Inclusive Investment in Agriculture: Cooperatives and the role of foreign investment
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Introduction

Investment in farmland has been in the spotlight for a number of years, and is increasingly being seen as a series of “land grabs”. However, other types of agricultural investment are more common, such as joint ventures, cooperatives, management contracts, contract farming and outgrower schemes. Although not without their own drawbacks, these business models can be profitable for farmers and investors, while at the same time being socially and politically acceptable—especially by allowing farmers to maintain control over their land, water and other natural resources.

This policy brief focuses on the business model of the cooperative as one that promotes inclusive agricultural investment. It examines the role of investors and governments in supporting the development of cooperatives. Although cooperatives are not without their own challenges, they nevertheless provide a valuable potential avenue for investors and farmers to enter into collaborative partnerships and ensure an equitable distribution of returns.

What Is a Cooperative?

A cooperative is defined by the International Labour Organization (ILO) as an “autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically controlled enterprise” (ILO, 2002b). Put another way, agricultural cooperatives pool production and resources of farmers and rural entrepreneurs in order to maximize the benefits for its members. Unlike corporations, they are focused on service rather than profit. Although members receive a payment for their capital contributions, it is not linked to the profitability of the cooperative; rather it is usually held at a fixed interest rate that can be tied, by law, to a maximum permitted rate (Stockbridge, Dorward, Kydd, Morrison, & Poole, 2003).

Different types of agricultural cooperatives

Agricultural cooperatives can be classified into service cooperatives or production cooperatives (Lerman, 2013). Production cooperatives involve farmers who operate the cooperative on jointly owned agricultural plots (Chambo, 2009).

Service cooperatives are more common. Under this arrangement members carry out their activities independently, and the cooperative provides them with a range of services, including machinery, processing, transport, packaging, distribution, marketing and information (Lerman, 2013). The Dutch cooperative Agrifirm, for example, includes more than 17,000 Dutch farmers who combine their purchasing power for agricultural products and equipment (Agrifirm, 2013). In the United States, the Michigan Sugar Company organizes more than 1,000 farmers in a cooperative that grows beets and sells beet sugar (Michigan Sugar Company, 2013).

Agricultural cooperatives play a crucial role in the development of the rural sector and in promoting food security: In Brazil “37 percent of agricultural GDP [gross domestic product] is produced through cooperatives; in Egypt, 4 million farmers earn their income through cooperative membership; in Ethiopia the equivalent figure is 900,000; and in India, 16.5 million litres of milk are collected every day from 12 million farmers in dairy cooperatives. In Europe, agricultural cooperatives have an overall market share of about 60 percent of the processing and marketing of agricultural commodities and about 50 percent of the supply of inputs” (FAO, 2013a).
Cooperatives that facilitate access to markets have been the most popular in terms of linking developing countries to commodity export trading (Chambo, 2009). For example, CONAPROLE, the milk cooperative in Uruguay, successfully competes in the international milk market (Food and Agriculture Organization of the United Nations [FAO], 1994).

Another important category of service cooperatives is a credit cooperative, which allows members to jointly finance their investments or working capital. Through credit unions, farmers pool funds to be loaned to members, and at the same time loans can be raised at better interest rates than those offered by commercial banks. Some of these small associations have become large international banks, such as Crédit Agricole and Crédit Mutuel in France, DZ Bank in Germany or Rabobank in the Netherlands. These European cooperative banks were born out of the needs of local rural populations and have now expanded to provide international services (Rabobank Report, 2011/2).

Advantages of Cooperatives

Cooperatives offer farmers advantages that are difficult to achieve working individually. According to the Dunsany Group, a “significant and compelling evidence exists demonstrating that cooperation leads to a more democratized economy and society at a local, national and transnational level alongside a wide range of other benefits” (Dunsany Group, 2012). Well-functioning rural cooperatives and farmers’ organizations are key to empowering small agricultural producers (FAO, 2013b). Their benefits include:

- Better organization: (i) farmers retain the governance of the cooperative, (ii) cooperatives reach a large number of beneficiaries and create networks of mutual support and solidarity for their members (Alianza Cooperativa Internacional (ACI), 2013).
- Farmers are able to collectively negotiate better contract terms and prices (FAO, 2012).
- Better access to a wide range of resources and services (FAO, 2012).
- Increased efficiency of smallholders and the efficient use of available resources by inspiring innovation, diversification and specialization in their members’ businesses (ILO, 2001; United States Department of Agriculture (USDA), 1990).
- Better access to markets (USDA, 1990).
- Better access to financing (Rabobank, 2012).
- Creation of productive employment (ILO, 2011).
- Social integration, particularly for women, youth, elderly and people with disabilities (FAO, 2012; University of Wisconsin Centre for Cooperatives (UWCC), 1995).

