

# Producer Organisations – the Way Forward?

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The extension of the producer organisation (PO) regime to all agricultural sectors is another milestone in the EU Agricultural policy designed to encourage the development of collective action to promote competitiveness and improve farm returns. This paper, through the lens of power dependency theories suggests that in any supply tier, additional players may not serve the interests of those for whom it is intended. In markets serving highly concentrated and consolidated downstream buyers, the introduction and continued presence of the PO can result in a negative yardstick effect and thereby have a deflationary effect on farm gate prices.

## Introduction

The recent reforms of the Common Agricultural Policy have placed even greater emphasis on the promotion of horizontal co-operative activity, extending policy and funding of the current “Producer Organisation” programme. Producer organisations were first recognised in 1972. Over time, from a position, where they were designed to facilitate the management of post-harvest supply in the fresh produce sector, they have emerged as a means of improving the competitive position of growers following market deregulations post 1994. Recent reiterations have extended policy beyond the European Union (EU) Fruit and Vegetable Regime to cover across all agricultural sectors (DEFRA, 2012; DEFRA, 2013).

This article suggests that whilst there is a general consensus that co-operatives present a solution to power imbalances, few have questioned this position. The academic and policy communities maintain that benefits accrue from “strength in numbers” but there is limited consideration of the extent to which this may be achieved given hostile downstream market conditions (Holland, 2013; Pereira, 2015; Ton et al, 2007; Eastham, 2014). This paper puts forward the position that at times, POs can neither become effective countervailing forces or deliver positive yardstick effects. It is suggested that measures designed to impede side-selling in POs can deflate farm incomes and result in negative yardstick effects.

## The Development of Producer Organisations

In 1972, POs were established as a statutory measure in the EU to support the horticultural sector under the framework of the Common Market Organisation (CMO). They gained progressively greater prominence following reforms in 1996, 2003 and 2007 (EC 2200/96, EC 412/97, EC,2003; EC 1182/2007).

In their initial incarnation, their major role was to manage the withdrawal of fruit from the market under the CMO, but from 1996, the PO regime placed more emphasis on enabling growers to improve their competitive position, where they were faced with growing global competition, the upshot of the World Trade Organisation (WTO) Agreement in 1994. Presumed successful, the scheme now covers all agricultural sectors.

Despite the extension to their role, POs continue to operate under the rules specified under the 2007 reform (no 1182/2007). PO status will be awarded where there is a minimum of five producers with a total value of marketed production (VMP) of €100,000, who engage to achieve one of the following objectives:

- a. market of product,
- b. manage production in relation to demand,
- c. optimise production to stabilise prices.

In their application for PO status, members need to design an operational programme stating their objectives and modus operandi. The activities outlined are match funded on a 50/50 split by members and the EU. In consolidating supply, reducing over production and investing technical processes to improve efficiency through collective effort, members are assumed to be able to improve leverage.

While the regulations offer a base line, POs do vary across the European Union and some of the Northern European Countries have a much larger membership with a greater VMP than those in the UK and many Southern European Countries. A condition of membership is that members should be loyal to the PO and not engage in side-selling.

## **Perspectives on the Value of Producer Organisations and Collectives of Producers in General**

This paper suggests that there is limited examination of the effectiveness of collectives as a mechanism to redress power imbalances in current literature (Van Bekkum, 2001; Bijman et al, 2010; Bijman et al, 2012; Eastham, 2014). Existing research examines the changes in fortune of co-operatives over time (Olson, 1965; Cook, 1995; Cook et al, 2009). Co-operatives are seen to have a lifecycle of five time periods or stages. The fifth and final stage, may be characterised by either the exit of the co-operative from the market or the emergence of the co-operative into an alternative governance form. This final stage is said to materialise as a consequence of divergent member interests emerging from the need to augment product value through diversification or differentiation (Cook, 1995; Cook et al, 2009; Chaddad, 2015). It is obvious that this body of literature inherently recognises imbalances of power, but it fails to explicitly consider the efficacy of collectives to redress these when faced with highly concentrated downstream markets.

Surely a key purpose of POs and collective action is to redress power imbalances and improve farm gate prices to farmers (Sijmonsma, 2015). Insights provided through the lens of power and dependency and resource dependency theories (PDT and RDT), would offer the idea that formation of a PO will reduce the number of alternative sources of supply, improve farmers' power position and thus farm gate prices (Emerson, 1962; Avermaete, et al, 2009; Eastham, 2014).

PDT and RDT maintain that the power held by one exchange party is dependent on the respective criticality of their resources to the other party (Emerson, 1962; Pfeffer & Salanick, 2003; Chicksand, 2009). The criticality of the resource is contingent upon the control of access to the product/service for exchange (ie the scarcity) as defined by property rights, causal ambiguity, market share, economies of scale, entry barriers, availability of alternatives/ substitutes and the importance of the product/service to the parties' current and future business. Economic value or rents are distributed within a supply chain depending on the respective distribution of such resources between the two parties.

