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# BRIEFING PAPER

## GROUPS, ASSOCIATIONS AND OTHER HORIZONTAL LINKAGES

### INTRODUCTION

There is general agreement that economic growth is necessary but insufficient for effective poverty reduction. The poor must be able to identify and access growth opportunities and find strategies to overcome the limits of small size and individualistic behavior if they are to contribute to and benefit from economic growth. Facilitating the competitiveness of industries in which the poor are concentrated, together with strategies that reduce transaction costs, can play a key role in fostering economic growth that reduces poverty.

### WHY GROUPS FORM

There is a necessary tension between cooperation and competition among firms that perform similar functions in a value chain and a balance must be struck for optimum performance (see text box). Usually, producers, processors and other enterprises decide to cooperate in order to address specific constraints or take advantage of business opportunities.

#### **FIRM-LEVEL COOPERATION AND COMPETITION**

Competition encourages innovation and the drive to upgrade, while cooperation helps firms achieve economies of scale and overcome common constraints to pursue opportunities. Vertical linkages that do not work well—e.g., when exporters collude on pricing—can cause an imbalance and undermine cooperation and competitiveness. Restoring equitable power and benefits along the chain can encourage cooperation and restore balance.

Horizontal linkages between firms—whether formal cooperatives and associations or informal groups—that reduce transaction costs and create economies of scale typically contribute to increased efficiency throughout the chain. In addition to lowering the cost of inputs and services, including financial services, cooperation contributes to shared skills and

resources and enhances product quality through common production standards. Formal and informal linkages also facilitate collective learning and risk sharing while increasing the potential for upgrading and innovation. Finally, producer groups have the potential to increase the bargaining power of small-scale producers in the marketplace.

Horizontal linkages can also be important for larger firms in a value chain to advocate for change, afford expensive services or achieve quantities demanded by importers.

### CATALYSTS FOR GROUP FORMATION

Catalysts for group formation may be internal or external. Internal catalysts can be a respected or innovative chief, business leader or farmer who realizes that cooperation can help remove obstacles to achieving a common goal. An external catalyst may be a lead firm,<sup>1</sup> an NGO, a donor or government entity that provides the impetus for cooperation and group formation.

Each has strengths and weaknesses. For example, although internal catalysts usually can apply social pressure on potential members to participate, they are likely to be hampered by knowledge and resource limitations and a tendency among some members to *free ride*. On the other hand, while external catalysts are generally more market-driven and savvy about business, particularly if they are connected to a lead firm, they often are unable to generate commitment to, and ownership of, the group. Whichever is the case, the primary motivation for group formation should be to increase members' efficiency, the quality of their products and services, and their ability to negotiate favorable terms and prices.

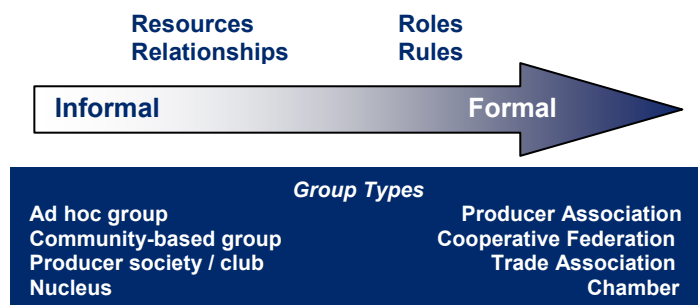
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<sup>1</sup> In this document, a *lead firm* refers to a private-sector firm within a value chain that is recognized as having influence because of its market position, resources, social capital or entrepreneurial nature.

Until recently, many of the organizational structures promoted among primary producers were based on traditional (and often unsuccessful) cooperative models. Formal cooperative systems and operational procedures can be cumbersome and beyond the management capacity of small-scale enterprises.

Groups can be informal or formal depending on their resources, relationships, roles and rules (see figure 1) and on their members' objectives and knowledge. The degree of formality needed to create or maintain the links between members depends on characteristics internal and external to the group. Internal factors include cultural context, social capital, the reason for group formation, and members' knowledge and resources and their leadership abilities. Externally, group structure and formality are determined by government policies and regulations governing groups or associations; infrastructure such as roads, communications systems and markets; and the nature and competitiveness of the industry or service.

**Figure 1: Formality Continuum**



## CHARACTERISTICS OF EFFECTIVE HORIZONTAL LINKAGES

The success of a collaborative venture depends on the following conditions:

- similar commercial orientation, knowledge and productive resources of members
- internal trust and social capital
- external demand for product quality and quantity that individuals alone cannot satisfy
- potential for economies of scale in production, processing, marketing and purchasing
- benefits of cooperation exceed its cost, including time invested

Critical to ensuring internal cohesion and a member-driven agenda are a common vision and purpose and a

match between members' skills and the activities they choose to implement. In general, groups that function well hold regular meetings, elections and activities to foster trust (see text box) and engage and educate members;

recruit professional management; have an open and transparent financial system and profitable operations; and increase their membership over time.

Factors that can erode cooperative behavior include a lack of trust between members; predatory, opportunistic or fraudulent behavior by leaders and *free rider* or *side-selling* behavior by members. An agenda driven by social capital activities or bonding, or group formation initiated by an outside organization with more than one agenda also undermine cohesion among groups.

Leaders are less likely to engage in corrupt behavior when there are systems in place that promote transparency. If written records are required, managers are paid, and producers have current market information (standards, demand, technologies, the price final consumers pay) and knowledge of good practices, leaders can be held accountable. Regular elections and training for all members in their roles and responsibilities and in how transactions take place and records are kept help build trust, reduce individualistic behavior and facilitate group and member communication with buyers as well as integration into national and global economies.

