)
IFFCO	5	17.53
Gujrat Cooperative Milk Marketing Federation	12	12.15

Source : 2017 World Cooperative Monitor Sector Rankings (Agriculture & Food Industry)

Cooperatives: The Smallholder Problem

FARMERS' SUICIDES

(includes those by farm labourers)

	2015	2016*	% Chg
Punjab	124	271	**118.0**
Haryana	162	250	**54.32**
Karnataka	1,569	2,079	**32.50**
Gujarat	301	408	**35.5**
Madhya Pradesh	1,290	1,321	**2.4**
Telangana	1,400	645	**-54.0**
Maharashtra	4,291	3,661	**-15.0**
Andhra Pradesh	916	804	**-12.2**
Chhattisgarh	954	682	**-28.5**
Total	**12,602**	**11,370**	**-9.8**

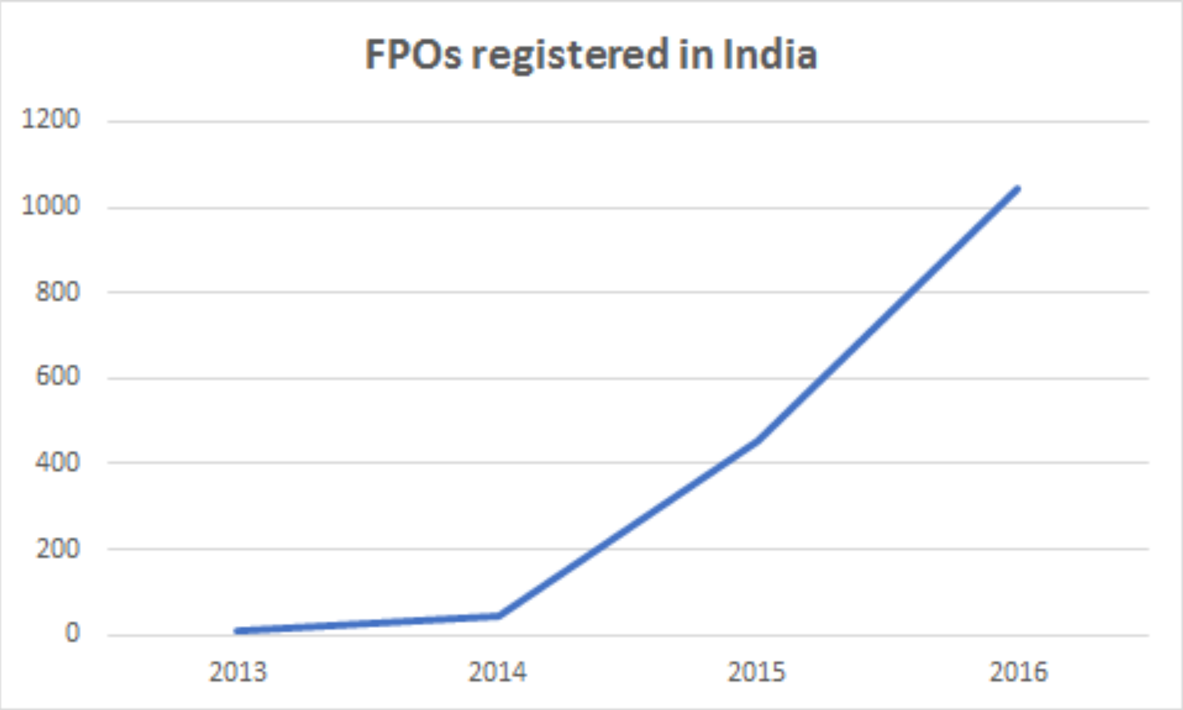
Note: Total might not match as all states have not been included

Source: Parliament questions

Source: "Big rise in farmer suicides in four states during 2016, says NCRB data". Business Standard, 23rd March 2018.

