Success or failure?
Comparative case studies focusing on trust and governance issues in the Hungarian fruit and vegetable sector[1]

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Abstract

The proliferation of Producer Organisations (POs) in Hungary begin to stagnate in the last few years, we tried to find the core sustainability problems in our PO system, using two case studies, one on a successful and another one on a once successful, but later failure one. According to the struggling experiences of two very important POs in Hungary it is of outmost importance for the cooperatives to get EU and national support. However, it is also obvious that problems of collective action of farmers and coordination issues in food chains cannot be solved simply by EU and/or government support. The other most important factor is the „human" of soft factor of cooperation, willingness to cooperate and trust should be improved and major psychological obstacles have to be removed in order to facilitate cooperation among the farmers.

Abstrakt

W ostatnich kilku latach formowanie organizacji producenckich na Węgrzech uległo zahamowaniu. Na przykładzie dwóch bardzo ważnych takich organizacji (POs), jednej- działającej z sukcesami, drugiej, której działalność po początkowym sukcesie zakończyła się porażką, sformułowano studia przypadku, ukazujące doświadczenia programów wsparcia takich organizacji z UE i narodowych oraz problemy dotyczące koordynacji działań kolektywnych ze strony farmerów i ich roli w tworzeniu „łańcuchów" dostawców żywności. Inny problem dotyczy niedostatku „miękkich" czynników, czyli kapitału społecznego ułatwiającego kooperację, opartego na zaufaniu i chęci współpracy.

Słowa kluczowe: organizacje producenckie, farmerzy, kooperacja

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1. Introduction

Fruit and vegetable sector is important for Hungary because it is a labour intensive rural sector, connecting around 100 thousand families to agricultural production. It contributes to bio- and cultural diversity: optimally utilizing ecological conditions and maintaining numerous specialty products. The reason for starting this research (supported by OTKA: Nr. K105730) was the fact that proliferation of Producer Organisations (POs) in Hungary begin to stagnate in the last few years, although every known market trend and EU fruit and vegetable policy recommendation suggested further rapid increase of their market share. We tried to find the core sustainability problems in our PO system, using two case studies, one on a successful and another one on a once successful, but later failure one.

The research topic of the study is to examine performance and sustainability of new emerging cooperatives in Hungary. As both success and failure of such cooperatives can be observed, the question arises as to what can make a producer owned organisation sustainable.

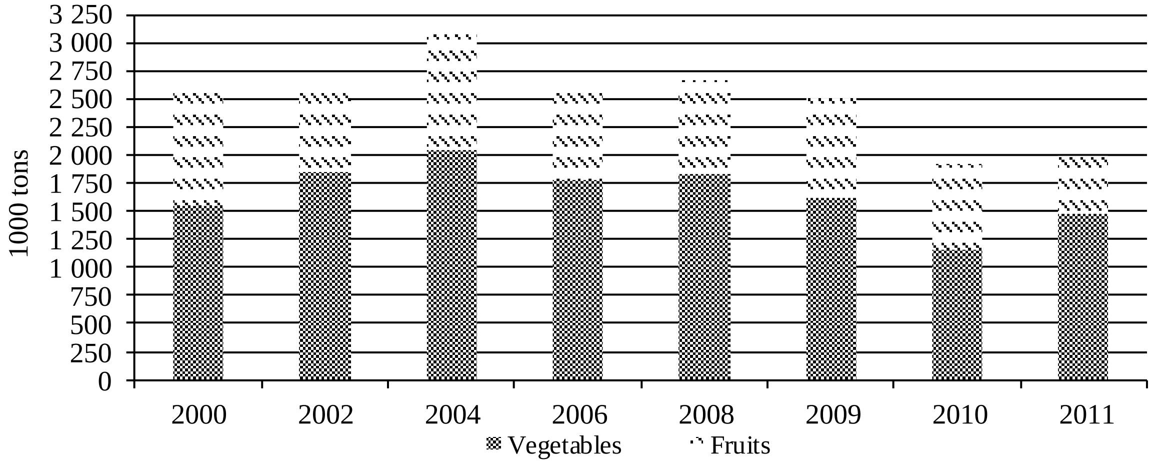
According to a recent (2011-2012) European Research Project: "Support for Farmers' Cooperatives (SFC)" which has been commissioned and funded by European Commission, DG Agri, there are at least three main factors that determine the success of cooperatives in current food chains. These factors relate to (a) position in the food supply chain, (b) internal governance, and (c) the institutional environment. The position of the cooperative in the food supply chain refers to the competitiveness of the cooperative vis-a-vis its customers, such as processors, wholesalers and retailers. The internal governance refers to its decision-making processes, the role of the different governing bodies, and the allocation of control rights to the management (especially the agency problems which are associated with the delegation of decision rights). The institutional environment refers to the social, cultural, political and legal context in which the cooperative is operating, and which may have a supporting or constraining effect on the performance of the cooperative (see Szabó, 2012a,b).

