

Best Institutional Arrangements for Farmworker Equity-Share Schemes in South Africa ¹

by

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Based on research conducted with Sharon Knight and Mike Lyne of the
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Theoretical Benefits

Benefits from agricultural production cooperatives (APC) theoretically derive from their ability to facilitate utilization of scale economies, promote equity, increase workers' incentives, enable technology adoption, and bring forth a higher level of public good provision.

The Failure of Cooperatives

Review of these arguments reveals that there are no significant economies held exclusively by production cooperatives, and communal production introduces severe disincentive effects. It is also questionable whether APCs have a comparative advantage in promoting technical innovations or providing public goods. On most counts, the APC will be less efficient than the large scale mechanized farm or comparable profit-maximizing firm.

World Bank (Deininger 1993)

Other Empirical Evidence

Examples abound of initial successes and then failure of cooperative farming experiments, disabled from without by poor external environments or lack of political support, or paralyzed from within by internal conflict and lack of individualized incentives:

Cambodia, Frings (1993)

Columbia, De Haan and Werter (1985)

Dominican Republic, Meyer (1989)

Grenada, Benoit (1991)

Peru, Hatzius (1994)

Sri Lanka, Gonneratne and Samad (1979)

Group farming enterprises tend to experience four generic problems (Stanfield and Childress 1989):

- Beneficiary demands for immediate consumption needs compete with capital requirements of the enterprise
- Problems incorporating family members into the group farming enterprise (working aged children, spouses)
- Free ridership
- External factors (excessive state control, corruption of management agencies, inadequate credit, new taxes imposed on the enterprise, low initial capital endowments, and inadequate land or natural resource base)

Ongoing search for New Cooperative Forms

Despite these problems, group ownership models have retained an important position in the agrarian systems of many economies. Even studies critical of cooperative performance have not been willing to do away with collective action altogether:

- CIS, Eastern Europe, Russia, Ukraine and Moldova (Csaki and Lerman 1997; Vaessen, Cortez and Ruben, 1999)
- Hungary (Toth, Varga and Paarlberg, 1996)
- Dominican Republic (Meyer 1989)
- Phillipines, Cornista (1992)

In their review of cooperatives in Honduras and El Salvador, Stanfield and Childress (1989) observed certain (not all) enterprises prospering. Those that prospered were able to discover innovations that reconciled self-interest with group interests, i.e. those that:

- 1) reinforced family ties through kinship
- 2) maintained group cohesiveness through place of birth or solidarity
- 3) achieved presence of strong monetary returns to collective action (input supply or export market delivery)
- 4) had access to or support of an external (donor) organization to provide credit, extend knowledge, or provide management, and
- 5) had a strong manager, co-manager or management team.

Problem with Traditional Cooperatives

The distinguishing features of property rights within traditional cooperatives can be summarized as follows:

- Returns are proportional to patronage and not to investment. Members are often required to make the same investments (i.e. purchase equal equity shares)
- Shares cannot be traded at their market value. They are repurchased at par value when a member exits the cooperative
- Voting rights are egalitarian and not proportional to investment

These property rights reflect the underlying Rochdale principle that cooperative enterprises should be controlled by their members and not by capital.

This is quite distinct from an Individual Owned Firm (IOF) where voting and benefit rights assigned to members (shareholders) are directly proportional to their individual investment, and may be traded at their market value.

Inadequate Property Rights? Consequences The Emergence of New Age Cooperatives

Jensen & Meckling (1976), Porter & Scully (1987), Cook & Iliopoulos (1999 and 2000), Hendrikse & Veerman (2001), and Sykuta & Cook (2001) explain the consequences of inadequate property rights:

- ***The free rider problem*** discourages member investment because some of the gains from the cooperative accrue to individuals that did not fully invest in developing the gains.
- ***The horizon problem***: Residual ownership claims do not extend as far as the economic life of the asset. Members tend to under-invest in long-term/intangible assets because they are prevented from realizing capital gains by retiring shares at their market value.
- ***The portfolio problem***: The Coop's investment portfolio does not reflect the interests of any given member. Members cannot trade shares at market prices, hence are unable to diversify/concentrate their asset holdings to fully reflect their personal risk preferences.
- ***The control problem*** refers to the cost that members face in monitoring managers to ensure that they make prudent investment decisions and do not shirk or cheat.
- ***The influence problem***. Above problems have starved traditional Coops of equity capital and raised the cost of capital for investment by increasing the financier's risk exposure. External financiers can do little to reduce this exposure as decisions are controlled by members who have equal or near equal voting rights.

Methodology

While recognizing the many advantages of sole proprietorship, this research project focuses on group ownership models because they represent an unavoidable, significant and (sometimes) flawed pathway to land reform.