Cooperatives can also improve relations between farmers and government, as the government can better understand the particular needs of groups in certain geographical areas or businesses, and therefore channel their policies to address those needs. In Israel, “the partnership between the Government and the cooperative movement has been the cornerstone of their economic and social development,” while in Panama, “cooperatives are implementing plans and employment programs that are consistent with the strategies of the government for socio-economic development” (UN General Assembly Economic and Social Council, 2001, p.4). Cooperatives also contribute to local economies by spending additional income earned by members in other businesses, creating knock-on effects to the broader economy (USDA, 1990).

Examples of successful cooperatives

Denmark: Cooperatives play an important role in Denmark’s agriculture sector. Danish farmers successfully responded to international trade dilemmas using cooperatives that innovatively transitioned grain production to livestock production, and now supply butter and bacon for overseas markets.

El Salvador: Cooperatives strongly participate in the coffee market and are agents of local development in providing their members more than economic benefits, contributing to the basic needs of the community.

India: After India became independent, milk procurement and marketing in urban areas was a problem. Producers in Kaira went on strike against their milk procurer and formed a cooperative, which transformed into a model known as AMUL. The AMUL model is a three-tiered structure with a village-level cooperative, a district-level union and a state-level federation that ensures a direct link from the producers to the consumers with producers controlling procurement instead of middlemen. This model organized milk marketing in India and has improved not only the business of producers but also the quality of milk arriving to consumers.

Kenya: Githunguri Dairy Cooperative Society, a farmer’s association established in 1961, survived a series of liberalization measures and was able to continue attracting finance. Management training, business plans, education and outreach, as well as good farming practices, made the difference. In 2008 the cooperative was already in the top three milk processors in Kenya, and a savings and credit cooperative was established to ease financial management.
Malawi: The Malawi Lake Basin Program consists of a consortium of the Farmers’ Union of Malawi (FUM), the Malawi Union of Savings and Credit Cooperatives (MUSCOCO), National Smallholder Farmers’ Association of Malawi, (NASFAM) and the Swedish Cooperative Centre. Each organization has one vote on the board and brings its specific experience to the program, including agriculture, financial services, marketing and organizational. The program has been innovative in its approach to poverty reduction in Malawi.

United States: A South Dakota soybean farmers’ cooperative opened a processing plant to add value to their production. A Missouri corn growers’ cooperative was able to enter the ethanol business. An Iowa farmers’ cooperative improved their methods of pork production to become financially profitable.

Zambia: The Organic Producers and Processors Association of Zambia (OPPZA) "contributed to poverty alleviation among smallholder organic farmers (...) by raising their incomes through the premium generated from the sale of organic products” (Costa Pinto, 2009, p.5). These results partially came from farmers in the cooperative adopting organic farming technologies with production volumes sharply increasing for most organic products. Also many farmers (140 females, 212 males) improved the quality of the production and gained organic certifications.


Weaknesses of Cooperatives

The history of cooperatives is not without its drawbacks, which may include poor organization of producers and a lack of technical knowledge of members. The management of cooperatives is demanding, particularly because of their democratic nature and sometimes due to the inadequate management skills of its membership (International Fund for Agricultural Development (IFAD), 2013). Unlike businesses, cooperatives require much greater participation by members, whose roles are a blend of member, owner, manager and employee (Stockbridge et al., 2003). However, those cooperatives that have been able to improve their management have reduced costs significantly (FAO, 1997).

Good management skills include an understanding of the specific market and financial challenges of the cooperative, serving the needs of the members, as well as acting according to specific laws. Planning, organizing, directing, coordinating and controlling are positive actions every cooperative management should smoothly perform (KCard, n.d.).

Capital formation and business performance are key issues facing cooperatives. Cooperatives need to take on services and businesses that also make commercial sense and, to support these activities, depend on the capital of members or external financing (Stockbridge et al., 2003).

However, where cooperatives are small their collective bargaining power is reduced against other actors in the agricultural value chain. It is true that small cooperatives may never achieve the volume that is required to develop and become efficient market players. Nevertheless, while it may seem reasonable to conclude that the larger the cooperative the better, this is not necessarily true. Member’s ability to organize plays a central role on the effectiveness of large cooperatives (Stockbridge et al., 2003).