2. The fruit and vegetable sector in Hungary

The sector had a period of decline after EU accession, a short growing phase until 2008 and then the crises period started (see Figure 1).

Figure 1

Production of the Hungarian fruit and vegetable sector



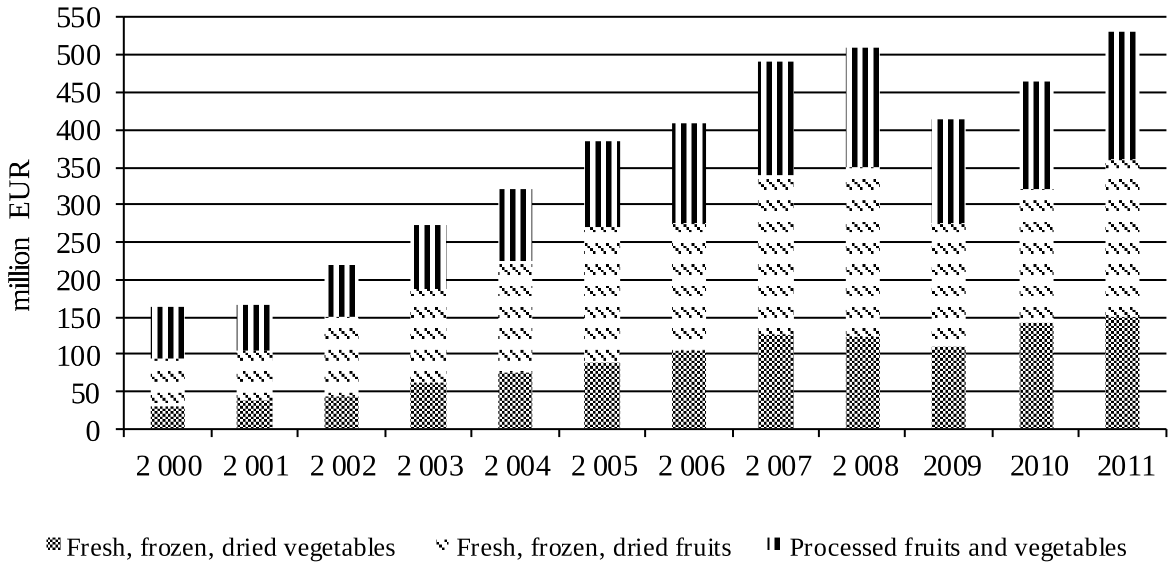
Source: Authors own calculation from data provided by HSCO

Share of fruit and vegetable sector from the agriculture production value declined from 14% to 9%, from the agriculture production area is around 3%. Processing industry buys around 35% of production and consumption from own production decreased considerably from 22% to 6%.

The world's fruit and vegetable trade has transformed, fundamental changes occurred, all of them enhancing international trade and competition. The consumers' preference to decrease seasonality provided remarkable market position for the producers of the Southern hemisphere. Our analyses of the Hungarian situation showed that trade liberalisation happened in a rapidly changing economic and social environment resulting in a complex food supply chain with deep-rooted structural problems. Starting point of steady import increase was 2002, the year of major pre-accession trade liberalization (Figure 2).

Figure 2

Import of the Hungarian fruit and vegetable sector



Source: Authors own calculation from data provided by HSCO

Although vegetable import increased the most, it started from low level, on the other hand fruit trade balance already turned into negative. Even some traditionally competitive Hungarian fruit and vegetables became under serious import pressure.

