

ILO Value Chain Development Briefing paper 2:

The role of Cooperatives and Business Associations in Value Chain Development



International
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VALUE CHAIN DEVELOPMENT



ILOs work on Value Chain Development (VCD) focuses on promoting pro-poor growth and job creation.

The VCD briefing papers series explores technical areas in which the ILO has specific knowledge and capacity to offer, contributing new pathways towards Decent Work.



While collective action organizations can be present at all levels of value chains, the focus of this briefing paper is mainly on the part of chains where micro and small enterprises operate. It looks at how organizations, like cooperatives or business associations, can help producers and small enterprises in addressing constraints within a value chain. It puts forward recommendations about the role of these organizations in the value chain development process.

Smaller actors in a value chain face problems often more forcefully than bigger enterprises. Limited resources and capacity make it difficult for small enterprises to become suppliers to larger firms, compete in value chains and enter higher-value markets. While large firms can often use their bargaining power in their supply chain, small enterprises need to follow the decisions taken by others. Often they have no other choice than to accept prices or product requirements that are given by a buyer.

Small Enterprises in Value Chains

Micro and Small enterprises in developing countries often emerge when entrepreneurship is the only viable employment option; most of these enterprises are very small in size, fragmented and with limited access to markets. Their financial and productive capacity gives them very limited bargaining power and their voice is often not heard when it comes to designing policies. They operate in the informal economy, often with poor working conditions and without access to social protection. Some of these challenges can be addressed by collective action organizations like cooperatives or business associations.

Value Chain: A value chain “describes the full range of activities that are required to bring a product or service from conception, through the intermediary phases of production (...), delivery to final consumers, and final disposal after use.”¹ This includes activities such as design, production, marketing, distribution and support services up to the final consumer (and often beyond, when recycling processes are taken into account). The activities constituting a value chain can be contained within a single firm or divided among different firms, as well as within a single geographical location or spread over wider areas.

Source: Value Chain Development for Decent Work (2009), page 3

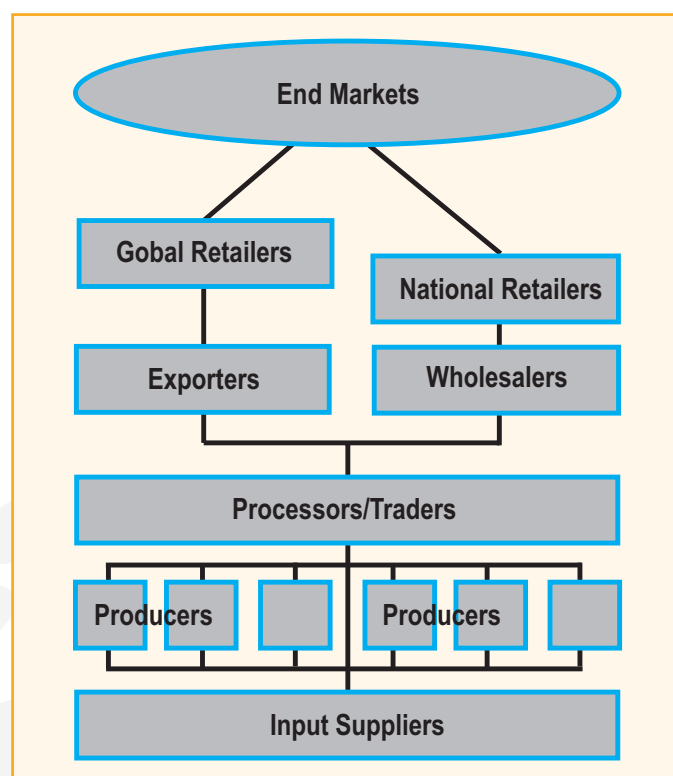
¹ Kaplinsky (2004). *Spreading the gains from globalisation: what can be learnt from value-chain analysis*, *Problems of economic transition*, vol. 47, no. 2, pp. 74-115

The figure on the right² shows the image of a generic value chain with several trade linkages between processors/traders and producers. Intermediary traders play a crucial role in the value chain and often have better market information and more financial resources than small producers. The trader relates to each of the small producers individually and can potentially use his bargaining position to exercise pressure on small producers (for lower prices etc.). This asymmetric bargaining power in a chain can lessen small producer revenues and, thus, limits their opportunities for improved livelihoods. Producers often do not have proper information on market conditions and processes and therefore run the risk of being treated unfairly.

