

Formal governance as a necessity for growth in the organic market

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1 Abstract

Different types of governance forms for markets and chains exist and have been described in the economic literature. Several authors show that the governance structure has an important influence on the characteristics, behaviour and performance of “chains” (Geyskens et al, 2006; Ménard, 2004; Scherer and Ross, 1990; Williamson, 1991). Williamson (1991) and Ménard (2004) indicate that the formalization of cooperation will improve performance of “chains” involving more specific products and more risky and more frequent transactions as transaction costs may be reduced. In this context, Ménard (2004) differentiates between different hybrid organisational forms (see Figure 1, below).

Organic products, *ceteris paribus*, have more specific demands than conventional ones as (i) there is the need for controlling whether the organic reference and labelling is respected; (ii) they incorporate more supply uncertainty due to the fact that the options for pest management techniques are more restricted; (iii) there remains more uncertainty about the future demand. This demand is influenced by the fact that the markets are still expanding, sometimes in combination with shock waves caused by food scares (e.g. dioxin and BSE crises in 1999 and 2001), and due to new knowledge that is released about healthiness, environment friendliness and other intrinsic and extrinsic characteristics of organic products.

Organic markets are also far away from perfect free (spot) markets. Firstly, the nature of the “organic rules”, as specified in the EU Regulation 2092/91, strongly limits the market access by requiring a conversion period of often two to three years. Next, atomism is far away, as the number of actors in the organic market is still relatively limited. Finally, transparency is still strongly lacking as indicated by the recent European EISfOM project. These market characteristics therefore also present a strong case for more cooperation.

In the full paper, we present an overview of 15 different examples of cooperation in the organic food sector, representing different European countries (e.g. The Netherlands, U.K.; Germany, Italy, Belgium, ...) and different subsectors (e.g. dairy, meat, vegetables, ...). We will hereby describe the characteristics of the organic products and the markets based upon the framework proposed by Williamson (1991) and Ménard (2004) and shown in table 1. These descriptives will then help to examine our hypothesis that the organic sector needs a higher degree of formal cooperation in comparison with the conventional food sector.

The examples presented in the paper illustrate the existence of some forms of cooperation, but also indicate that in most cases this cooperation has not gone far enough, yet. The report of Willer and Yussefi (2007) indicates that there is currently a strong undersupply of organic produce at global level. Examples from the UK, the leading country in organic consumption in the world, demonstrate that more initiatives are being taken to make stronger alliances to cope with the supply and demand problems within the organic chains. The examples addressed in the paper will therefore cover the importance of cooperation within (hybrid) governance structures to deal with (i) the uncertainty at the level of production and (ii) consumption; (iii) reducing the risk at the producer level; (iv) improving quality and (v) the combination of the former aspects.

2 References

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Figure 1: Classification of “hybrid governance structure” according to product-specificity and risk and the related transaction costs (Ménard, 2004)

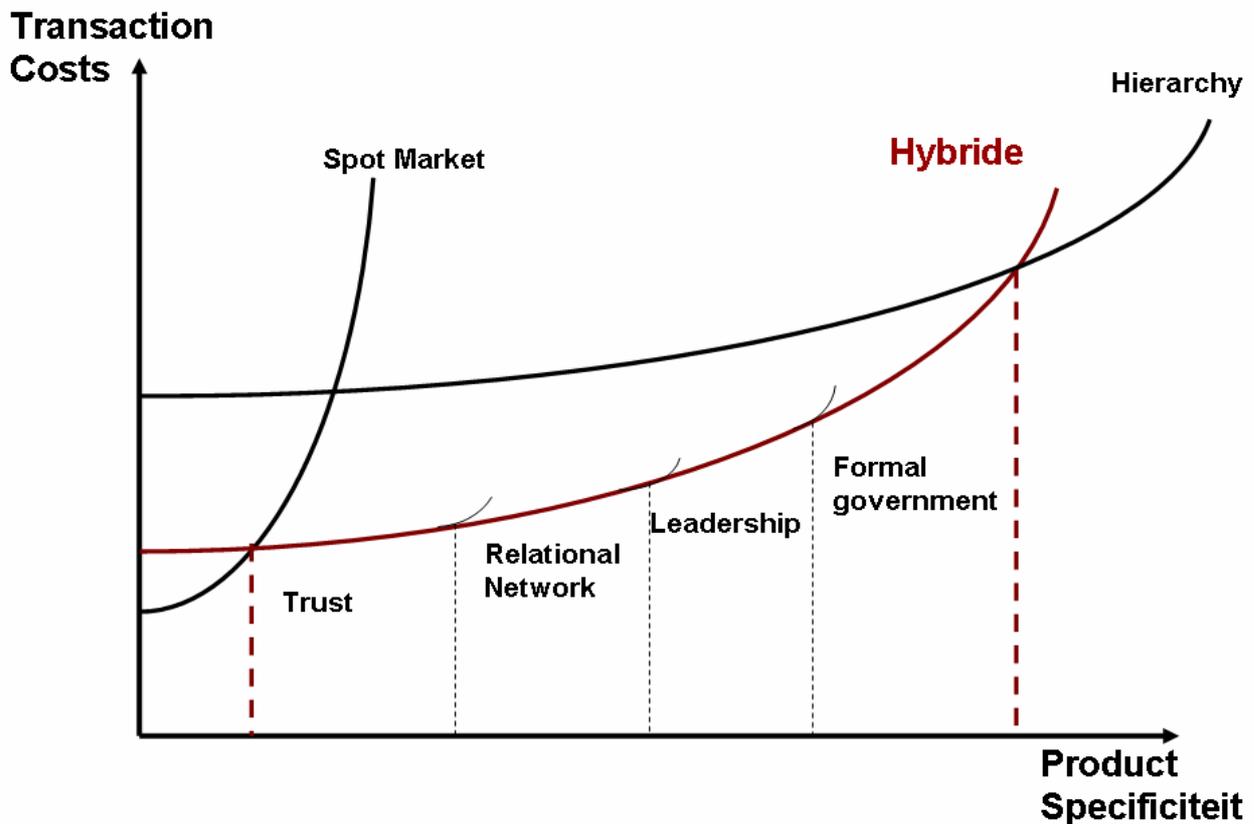


Table 1: Comparison of different market structures

	Spot market	Hybrid form	Vertical integration or Hierarchy
1) Structure	Atomicity : : : - : : : - : : : : - :	Multi- of bilateral : - :	Bilateral : - :
2) Market transparency	Very high	In between	High within the firm/chain not transparent to the competing chains
3) Market access	unlimited	easy to easy	Very easy
4) Power and Coordination	“Invisible hand”: Price & S&D	a) Informal & formal agreements b) “captain of chain” sometimes	1 company owns and steers the whole “chain”
5) Interdependency	No	Moderate to High	Very high
6) Loyalty & cooperation	None	Fairly high	Very high
7) Stability of partnership	none or very low	Fairly High	Very high
i) Product Specificity	Very low: “bulk”	Fairly high	High
ii) Uncertainty / Risk	Low	In between	High
iii) Frequency of transaction	Low	In between	High