The changes in the food demand and supply characteristics such as the urban, fast lifestyle of consumers (demand) and the development of logistic and IT solutions (supply) resulted in a radical change of the fruit and vegetable supply chain. Restructuring of the retail sector has direct and indirect implications for the fruit and vegetable value chain. Centralised order and distribution is quite widespread among the retailers present at the Hungarian market even in case of fruits and vegetables. The requirements of large volumes, continuous supply and wide assortment of fruit and vegetables exclude most of the small farmers. These trends were favourable for POs, professional wholesalers and unfortunately also for the large importers.

3. Introduction to the cooperative sector in Hungary

3.1. Cooperative legislation and types in Hungary

The current definition of the co-operative in Hungary is the following:

„The co-operative is an economic organisation and a legal entity, with open membership and variable capital, aiming to meet the requirement of promoting (complementing) the members' business (farming) and in certain cases to meet the demands of membership according to their cultural, educational and social needs." (X/2006)

Personal contribution can be required from the potential members applying for membership and there are so-termed investor-member in the law (60§/X/2006). Altruism and business at cost principle are valid, as well as institutions of the self-governance (General Assembly, Board of directors (5 pers.) – Board of supervisors (3 pers.) etc.) are the same as in every co-operative. The one member – one vote principle is still valid. The law fixes the common rules for the organisational changes.

Regarding agriculture, 3 main types of co-ops can be found in Hungary:

A) "Production type" co-ops (in Hungarian "TSZ") which are most of the time multipurpose co-ops as well and they transformed many times due to the ever changing co-operative laws.

B) Supply and Marketing Co-operatives (in Hungarian "BÉSZ") organised on territorial bases (e.g. integrating more activities and marketing channels) which have not got any support at present (2013).

C) Marketing or "new", western type co-operatives, like POs (in Hungarian "TÉSZ") and PGs (in Hungarian "termelői csoport"), which are often single purposed ones focused on one marketing channel and got support from EU and/or national budget. These are mostly marketing and/or supply co-ops which does not carry out production, but they supplement the farmers' production activity.

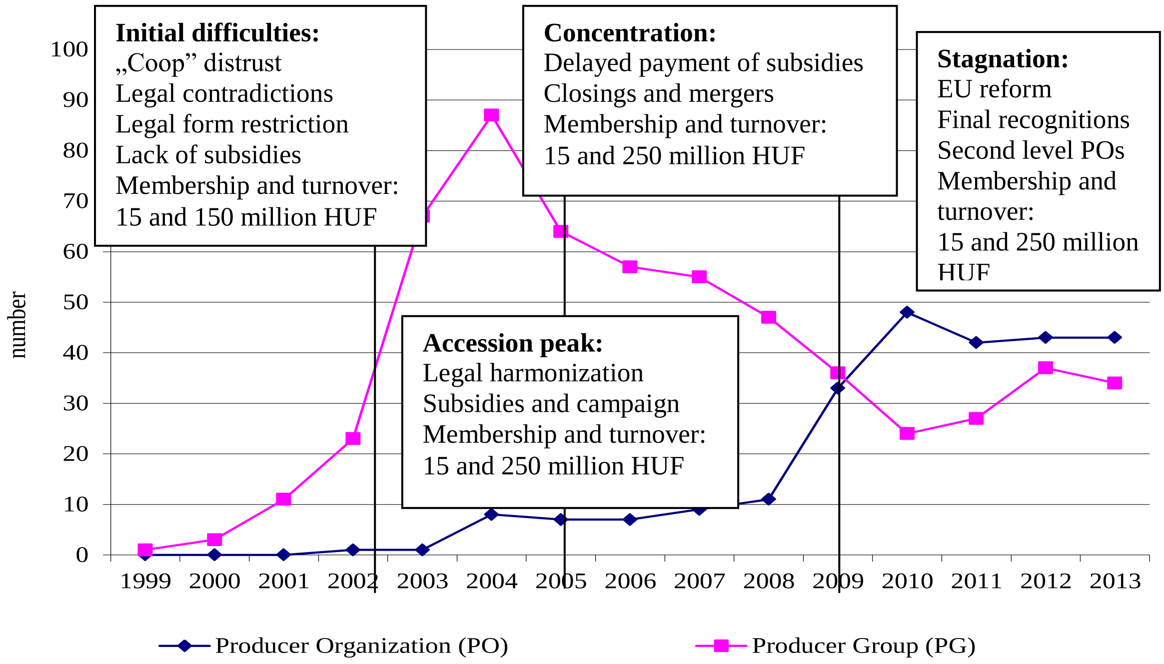
We focus our attention to the C) type of co-ops since the emerging organisations like the two case study co-ops in Hungarian agriculture belong to that that category.