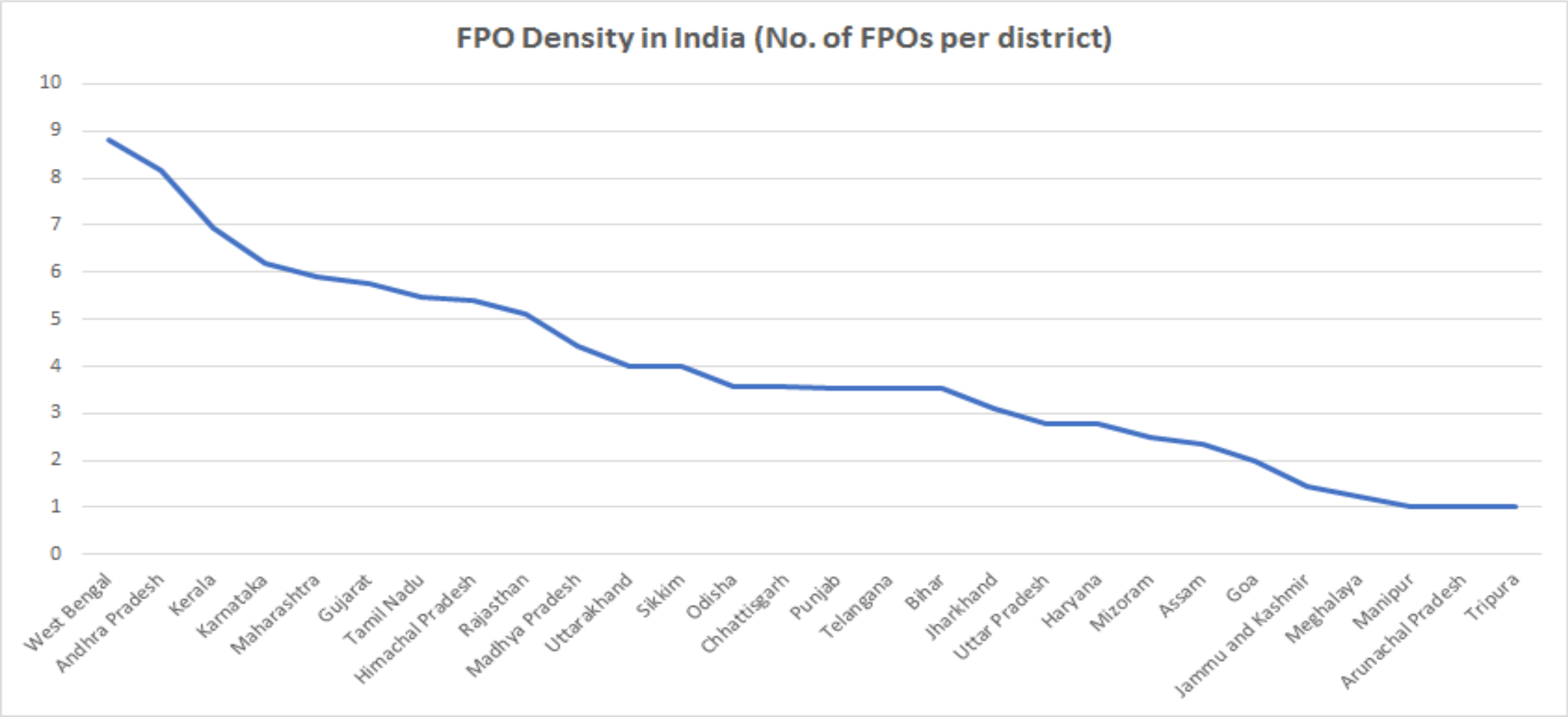
The Farmer Producer Company

- It is a hybrid between a cooperative and a private limited company
- It combines *cooperative values* of mutual benefit and a *professional style* of functioning
- It is seen as the most appropriate organizational form to address the issues of market linkages and smallholdings.



On the recommendations of an expert panel led by Y.K. Alagh, Centre had amended the Indian Companies Act, 1956, in 2002-03 to provide for “producer companies”. Data Source: SFAC/NABARD.