The Role of Foreign Investment in Agriculture

Cooperatives and investment are related in two ways. On the one hand, foreign investors can be attracted to invest in the activities or businesses of cooperatives. On the other, when the cooperative reaches a certain maturity and size, it can also become an investor. It is the first case that provides an interesting example of how governments can promote investment in cooperatives as a tool for agricultural development.

The central characteristic of successful cooperatives is organization. This includes organizing the interests of farmers or entrepreneurs, ensuring a strong level of participation of members and finding the correct management strategy. This is crucial to attracting foreign investment. Well-organized cooperatives upgrade the skills of their members, offering investors a more sophisticated and reliable market.

Cooperatives bring together dispersed producers and entrepreneurs in the agriculture sector to create economies of scale for their members. They form interdependent units where the output of one (seeds, chemicals and fertilizers, for example) is the input of another (the farmer, for example) (Bijman, Cechin, & Muradian, 2009). The cooperatives thus provide reliable partners or suppliers for foreign investors and growth prospects for the rural economy. When analyzing the opportunities and risks of investing in a country’s agricultural sector, the presence of cooperatives in the sector’s value chain lowers the perception of risk for investors and reflects a stronger economy. For example, when an investor invests in agricultural production, the existence of seed suppliers in a cooperative, or of processing cooperatives, lowers the investor’s perception of risk of seed shortages or of potential buyers for the investor’s agricultural goods (Sexton & Iskow, n.d.).
A recent World Bank and UN Conference on Trade and Development (UNCTAD) of 39 large-scale agricultural investment projects found projects where investors had successfully contracted with outgrowers who were part of cooperatives. Cooperatives were generally encouraged by investors because they facilitated the contract process and logistical arrangements so that, instead of dealing with large numbers of farmers, investors could deal with one cooperative, which made the process easier to manage. According to the study, “those who were part of cooperatives were particularly vocal about the advantageous access to credit schemes, as well as the ability to get better deals on agrochemicals and fertilizers and sell their produce to major buyers.” (Mirza, Speller, Dixie, & Goodman, in press).

Furthermore, in working within a value chain of cooperatives, foreign investors have collaborated in upgrading members’ skills as well as taking advantage of their local integration to channel their efforts to help the community as a whole. For example, Nestlé’s International Cocos Initiative project in the Ivory Coast works with cooperatives to minimize the risks of child labour (International Cocoa Initiative, 2014).

Cooperatives can also create linkages to other investment opportunities. In Zambia, for example, a cooperative of farmers producing sugarcane formed a partnership with a processing company that gives farmers shares in the company and representation on its board. These inclusive investment models combine the strengths of the investor—bringing capital, technology and expertise in management and marketing—with those of local farmers who provide labour, land, traditional know-how and knowledge of local conditions (Liu, 2013).

Finally, there is also the opportunity of investing in cooperatives. The investor can become a member of the cooperative through its local business. On the other hand, an investor can also make a capital investment in a cooperative. Many cooperatives, after reaching economies of scale, have accepted the investment of non-member capital, transforming themselves from member organizations to investor-driven enterprises (ILO, 2001). Generally, in this situation, the investor has minimal or no voting rights (ILO, 2012).

**The Role of Government**

The key factor of success for cooperatives is in the drive and motivation of its members, i.e., their entrepreneurship and organizational ability (ILO, 2001). However, the government can play an important supporting role, in terms of providing information and creating a sound legal environment. But its involvement must be limited and targeted to the needs of cooperatives—members should retain ownership and management.

Experience shows that cooperatives created from the bottom up, through initiatives in rural areas, have been more successful than those created through government programs (Lerman, 2013). In Nigeria and Tanzania, post-independence, government food-buying bodies bought all cereals from cooperatives. However, following liberalization policies in the late 1980s these bodies were disbanded, and most cooperatives were unable to survive in the open market (Chambo, 2009). In the Iranian county of Marvdasht, one of the reasons for the failure of cooperatives was the strong interference of the government with little involvement of farmers in decision-making (Allahdadi, 2011).

Governments should confine their role to registration, dissolution and liquidation of cooperatives and enforcement of cooperative laws. They should avoid interfering in the cooperative’s internal affairs (ILO, 2001). The areas of support can include: human resource development, research and management consultancy, accountancy and auditing, information technology, laws and taxation, and relations with the private sector (ILO, 2002a). Education and training before and after forming a cooperative can be crucial for farmers and entrepreneurs to make informed decisions.