3.2. Development of POs/PGs in the Hungarian fruit and vegetable sector

At present the modern and the traditional fruit and vegetable marketing channels are the most typical ways of supplying the Hungarian consumer with fresh products. In Hungary in spite of the major changes in the fruit and vegetable value chain the wholesale markets share of from the sales is still quite high, approximately 30-35%. The positive elements keeping it alive are the distributional importance, on the spot price formation and rich assortment of new or rare fruits and vegetables. On the negative side wholesale markets are also the place of semi-illegal "tax-minimizing" trade without the least possibility of traceability. Semi-illegal trade is a main obstacle of the further development of POs – being registered as wholesalers – because they have to operate transparently in a sector of the economy where all the others are half hidden (Fodor, 2013). It is no wander that the forming of POs started slowly, until 2003-2004 only the very brave and strong minded formed PO (Figure 3).

Figure 3

POs and PGs in the Hungarian fruit and vegetable sector



Source: Authors own calculation from „E-beszámoló" data provided by National Tax and Custom Office (NAV)

Before the EU accession dynamic development action took place because POs had market regulation functions in the EU, much needed for the Hungarian sector as well (Dorgai et al., 2010). The favourable changes in the subsidy system proved to be successful resulting in a peak number of POs just before the accession. Until today the number of POs decreased considerably and the sales value also seems to increase slowly. The operation of POs did not result in the expected concentration still not being a generally excepted form of cooperation among the Hungarian fruit and vegetable growers.

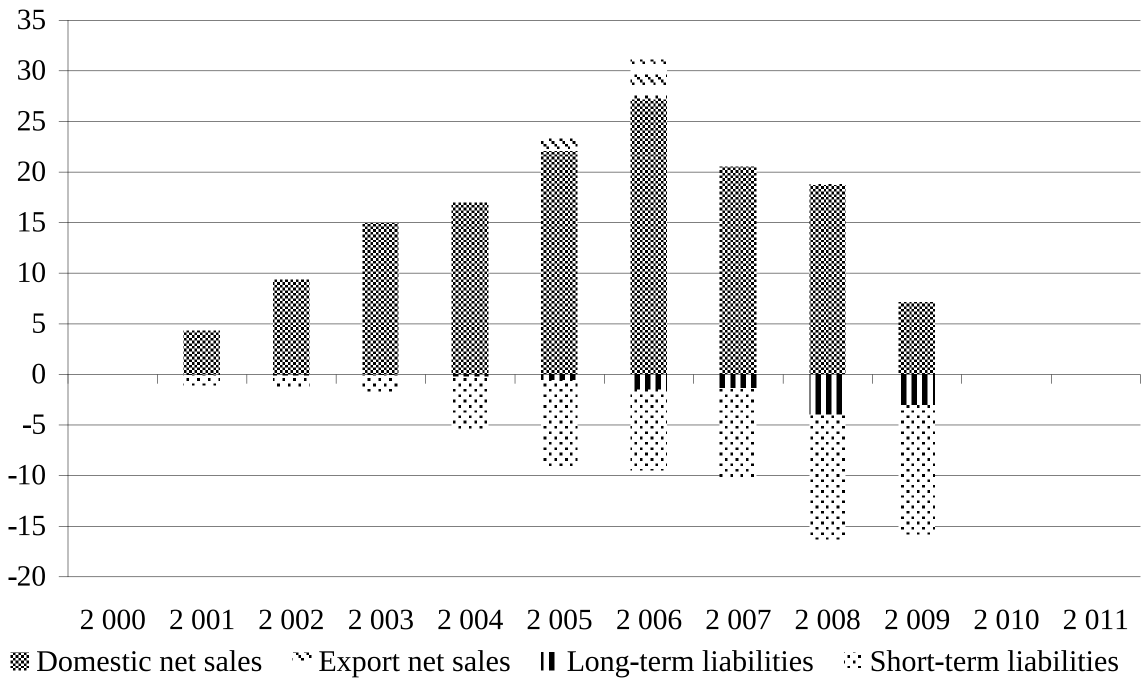
4. Facts and figures of the two case study POs