FPC density in India



FPOs emerging in India

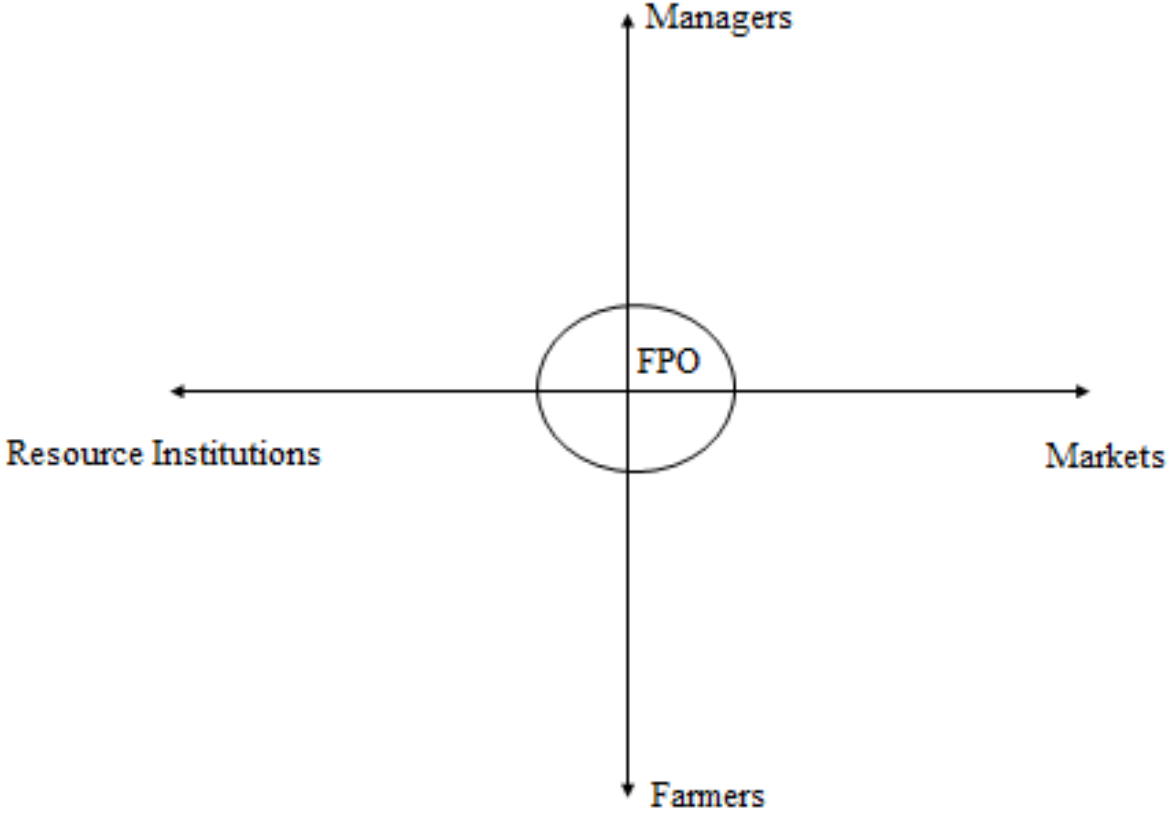
Dindigul to have first Farmer Producers' Organisation (The Hindu, 2014)

"Dindigul district will have a Farmer Producers' Organisation (FPO), the first of its kind in Madurai, Theni and Dindigul districts, as the State government has given approval for establishing one for guava growers in Ayakudi".

Agriculture's big hope: Farmer producer companies learn to tame middlemen (First Post, 2015)

"Subburathinam who did not study beyond class 12, is director of the Kovai Farmers Producer Company. It has 520 shareholders who between them produce about 50 tonnes of gourd a day"

FPC Ecosystem



This institutional arrangement facilitates an "alternative method of coordinating production"

The effectiveness of this structure depends on the *nature of transactions (conflict, mutuality and order)*

- Within farmers group
- Between farmers and resource institutions
- Between farmers and managers
- Between farmers and markets

Resource Institutions

- Resource institutions - can be an NGO, a private company or a government agency.
- The resource institution executes the policies of the government and offers a **rules-based trust mechanism**; i.e., the rules promulgated from time to time must be in coherence with previously crafted rules.
- New rules that conflict with old rules or are not as favorable as the older ones create a trust deficit and impact the growth of the producer-cooperative [rules that differentiate FPC from cooperatives]
- Empirical evidence from Mexico and Central America shows that when farmer producer organizations are supported by and directly linked to supermarkets, they are more likely to remain economically sustainable as opposed to farmer producer organizations supported by non-governmental organizations (Hellin et al., 2007)

Managers

- Managers are hired by the producer company to provide professional expertise in operating the producer company and the necessary *human capital*
- Early studies in the Asian context associate poor performance of producer organizations to *'sizeable inefficiencies'* of human capital and management variables rather than the size of the producer organizations (Ali and Byerlee, 1991)
- Evidence from China also indicates that more than size (the average farm size of the Chinese farmer is smaller than that of the Indian farmer) it is the *access to advanced technology* that explains the difference in farm incomes between contract and non-contract farming (Miyata, Minot, & Hu, 2009)