But the fragmentation of small producers is not always in the interest of the intermediary buyer. Having fragmented suppliers is costly due to the arising transaction costs. Buyers often want to buy large quantities with good and stable quality, in other words, find reliable business partners. So buyers would also have an interest in dealing with a single trading partner. Constraints that affect small producers and farmers in the end can have an impact on the overall performance and competitiveness of the chain and as such will also affect large buyers. So potentially both traders and small producers need effective mechanisms by which the issues of fragmentation can be addressed. Producer associations or cooperatives provide a possible way of dealing with these concerns.

Collective Action Organizations

Collective action organizations come in many “shapes and sizes” depending on the purpose and ac-



tivities of the organization. In this brief cooperatives and business association are presented as examples of a collective action organization. Collective action organizations can play a key role in helping enterprises and producers to address value chain requirements irrespective of their exact legal form. They can facilitate and leverage market linkages for small scale entrepreneurs and producers, improve their bargaining power and access to market information. For instance, joint purchasing, financial and other activities enable organizations to achieve economies of scale that cannot be achieved by single firms. Members of collective action organizations can potentially benefit from networking, collaboration and joint initiatives. Collective action organizations are often members of and thus linked to a bigger structure such as a cooperative union, a federation or a chamber of commerce.

² Adapted from USAID-Mirolinks: www.microlinks.org

Business associations are voluntary member-based associations of business people who cooperate to pursue common interests. Business associations support members to develop their production and business activities, protect their interest and represent them. Activities can include lobbying, information gathering, creating market protection mechanisms, providing business services and market research. Some business associations have also a social function and they can, for example, participate in unexpected expenses of their members (such as funeral costs or doctor visits).

“A **cooperative** is 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.” Cooperatives can be formed by any group of actors, for example, farmers, wholesalers, retailers or workers or a combination of them. What all cooperatives have common is that they are owned and controlled by their members. The cooperative has a dual nature of being both an association and an enterprise at the same time. This means that the cooperative must balance between serving its members and satisfying customers. As social enterprises they have obligation to social functions. Profits generated by the cooperative are democratically decided how they should be used or they can be distributed to its members. Cooperatives have often formulated and created a strong sense of belonging among their members.

Engaging with Collective Action Organizations in Value Chain Development

The role of the collective action organization in a value chain depends on the activities it conducts. The organization can be linked to a value chain both vertically (buyer-seller relationships) and horizontally (inter-firm coordination, linkages to services providers and to policy makers). In the past organizations, especially cooperatives, used to have a more defensive role and focus on horizontal coordination (e.g. collectively selling the members' produce). However, the role of the organizations has changed. Nowadays organizations are taking on more proactive roles, higher-up or further-down the chain and engaging in value chain integration.

They must consider vertical linkages in the chain as well and combine horizontal and vertical coordination³. This often goes hand in hand with a diversification of services these organizations provide to their members.



³ Bijman, J. and Wollni, M. 2008. “Producer organizations and vertical coordination: an economic organization theory perspective”, Paper presented at the International Conference on Cooperative Studies (ICCS), 7-9 October 2008, Köln, Germany

Urii Farmers Cooperative Society – Soy Bean Production and Value Chain Addition - Kenya

The Urii Farmers Cooperative Society Ltd. has been registered since 2005 in Kenya. The cooperative operates in the Rongo District in Nyanza Province. The cooperative helped developing soybean production, value addition and utilization in order to generate higher incomes for farmers in the region. Soy beans are a good source of protein and much cheaper than meat, which many people in the area cannot afford. Additionally, it has higher market price than other grains and requires only three months harvesting, ensuring better land utilization.