We selected two POs, representing in many aspects two distinctively different types of the Hungarian POs. DélKerTÉSZ is an off-spring of a former cooperative based production system, with members mainly producing vegetables in intensive glass-house and foliage systems. While Mórakert (established in 1995) was the first officially recognised PO in Hungary, certified in 2002, it was also the largest "flagship" organisation of the Hungarian fruit and vegetable sector and after having been successful for many years, it went under bankruptcy at the end of 2010.

Mórahalom is a city in the centre of the Homokhát Region, the area is a typical agricultural area, approximately 75 per cent of the population of Mórahalom is involved in agriculture. There was a situation in the micro-region of Mórahalom in which about 1500-1800 private (small-holder) economic units attempted to do business at their own risk in the beginning of the nineties. The average area cultivated by the small-holders varied between 3 and 5 hectares. The producers faced oligopolistic and monopolistic players on the market, so they could not influence the negotiation process (including the price offered to them) with their potential partners. At the same time producers did not have enough information about the market, like prices and different actors, and they have very limited negotiation power. It was a real and huge need to build up countervailing power for the small-holder economic units. These joint purchasing activities were extremely successful, as they could decrease transaction costs, e.g. information, negotiation and transportation costs (Figure 4).

Figure 4

Financial data of Mórakert PO



Source: Authors own calculation from „E-beszámoló" data provided by National Tax and Custom Office (NAV)

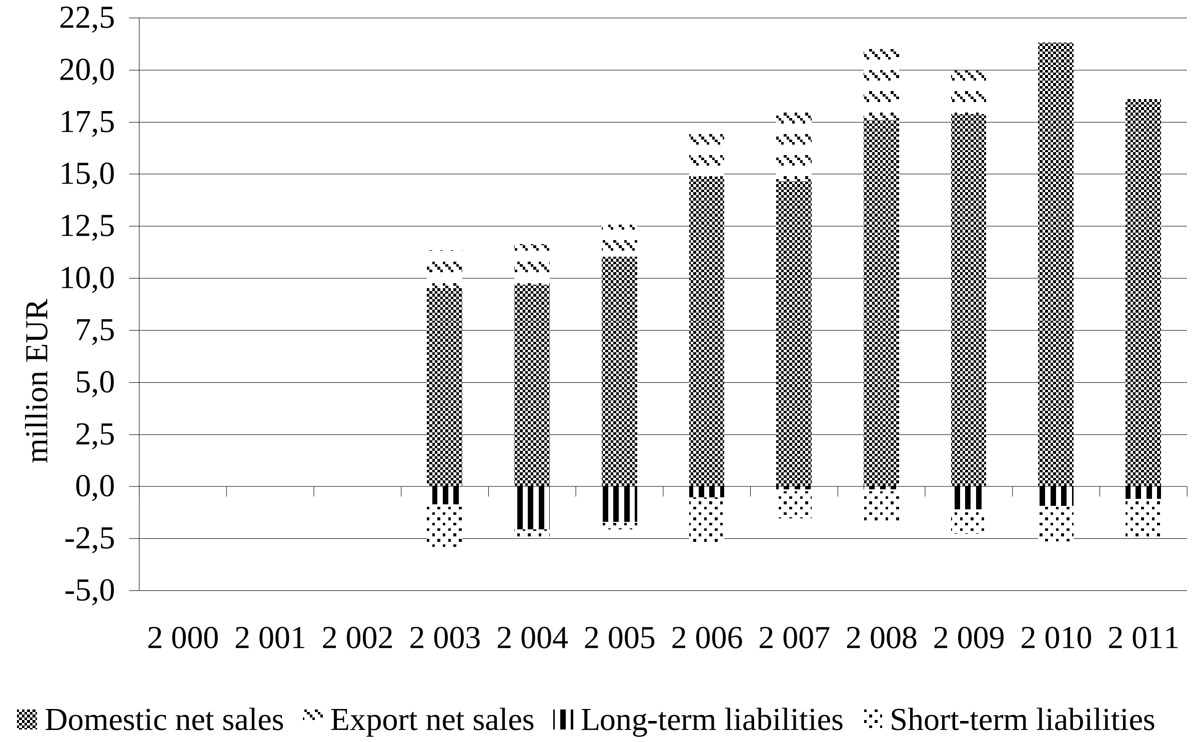
Therefore, the next step was to set up the Mórakert Purchasing and Service Co-operative of Mórahalom in April 1995. The co-op was provisionally recognised as a PO in 2000 and was the first to be officially acknowledged as a PO in Hungary in 2002. The co-operative extended its membership and circle of suppliers (2000 in total in 2005 during the period of 1995-2007 and tried to involve more segments of the chain). The increase in both membership and the turnover of the co-operative demonstrated that the co-op was operating efficiently and it was the biggest and best known PO during that period. The total net revenue of Mórakert co-op reached HUF 8.2 billion in 2006 (EUR 32,6 thousand), a very significant result for the sector. The turnover has decreased in 2007 since it was HUF 5.2 billion (EUR 20,4 thousand), but still a very impressive number. However, 2008 and 2009 were not as successful as the previous ones, for example the turnover of the co-op was HUF 4.7 billion (EUR 17,8 thousand) in 2008 and in 2009 it was about HUF 2 billion (EUR 7,4 thousand). The number of members also declined in 2009, the co-operative had 776 owner-members in July 2009 and 670 in November 2009.