Expected viability of rural enterprises		Macro or Meso Policy Environment	
		KR: Constrained Policy Environment	SA: Enabling Policy Environment
Organizational and Institutional Arrangements	Sub-optimal arrangements: Large beneficiary group Non transferable shareholdings No external capital Weak accountability Poorly defined property rights Non-proportional income sharing	Unsuccessful	Minimally Successful
	Optimal arrangements: Small beneficiary group Transferable shareholdings External capital Strong accountability Well-defined property rights Proportional income sharing	Minimally Successful	Successful

Objectives

- Identify institutional/organizational practices that constrain group enterprises created by privatization & land reform using relevant principles from the theory of New Institutional Economics
- Determine the set of best institutional practices that broaden and deepen beneficiaries' access to resources and encourage their productive use
- Apply these best practices to the design or redesign of one or two equity-sharing enterprises that will be facilitated in each country

Comparative characteristics of farmworker equity-share schemes (FWES)

Name of FWES, Location, Registration Date	Turnover 2000/1 (Rands)	Main Enterprises	No. of worker- shareholders	% female worker- shareholders	Workers=equity ¹ (%)		Workers equity – 2000/1 value (Rands)	3 rd party investor/ lender?	DLA grant funding?
					(a)	(b)			
Project 1, Paarl 1997	15,000,000	Olives Table grapes	34	59%	3.5% Trust		551,924	Yes	Yes
Project 2, Piketberg 2000	1,500,000	Stone fruit Pome fruit Proteas	66	52%	6% Company		902,220	Yes	Yes
Project 3, Piketberg 2000	850,000	Stone fruit pome fruit Citrus	70	54%		49% ²	2,170,000	Yes	Yes
Project 4, Elgin 1998	3,100,000	Wine grapes Pome fruit	48	56%	5% Company		656,000	Yes	Yes
Project 5, Elgin 1996	1,200,000	Wine grapes Stone fruit Pome fruit	12	33%	17% Trust ⁵		228,382	No	Yes
Project 6, Piketberg 1997	3,500,000	Table grapes Wine grapes Citrus	36	39%	20% Trust		428,217	Yes	Yes
Project 7, Lutzville 2001	2,500,000	Wine grapes Vegetables	27	33%	40% Company		405,000	Yes	Pending
Project 8, Stellenbosch, 2001	0 ³	Wine grapes	72	53%		50% ⁴	1,440,000	No	Yes

Source: Knight and Lyne, 2002.

¹ (a) - Equity in a single farm-owning and operating entity

(b) - Equity in separate land-owning and operating entity

² Workers have a 49% share in both the land-holding company and the operating partnership

³ Project began in 2001, vines planted in same year. No turnover for 2000/1 as vines were not yet producing grapes

⁴ Land is rented from the Stellenbosch Municipality. Shares are held in the operating partnership only