The Urii Farmers Cooperative Society Ltd. in collaboration with ILO's Cooperative Facility for Africa (www.ilo.org/coopafrika), the Tropical Soil Biology and Fertility Institute, the Ministry of Agriculture and the Ministry of Cooperative Development and Marketing jointly implemented a value addition project on soybean production.

The project covered seven operation zones within five districts. The cooperative organized training, recruited farmers and facilitated seeds, fertilizers and soft loans for participating farmers. It facilitated market linkages and identified local markets for soybean products and created export market linkages as well. In addition to that, the cooperative engaged in soybean production through recruited farmers and value addition to produce products like soymilk, soya yoghurt and soya meat. Production was divided into three levels: household level (farmers were encouraged to consume soybean for food and sell a portion of their production for additional income), cottage level (soybean were processed and sold in the local markets by the Resource Center established by local actors in collaboration with the project) and industrial level (soybeans that cannot be processed at the cottage level are sold on to be processed in larger cities).

The project effectively alleviated malnutrition, poverty, unemployment and food insecurity, benefitting 5000 farmers. The cooperative's income increased by 20%.

Source: CoopAfrica

Vertical activities

Cooperatives and business associations can have an important role in providing information about market requirements and supporting their members in complying with them. The organizations can help for example by providing training and improving skills in modern production and management techniques. For instance, the Supirisara Rural Economic Development Entrepreneurship Association in Kurunegala, Sri Lanka, was established to improve dairy farmers' access to business development services and increase their bargaining power, organize trade fairs, link members to new buyers

and suppliers, undertake marketing and common purchasing as well as providing members with information on market trends and opportunities.⁴

Horizontal activities

Horizontal activities have a strong potential to reduce transaction costs and create economies of scale. Horizontal activities include grouping together to increase small producers' bargaining power and therefore, strengthening their position in the value chain. This is often a key role of collective action organizations. Joining forces can result both in a more stable and profitable relationship

⁴ International Labour Organisation (ILO). 2009. "Small Business Associations Project Intervention report", ILO Enter-Growth, February 2009, MDF-SA, Colombo, Sri Lanka

with intermediary buyers as well as help producers getting access to cheaper inputs when by pooling their purchasing power and buying in bulk.

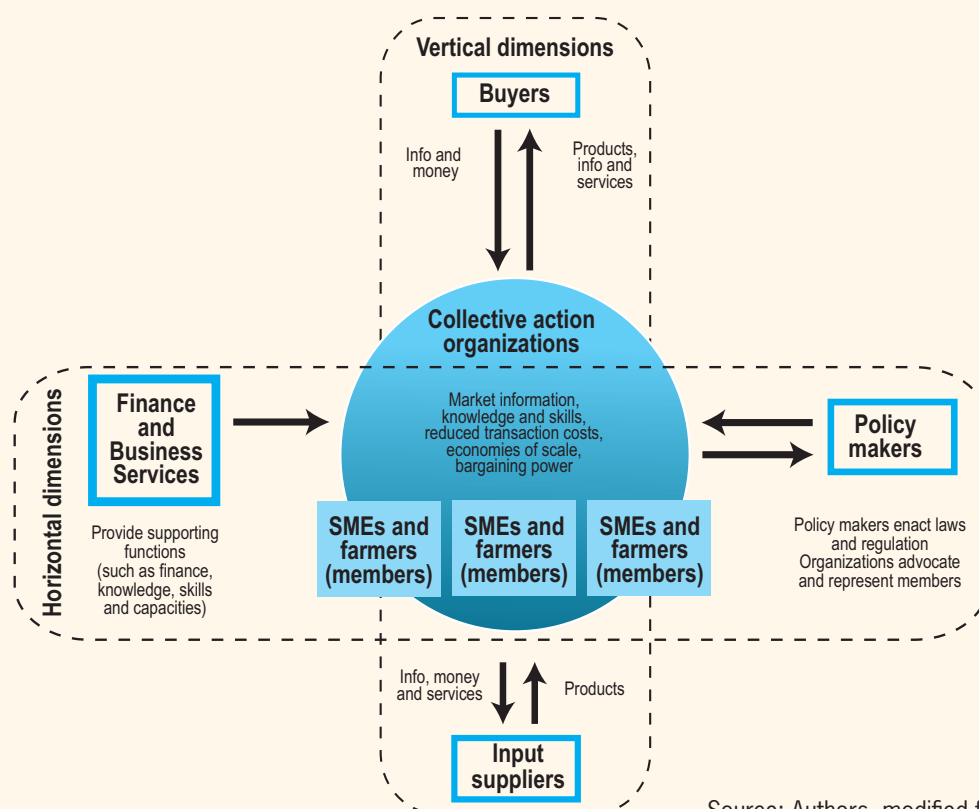
Collective action organizations can also be active players in trying to influence the business environment under which they have to operate. The organization can not only represent its members vis-a-vis buyers but also towards local and national government and play an advocacy role, exercising influence on rules and regulations that might affect the operations. The organization can give enterprises a chance to participate in decision-making processes and also help with new regulations.