DélKerTÉSZ PO is located in Hungary, Southern Great-Plain region, Csongrád county, Szentes town. The area is a traditional vegetable growing region, where glass-house and foliage production appeared in the 1960's after searching for oil resulted in finding geothermal energy (hot water). In 1975 the former cooperative founded KZR (Early Vegetable Production System) operating as a quite successful integrator of part-time growers in the region. At the peak of KZR (mid eighties) the marketed volume of vegetable (mainly paprika) reached 23 thousand tons, 85% from glass houses and foliage. At the change of political systems, KZR stopped operation but coordination of the farmers continued by the local cooperative (Árpád Cooperative) albeit coordinated volume and number of farmers dropped considerably. The appearance and proliferation of new market players in wholesale and retail promised freedom and new opportunities for the producers. Few years of hectic market conditions had to come for the glasshouse-foliage vegetable growers to realize the need of a new cooperation. More than ten years elapsed from the end of KZR to the founding of DélKerTÉSZ, the time was just right in 2002: the ever increasing input prices and requirements of retailers, the bad experiences with semi-illegal wholesalers, and the uncertainty of the coming EU accession all helped but the final incentive was the new, quite favourable subsidy opportunities for POs (Juhász and Kozak, 2009).

At the end of 2002 277 members founded Délalföldi Kertészek Zöldség-Gyümölcs Értékesítő Szövetkezet (DélKerTÉSZ) PO which applied for and got the final accepted status in 2004 just before the EU accession. In 2007 the PO coordinated the production of 587 members (most of them being small scale farmers), 347 hectares, 12,6 thousand tons of fruit and vegetable and reached 3,8 billion HUF sales (approximately 15,3 million EUR). (Figure 5).

Figure 5

Financial data of DélKer-TÉSZ PO



Source: Authors own calculation from „E-beszámoló" data provided by National Tax and Custom Office (NAV)

Further aims of the co-operative included extending the fund for the operational programme, full extension of integrated pest control, giving professional advice and further improving the quality assurance process, extending the number of costumers inland and abroad, improving logistics and added value (DélKerTÉSZ, 2012)

However, lack of financial resources became the biggest obstacle of the co-op development: more trade could not be financed because of the lack of current assets (revolving funds). Since EU support is post-financed and the administration is very complex the co-op needs (preferential) credits to be able to pay for members' produce. According to experts, apart from the measures mentioned in the report (e.g. New Hungary Producer Organisation Current Assets Credit Programme) factoring with a state warrant would be a solution for the problem.

5. Success and failure factors of case study POs

The analysis of the governance, marketing and embedding in the institutional environment of the two co-operatives (DélKerTÉSZ and Mórakert) showed similarities and distinctive differences in their operation and strategies. Timeline also shows similar development stages: distribution centre, improving grading, packaging, transport and traceability but starting from a different point and different pace of development. We summarise the key success and failure factors of the development of the two co-operatives in Table 1.