Farmers

- Farmers – are the smallholders who form and own the producer company. The social structure (or the nature of inter-relationships) of farmers represents the social capital in the system (Wambugu et al., 2009)
- The evolutionary trajectory of the producer company depends on the interplay between the social structure and the market structure. The more closely knit structures have greater cohesiveness which leads to higher levels of trust
- In the producer company, farmers are expected to imbibe both – *cooperative* and *market-oriented* values, which leads to a peculiar conflicting situation.
- The owner-shareholder dynamic, a key element of the cooperative form, promotes an inward approach which is likely to conflict with the development of a market-oriented *approach* (outward approach).

Transaction Cost Economics Theory

The FPC institutional arrangement is basically a set of contractual relationships, *explicit or implicit*

Governance issue arises when

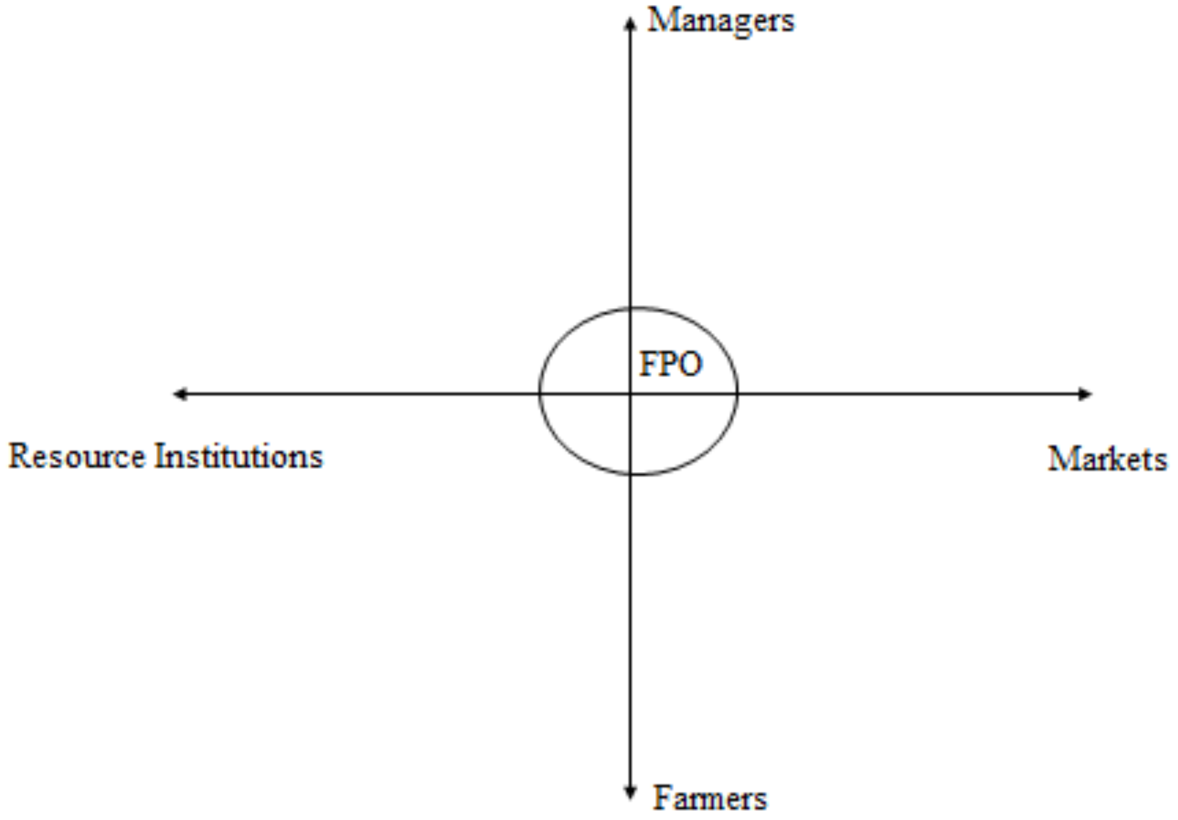
(a) 'there is an agency problem, or conflict of interest, involving members of the organization, such as owners, managers, workers or consumers' and,

(b) 'the transaction costs are such that this agency problem cannot be dealt through a contract' (Hart, 1995, p. 678).