Many organizations, especially cooperatives, do also provide finance and business services to their members. Alternatively they can help in linking up to existing financial institutions and business service providers to collectively get a better deal for services provided to members.

The Uruguayan Association of Rural Women works on strengthening women's enterprises (such as production of preserves, honey and baked goods) through training, managerial advice, and access to credit. However, despite all the support, the women had poor access to markets. Therefore, the association decided to shift its focus from institutional support to commercialization and marketing and established Delicias Criollas, a women's cooperative. Delicias Criollas enhanced market access by creating a strong brand, developing marketable products, and finding outlets for sales. Furthermore, the cooperative works towards long-term sustainability by developing new products and creating business relationships with supermarkets and exporting companies

Source: My.COOP. Managing your agricultural cooperative. Module 1.

Basics of agricultural cooperatives. 2011



Source: Authors, modified from ILOs VCD guide

Risks of Collective Action Organizations

The most important actors of the collective action organization are its members. Their engagement and sense of ownership is key. Collective action organizations set up by outsiders or for the wrong reasons are in a great risk of failure. If an outside agent (such as a NGO or government) sets up a collective action organizations in combination with financial help, there is a risk of the organization becoming dependent on the financial aid and it thus might not respond to the incentives set by its market context.⁵ Such a set-up has a high probability of failure as in the long-term the organization needs to be able to operate in the market.

Collective action organizations like any other (commercial) organization are also at risk of being mismanaged. Leading the organization requires entrepreneurial and managerial skills, which members of the organization might not always have. Especially small organizations might not be able to afford to hire professional managers owning the needed skills. Furthermore, managers may take an advantage of the information they have and pursue their own interests instead of interests of the organization.

There are also risks associated to other types of opportunistic behaviour at the expense of others, like free-riding. A free-rider can be a non-member

who receives benefits of the collective action organization without contributing respectively or a member receiving (and paying for) inputs of her cooperative whilst side selling her produce. In both cases the free-riders are undermining the business activity of the organization.⁶

How Can Value Chain Development Help?

Value Chain Development enables policy makers and value chain stakeholders to get a better understanding of their role and potential in a specific Value Chain. A Value Chain Development approach can help in providing crucial information about end-markets and about key underlying constraints that hinder further development. This in turn can inform and enhance the work of business associations and cooperatives or help small entrepreneurs in the decision of why and how to form a collective action organization. Collective action organizations give a voice and representation to producers and small enterprises enabling a more informed and empowered dialogue with other value chain stakeholders. However, it is important to remember that the success of the organization largely depends on the local situation, engagement of people and whether members have a sense of ownership or not.

The example below illustrates the role business associations can play in VCD.

Supporting Sri Lankan MSEs to form Small Business Associations

The ILO Enter-Growth project, an MSE development project financed by the Swedish government, promoted the establishment and capacity-building of small business as-

sociations based on local demand. The project applied a 'light touch' approach instead of direct interventions, the establishment and capacity building were not promoted directly, but it depended on the businesses themselves to take the initiative as a result of their identifying common problems during the value chain analysis process.