Table 1

Internal governance: key success and failure factors

	Mórakert	**DélKer-TÉSZ**
Developement pace	Too fast, the internal governance had less time to adapt	Already existing coop before and sustainable development
Efficiency	Because of increasing HR problem	Quite developed and working management
Members' size	Heterogenity large	Heterogenity considerable
Members' commitment	Only interested in business no real cooperation	Main interest also business
Exclusion of members	Very rare	It is difficult to become a member
By-passing	Increasing problem	Less important because of the incentive program
Trust	Decreased considerably with the management involved in production	Still quite high, especially in the management who is not involved in production

Source: Authors own figure based on the case study results

The most important institutional and financial challenges for both co-operatives were the followings. Financial and economic crisis from 2008 resulted less domestic demand for food products (e.g. fruit and vegetables) and the share of import (e.g. in case of fruit and vegetables) in the Hungarian food market increased. Producers' organisations and co-operatives were and are not competitive because of the black and grey trade on „spot" markets. Banks' willingness to finance current assets (revolving funds) decreased. Late pay-off of the supports (EU funds) and delayed payments (60-70 days after delivery) from the retail chains were also obstacles in the development of the co-ops. High financial burden until 2010-2011 due to "back margin" (e.g.: listing and the so-called "shelf" fee, various donations and bonuses etc.) set up by the majority of retail chains has a negative effect as well.

We have to state that according to our empirical research results, the conditions of successful collective action done by POs are the followings:

- real economic necessity,
- willingness to co-operate – demolition of mental/psychological barriers,
- screening of potential members,
- strict and exact quality and quantity requirements for products delivered to Co-op/POs/PGs,
- consistent adherence to delivery obligations,

- ensuring balanced (liquid) financing both short- and long-term,
- efficient and multi-way communication,
- trust between members and management,
- to get a qualified, skilled and trustworthy manager (either outsider or an active member but professional).
- the crucial issue for the future of agricultural co-ops is the loyalty of farmers to their co-op and to the leaders of the co-operative, especially under uncertainties dominating in transition agriculture like Hungary.

6. Summary, conclusions and recommendations

There were differences between the product marketing strategies of the two fruit and vegetable co-ops since Mórakert tried to provide the whole assortment, whereas DélKerTÉSZ Co-op specialised to be more effective. There was also difference in the pace of the development of the case study co-ops. Mórakert showed a very fast one creating too a large pressure on the financing the co-op. Mórakert exhibited a great heterogeneity of members and other human-factor related problems, while DélKerTÉSZ could retain the trust of the members thus the human capital of the organisation definitely proved to be an important success factor. Unfortunately even in case of DélKerTÉSZ the most serious problems were connected to members' loyalty and commitment. The reasons explaining them are numerous, but the most important one is the high percentage of VAT (27% in 2012) which increase the possibility that members will sell on the spot without any documents/invoices thus by-passing the co-operative route and causing harm to the PO. This opportunistic behaviour is closely linked to the fact that the black and grey economy plays an important role in Hungarian agriculture; its share is estimated to be more than 40% in cases of fresh fruit and vegetable products.

According to the struggling experiences of two very important POs in Hungary and with view on emerging producer owned organisations, *it is of outmost importance for the cooperatives to get EU and national support*. Most of them would have never been able to start without support. However, it is also obvious that problems of collective action of farmers and coordination issues in food chains cannot be solved simply by EU and/or government support. The success stories of the DélKerTÉSZ Co-op and Mórakert Co-op are good examples for the vertical integration based on the horizontal coordination of farmers as initiators. The other most important factor is the *„human" of soft factor of cooperation. Willingness to cooperate and trust should be improved and major psychological obstacles* have to be removed in order to facilitate cooperation among the farmers. So, morals/attitude of farmers has to be changed and psychological barriers should be demolished. Education as early as possible and knowledge dissemination (e.g. different models, forms of co-operation, good practices, successful case studies etc.) are essential in this sense. Economic actions, like support in form of giving (preferential) short term credits for current assets, solving the problem of the black market (e.g. with decreasing high VAT) are also needed in order to help co-operative development:

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