The FPO Ecosystem (from a TCE lens)

First, the role of the resource institutions is *transitory* with the objective to facilitate the progression of the producer company towards the adoption of market-based mechanisms.

Second, farmers would *eventually imbibe*, partially or substantially, technical, financial and market knowledge, and take up or actively guide the management of the producer company.



Cooperatives vs Markets
(alternate coordinating mechanisms)

Cooperatives are based on the values of self-help, self-responsibility, democracy, equality, equity, and solidarity (Novkovic & Mary, 2014)

Cooperatives represent the *plural* sector which is different from the predominant public and private sectors (Mintzberg, 2015).

Cooperative behavior reduces negative externalities and improves positive externalities which are not done by free-markets (Staatz, 1987; Williamson, 1979)

Markets are characterized by transactions that are monetary, reciprocal, voluntary, repetitive, homogenous, anonymous and are open to new entrants (Jackson, 2007)

Markets have a multi-layered structure. From a near-ideal commodity exchange, where transactions are impersonal, to the physical mandi, where social relations are dominant, these layers vary in their degree of perfectness (Jackson, 2007).

The FPO Ecosystem (from a TCE lens)

Social Structure (key to internal governance)

- Cohesiveness - strong social relationships build trust which (reduces opportunism) improves internal governance
- Homogeneity, social, cultural or economic, improves governance, i.e., consensus building and decision making involves less transaction costs
- Cohesiveness and Homogeneity increase the size of farmer producer company without dissipation of governance capacity (why cooperatives do not spread beyond a particular socio-economic region)
- Knowledge – low levels of technical and market knowledge induce conflicts with managers
- in the absence of cohesiveness, homogeneity, and knowledge, the managerial role becomes more powerful, the FPO may operate more like a commercial entity.

The FPO Ecosystem (from a TCE lens)

- Different types of farm produce will need different markets. Commodities can be traded anonymously on commodity exchanges; however, highly differentiated farm produce may need relational markets
- The output-side benefits for the producer company depend on the idiosyncrasy (or asset specificity) of the produce
- Studies indicate that when the produce (such as high-value vegetables) is characterized by high transaction costs associated with market access, the benefits for farmer organizations are more evident (Hellin et al., 2007)
- On the contrary, when the produce is more of a commodity, like maize, there is very little difference between market governance and the producer-company (Cheney, Santa Cruz, Peredo, & Nazareno, 2014)

The FPO Ecosystem (from a TCE lens)

- When FPOs exploit market opportunities and gain more operational control, they are more likely to integrate vertically in a hierarchical fashion or expand horizontally along the agribusiness value chain or both.
- Evidence indicates that farmer producer organizations integrate vertically to form federations at a national level that has more bargaining power.
- Governance in the federation is executed through a supra-mechanism. However, their combined power, mainly driven by their collective landholdings and members, can drive them into opportunistic behavior or monopolistic behavior.
- Large-sized federations have the potential to influence policy and alter market dynamics. Prior literature conceptualizes this as bilateral oligopoly between the federation of producer-organizations a few large buyers (Jackson, 2007)

Recommendations

Policy focus for Markets - to improve market alternatives using technology such as platform-driven technology. A multi-layered market provides more flexibility and transparency to small holders.

Infrastructure Focus – to enhance the capability of farmers to stock and stagger their sales to avoid low prices

Resource Institutions – to strengthen, or at least preserve, the cooperative ethic and build capacities of farmers to reduce transaction cost. [Improve credit facilities, acquiring licenses]

Managers – If the managerial roles are not taken up by farmers themselves, the motivational component of managers needs to be structured with appropriate compensation and career progression plans

Farmers – Developing a mix of production activities to ensure steady source of income

Research focus

1. How do FPOs evolve governance mechanisms (of smallholder farmers)?
2. How does social cohesion and/or cultural homogeneity impact the size of the FPO, and its outcomes?
3. When is it economically prudent for FPOs to expand vertically or diversify horizontally in the agribusiness value chain?
4. How do FPOs create a portfolio of market linkages?
5. How do federations (local, regional or national) impact FPO governance?
6. How does asset specificity of produce impact economic gains?
7. What is the role of non-land assets in improving the plight of smallholders in India?