The government should provide the cooperative with an enabling environment to pursue its objectives. Canada and United States have stories of profitable cooperatives because of government subsidies to the sector. However, subsidies are not a condition for success. For example, New Zealand has a positive history in cooperatives without government subsidies but with more flexible legislation than other jurisdictions, enabling innovation in cooperative design (Evans & Meade, 2005).

In addition, farmers in cooperatives still need to access sufficient land, infrastructure, affordable credit, information and networks in order to succeed in business. Cooperative cannot always cover these needs. The government and financial sector can play a key role in attending these problems. With tax incentives and concessions governments can encourage particular investment, for example, in innovation.

**The Legal Framework for Cooperatives**

Cooperatives benefit from a flexible cooperative law, single taxation scheme and clearly defined competition rules (European Commission, 2012). These aims can be achieved through different types of legislation. Regulations should consider international principles and could follow the International Labour Organisation (ILO) Guidelines for Cooperative Legislation. UN Guidelines aimed at creating a supportive environment for the development of cooperatives, 2001, and the
principles of the International Cooperative Alliance (ICA). In South Africa, for example, national legislation is strongly based on international principles of cooperatives (Theron, 2010). Denmark and Ireland have developed a large number of cooperatives without using specific cooperative laws. However, in general, a comprehensive law provides greater legal security (ILO, 2012).

One legislative approach is taken through a general set of rules that include regulations for cooperatives, including the 2004 British Act on Community Interest Companies, 2003 Finnish Law on social enterprises or the Spanish Law of Social Economy (Ley 5/2011 de Economía Social).

Another approach is to create specific laws and codes on cooperatives such as, for example, the Multi-State Cooperatives Act, 2002, of India, the Canada Cooperative Act, 2010 and the Cooperatives Code of the Philippines (FAO, n.d.). Most Latin American countries have specific cooperative laws. Some have a combination of laws like Argentina’s Cooperatives Law (No. 20,337) and the Law for the creation of an Education and Promotion Fund for Cooperatives. One of the most recent laws is the Cooperative Organizations Law in Mexico (2012) that now exempts cooperatives from commercial laws, protects new labour rights and prevents the use of cooperatives to evade social, labour and tax obligations (ACI, 2012).

At the regional level, European Union Regulation 1435/2003 on the Statute for a European Cooperative Society came into force as applicable to all member states in 2006, creating a new type of cooperative. These cross-border cooperatives needs at least two EU member countries and make reference to national cooperatives laws. In South America, the Mercosur Common Cooperative Statute follows the same path (ILO, 2012). In Latin America, the Framework Law for Cooperatives in Latin America 2009 has been created as a guide for policy-makers.

Whichever form the law takes, it needs to be clear about the process for becoming incorporated and registered as a cooperative (in order to give confidence to those doing business with them) as well as the process for liquidation and dissolution. At the same time, legislation should be flexible enough to allow cooperatives to organize and work in an autonomous manner and to accommodate different sizes of cooperatives. Italy and Cameroon, for example, have strong laws to regulate large cooperatives but which allow for simplified procedures for small ones (ILO, 2001).

Regarding processes around drafting legislation, participation and consultation of cooperatives is essential. The federal cooperative law of Canada was enacted after an extensive nationwide consultation by the Canadian government in 1996 (ILO, 2001).

**Conclusion**

Agricultural cooperatives greatly contribute to poverty reduction by offering an inclusive and democratic avenue for economic growth. Cooperatives are key economic players for improving food security. The challenge is to build self-reliant organizations that operate efficiently within a market economy and contribute to improving incomes, creating employment opportunities and integrating small producers.

The central characteristic of cooperatives—organization—is crucial in attracting foreign investment. Clustering smallholder farmers and agriculture entrepreneurs and upgrading their capacities offer investors a more sophisticated and reliable market to invest in.

Appropriate policy and legal frameworks are needed for successful agricultural cooperatives. The government can act as a promoter and facilitator, generate policies and programs to support cooperatives, develop adequate infrastructure and social services, and eliminate any barriers to cooperative development. However, onerous legal regimes and requirements should be avoided because they may stifle cooperatives.

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Notes

1 An outgrower scheme is a contractual partnership between growers or landholders and a company for the production of commercial forest products. See http://www.fao.org/docrep/004/ac131e/ac131e03.htm.
References


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