Mainstream research in co-operatives normally considers the removal of alternatives on the supply side but fails to consider the demand side problem. That is, on the one hand, where the collective attains a significant proportion of the supply, the formation of a collective can reduce the numbers of alternatives for buyers. Yet, this position fails to consider that the ability of the collective to leverage on price and redress power imbalances is also contingent upon the power attributes of the downstream player. The position that even where the collective is unable to significantly influence the alternatives for buyers, for example the collective has a small market share, a positive impact on the price would emerge as a consequence of an increase in the number of channel options to farmers. This effect, known as the yardstick effect/positive externality, similarly fails to consider the balance of power and dependency between the two parties (Nourse, 1945; Pereira, 2015).

Let us consider this in the context of a UK horticultural PO, SGT, which became a PO following the 1997 reforms. An established small co-operative with just 21 members, it faced augmented

competition as a consequence of global market liberation. As the only remaining English top-fruit co-operative in the UK, in a market where lobby groups and the media had consistently promoted the importance of English apples and pears, it might be assumed that SGT could be in a relatively strong position over its buyers (Eastham, 2014).

SGT originally sold its top-fruit directly to the retailer, but post 1997, the retailer Sainsbury's had introduced and promoted the development of an intermediary, Chingford. Chingford emerged as one of two category leaders, heavily tied to the retailer through a dedicated supply relationship and specifically constructed dedicated facilities. Their remit was ensure highest quality fruit at the lowest cost, 364 days a year. Ninety percent of Chingford's business was contractually bound to the retailer's business, and if they were to be delisted, there would be few alternative buyers to equal the volumes supplied to Sainsbury's and cover the costs of specific dedicated investment. Furthermore the very real risk of being delisted has made the company willing supplicants. Consequently, SGT, who dedicated 60% of their total sales to the relationship, found that not only were they expected to absorb increased costs of transportation and packaging but also a decline in top-line farm gate prices. Readily available global sources of supply meant that growers were also to face the rising costs of quality improvement. In contrast, despite the importance of fresh produce as a destination product, the relatively low barriers to entry into the fresh produce "wholesale" sector, enhances the retailer's position of power (Eastham, 2014).

As noted earlier, it is presumed that positive yardstick/externalities emerge where the number of alternative buyers for farmers increase but the addition of a further supplier also represents an alternative source for downstream players/retailers. Where downstream markets are highly concentrated with a few dominant players, the addition of a supply source can only strengthen the buyer/retailer's resource attributes and negatively impact even distribution of economic rent/value (Nourse, 1945; Sexton, 1990; Bijman, et al, 2012; Pereira, 2015)

If the numbers of alternative sources of supply to highly concentrated and contested downstream markets increase, this can lead to a greater degree of horizontal competition, particularly in conditions where there is a threat of delisting. In such situations companies such as Chingford will need to ensure improved quality, greater "value" or functionality than their rivals.

The constant quality improvements to fruit led to a continual escalation of farm investment and costs, albeit match funded by the EU. These are depreciated over a five year period and inhibit member exit prior to the full depreciation as this would result in forfeit of the whole asset, including the growers' personal investment. The inability of growers to shift their supply/side-sell, where the PO has no control over price, (Sykuta et al, 2001; Agbo, et al, 2015) can result in negative consequences for both the PO and indeed the sector as a whole.

Given that the PO has no control over price, binding members to the collective through both rules governing side-selling and investment, effectively eliminates any value for farmers in the entry of in an alternative buyer in the market. It eliminates any potential for a positive yardstick effect it is only in the ability of farmers to switch that positive yardstick effects can materialise. To the contrary, locking farmers into a relationship where there are high levels of consolidation in retail sectors reinforces the dependency of the PO on their buyers. Where POs are limited in size, and are particularly vulnerable to pressure placed on them by buyers/intermediaries, contestation can have, it appears, a negative influence on all the sector prices the negative yardstick effect.

## **The Implications for Policy**

The policy promotion of POs as with other denotations of collective action within farming sectors is that they offer farmers strength in numbers. Such strength, it is suggested, will increase the product scarcity and eliminate choice to downstream buyers, thereby eliminating the need for other forms of intervention to support farm gate pricing. Where monopolistic or oligopolistic rents

are not able to be attained, it is normally supposed that positive externalities emerge from the entry of the collective with a corresponding inflationary impact on prices. This paper suggests that this position may be overly simplistic.

It may be that POs offer farmers the opportunity to improve technical efficiencies and facilitate innovative practices ostensibly reducing the productivity gap where subsidies and trade barriers allow for greater global competition. Literature on power suggests, however, that when faced with highly contested markets and readily accessible information on technological improvements to growing techniques, CMO funding provides farmers with little competitive advantage (Chicksand, 2009; Eastham, 2014).

Furthermore, by ensuring that POs inhibit side selling or member defection it may be that there is a net effect of reducing any real impact on the returns received, not simply by the PO members but by the sector as a whole. This is particularly a concern, where retailers use the additional sources of supply as a means of driving down price by threat of delisting.

The paper calls for more careful consideration of PO regulations with respect to both specific investment in farm processes and infrastructure and potentially on the reality of the “strengths” of collectives when faced with contested horizontal and downstream markets.

## The Author

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