⁵ Hellin, J., Lundy, M. and Meijer M. 2007. *Farmer organization, collective action and market access in Meso-America. Research Workshop on Collective Action and Market Access for Smallholders, October 2-5, 2006, Colombia. CAPRI.*

⁶ My.COOP. *Managing your agricultural cooperative. Module 1. Basics of agricultural cooperatives.* 2011

The reasons for supporting Small Business Associations (SBAs) were to promote the dialogue between MSEs and the authorities by providing a stronger voice, improve MSEs' market access in value chains and increase negotiating power with buyers and suppliers, as well as improving the access to training and other business services. All this in turn would contribute to the growth of income and employment within the MSE sector.

Enter-Growth and its partners provided training, overall guidance and management support on how to better manage associations. Through partners the project also facilitated access to technical training on production techniques and entrepreneurship development, negotiation skills etc. It fostered linkages with buyers and suppliers through various events and workshops and helped associations introduce new services which helped to attract more members.

Based on local demand the project helped setting up seven new sectoral SBAs that now serve about 900 members. In addition a majority of the existing associations (19 out

of 27) witnessed an increase in membership numbers. 25 out of 27 SBAs introduced new services from 2006 to 2009. These new services included information on market trends and opportunities, access to fair trade markets as well as accounting and record keeping support. Special attention was paid to the services related to improved market access. More than half of the 27 surveyed SBAs offer services related to increasing members access to markets. Furthermore, SBAs have an increased public profile through advocacy and lobbying activities and many claim that their relations with the authorities have improved. In many districts SBAs now have regular meetings with the authorities to discuss topics related to tax and land issues, sector related problems and how local authorities can help solving arising problems.

Source: International Labour Organisation (ILO). 2009. "Small Business Associations Project Intervention report", ILO Enter-Growth, February 2009, MDF-SA, Colombo, Sri Lanka

Briefing paper written by Emilia Saarelainen and Merten Sievers, November 2011



Links

ILO: Value Chain Development: www.ilo.org/valuechains

ITC ILOs training Course on Value Chain Development and Pro Poor Growth: www.itcilo.org/marketdev

The Donor Committee for Enterprise Development websites: www.enterprise-development.org and www.value-chains.org

ILO and ITCILO: Knowledge-sharing with LED practitioners from across the world: www.ledknowledge.org

Tools

ILO: Value Chain Development for Decent work: A guide for development practitioners, governments and private sector initiatives. 2009. www.ilo.org/wcmsp5/groups/public/-ed_emp/-emp_ent/documents/instructionalmaterial/wcms_115490.pdf

My.COOP. Managing your agricultural cooperative. Module 1 - 4. Basics of agricultural cooperatives. Training package. 2011. Contact Carlien Van Empel: vanempel@ilo.org

ITC ILO Project Design Manual. A Step-by-Step Tool to Support the Development of Cooperatives and Other Forms of Self-Help Organizations. 2010. CoopAfrica, Cooperative Facility for Africa.

<http://www.ilo.org/public/english/employment/ent/coop/africa/download/coopafriaprojectdesignmanual.pdf>

ILO Managing Small Business Associations. Trainer's Manual. 2006.

http://www.ilo.org/wcmsp5/groups/public/@ed_emp/@emp_ent/documents/instructionalmaterial/wcms_101260.pdf

ILO: An operational guide to Local Value Chain Development, Enter-growth. 2007. Colombo.

ILO: Making the Strongest Links: A practical guide to mainstreaming gender analysis in value chain development. 2009.

http://www.ilo.org/wcmsp5/groups/public/-ed_emp/-emp_ent/documents/instructionalmaterial/wcms_106538.pdf

ITC ILOs Market Development Distance Learning Course. Enterprise Development through Value Chains and Business Service Markets: A Market Development Approach to Pro Poor Growth. 2008. www.itcilo.org/marketdev

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