When groups form for reasons that negatively affect member commitment and performance—for example, to access free or subsidized assistance—the groups are often unable to maintain cohesiveness over the long-term.

## RECOMMENDED GOOD PRACTICES

- Analyze the value chain, markets and local culture to determine the most appropriate structure for realizing economies of scale, collective learning and increased bargaining power.

### TRUST

- Engenders cooperative behavior
- Strengthens member commitment
- Helps sustain cooperation
- Improves communication between producers, buyers and other players

- Work with small groups at the bottom of the chain on limited activities with clear economic benefits. Allow group formalization to be driven by the members themselves in response to economic needs.
- Carefully weigh the costs of meeting product requirements in a highly competitive market and of sustaining horizontal linkages with expected returns to group members. Producers should not be encouraged to form associations if the rest of the chain does not function properly.
- Value chain linkages should be based on economic win-win relationships and initiated by internal catalysts, where possible. Links forged by outside agents can lead to expectations of long-term, subsidized assistance and are less likely to be sustainable.
- Trust is an essential element of effective cooperation. Building on social capital generated by existing group activities can provide an entry point for developing horizontal linkages for economic activities.
- Form links at several levels of the chain. In addition to having the resources and political influence to lobby government for more favorable policies, processor, trader and exporter associations consolidate production, set standards to improve quality, and undertake product development and diversification.

## LESSONS FROM THE FIELD

Participation in value chains does not necessarily translate into increased benefits for MSEs—producers must also be able to access higher-value markets and more profitable functions within the chains. Upgrading is key to profitable and sustainable MSE participation, and horizontal linkages can provide opportunities for upgrading through collective learning, cost and risk sharing, enhanced management capacity and better access to support services. The following examples from the field reveal some lessons learned about developing strong horizontal linkages and the types of benefits that can result.

### 1. Understanding the benefits sought through cooperation is essential.

*Horizontal linkages can help producers upgrade, and move into higher value markets.* When the Guatemalan textiles industry faced fierce competition from mass-marketed products manufactured in China and India, it developed a

competitive strategy focused on high-quality, differentiated products. Producers formed linkages to more efficiently learn new designs, upgrade their skills, and market their products.

*Collaboration can increase the bargaining and advocacy power of individual firms.* The Kenya Horticultural Exporters Association negotiated a more favorable EUREPGAP agreement with buyers who agreed to drop some of the most stringent requirements, thus allowing more farmers to participate in the high-value export market.

*Linkages among lead firms can promote national or regional branding and the development of quality standards.* In the Philippines, collaboration by industry leaders in mango exports led to the development of an internationally recognized standard and the branding of Philippine mangoes.

*Linkages can facilitate collective learning, which can drive innovation, increase demand and grow markets through product diversification and new product development.* Specialty coffee producers in Rwanda undergo continual learning in coffee grading, processing and cupping that facilitates the emergence of a common language of quality and taste characteristics and ensures they are able to respond to constantly changing quality requirements. This collective learning opened up opportunities for producers to deal directly with buyers and introduced them to higher-value organic and FairTrade certification protocols.

### 2. There are a range of factors that influence the form that cooperation takes.

*National culture plays an important role in how horizontal linkages are perceived and can act as a barrier to their formation, even in the face of strong evidence that they would be effective.* The horticulture sector in Guatemala provides significant market opportunities (supermarkets) and strong potential for horizontal linkages among producers. However, an historical lack of confidence in the group concept and low levels of trust between producers and buyers hampers group development.

*Conversely, cooperation resulting in clear economic benefits can promote trust among historically conflicting parties.* In Egypt, dairy processors formed an association that broke down decades-old barriers of mistrust and through collaboration led to a dramatic increase in product development and diversification. The association also facilitated the development and acceptance of industry grades and standards.

*Assisting a lead firm to upgrade can stimulate producers to form horizontal linkages to respond to new or increased demand.* In Bangladesh, the Job Opportunities and Business Support project recruited a consultant with expertise in Italian footwear to help a local firm increase its access to export markets. This assistance drove up demand and, as the number of orders for shoes rose, clusters of entrepreneurs began joining forces to form producer groups to meet the growing demand. As these groups grew, they began supplying multiple export firms, which in turn began cooperating with one another on large orders.

*Linkages that facilitate collective learning may be necessary to address cross-cutting constraints to producer and industry competitiveness.* With issues such as soil and water resource management, horizontal linkages make it possible for best practices to be quickly identified, systematized and shared with other industry players. Ethiopian coffee producer groups adopted leeching ponds at washing stations to channel coffee cherry pulp and filter the water before returning it to the ground supply. At the end of the processing season, the groups drained the ponds and used the composted pulp to mulch their coffee trees.

### **3. Appropriate systems and tools can improve the effectiveness of horizontal linkages.**

*ICT can strengthen relationships and increase the effectiveness and bargaining power of groups by giving them access to information.* The Self Employed Women's Association (SEWA) in India provides loans to members for the purchase of cell phones, which enable them to obtain market information and confirm buyer-seller meetings. SEWA also breaks down large handicraft orders and distributes them via cell phone to individual member artisans, and uses video to disseminate technical information to illiterate members.

*Professional management and a common vision among members help reduce fraudulent and opportunistic behavior, increase trust and social capital, and ensure good governance and sustainability.* Despite years of government misuse of the cooperative system, the USAID Agricultural Cooperatives in Ethiopia project won producers' trust by assisting producer groups to form unions, purchase bulk inputs and consolidate production, and by introducing innovative organizational development including professional man-

agement and training for all members. The unions eventually took on the task of advocating with government on behalf of members, resulting in the granting of authority to unions to directly export specialty coffees and import fertilizer, bypassing parastatal and other intermediaries.

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