⁵ Trust now to be registered as a company

Conceptual Framework

{Factors contributing to the performance of a farmworker equity-share scheme}

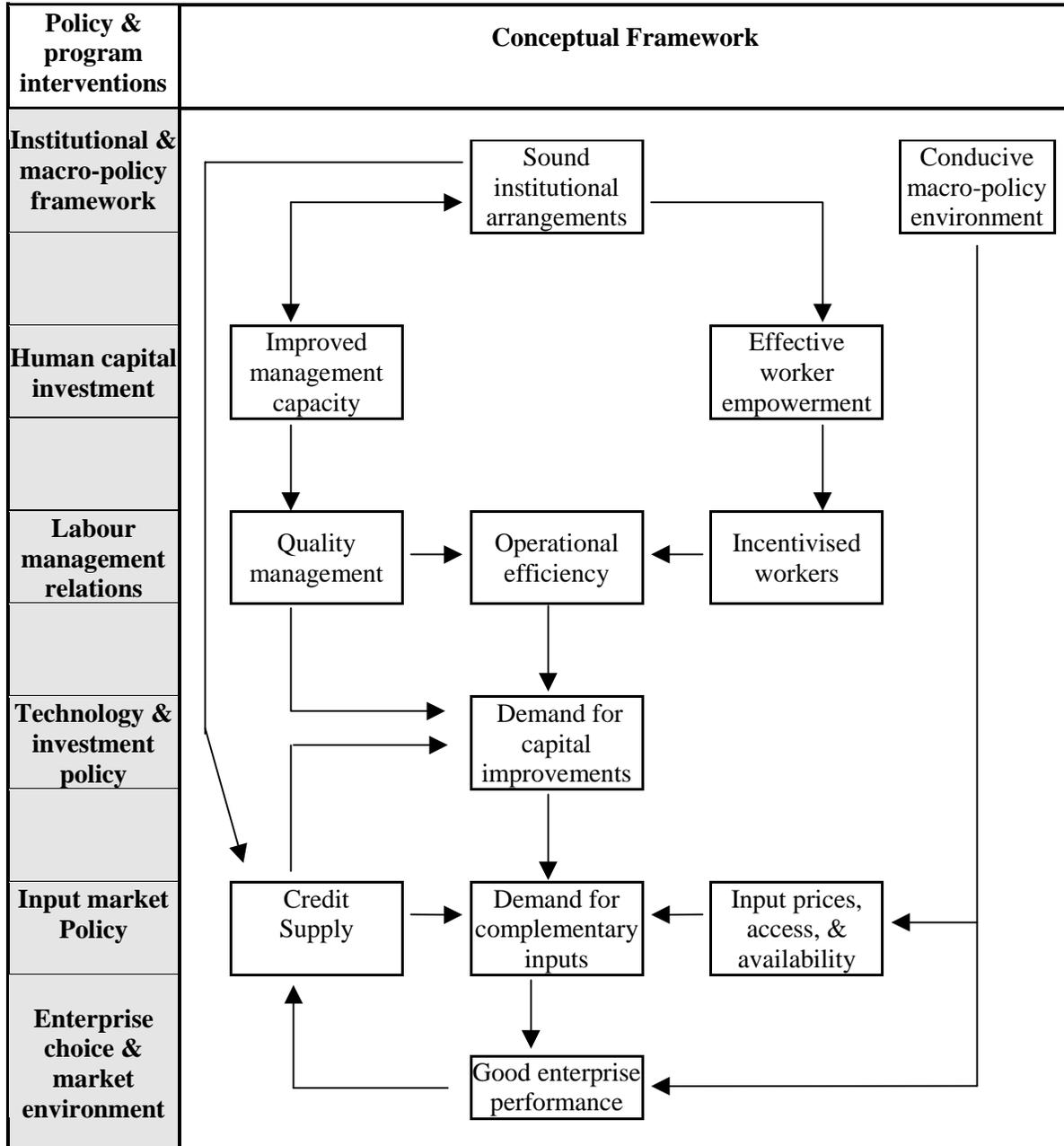


Table 2: Inter-relationships between empowerment, management, institutional and performance indicators

Performance indicators	Skills	skillsm	equity	fertrust	Company	decpower	mgtqual	skillsl	partdm	skillsf	partest	labrel	extaudit	busplan	resolve	incentives	propvote	propprof	nolimit	noheirs	moratorium	noout	exit	grpsize	future
Cluster	1					2					3										4				
Dividend																									
Enterprise																									
Empower																									
Profits																									
Housing																									
Capgains																									
Conditions																									
Wages																									
Collateral																									
Pvtfin																									

Key

Variables measuring worker empowerment	
Variables measuring institutional arrangements	
Variables measuring management quality	

Table 3: Ranking of case studies according to performance and empowerment indicators

Indicators	Enterprise Performance								Social Objectives			Attributes present	Ranking
	Dividend	Enterprise	empower	profits	Housing	Conditions	collateral	pvtfin	skillsg	skillsl	skillsf		
Enterprise 1	1	1	1	1	1	1	1	1	0	1	1	10	1
Enterprise 2	0	0	1	0	1	1	0	1	1	1	1	7	2
Enterprise 3	0	0	1	1	1	1	0	0	0	1	1	6	3
Enterprise 4	0	0	1	0	1	1	0	1	1	1	0	6	3
Enterprise 5	0	0	1	1	1	1	0	0	0	0	1	5	5
Enterprise 6	0	0	0	0	1	1	1	1	0	0	1	5	5
Enterprise 7	0	0	0	1	1	0	1	1	0	1	0	5	5
Enterprise 8	0	0	1	0	1	1	0	0	1	0	1	5	5
Enterprise 9	0	0	0	0	1	0	0	0	0	0	0	1	9

Best Institutional Practices

(Benefit Rights and Transferability of Shares)

An equity-share scheme should be operated as, or like, a company with voting & benefit rights proportional to the investment of each member, but with restrictions on certain share transactions:

1. Limits on the transfer of shares by employees to non-employees through sale or bequest. The workers' trust usually buys shares from workers who leave a enterprise, disbursing the proceeds to the worker or, in the event of death, his or her estate
2. A temporary moratorium on the sale of shares (especially by the previous owner) coupled with a long-term plan to effect a gradual reduction in the proportion of equity held by the previous owner

Best Institutional Practices

(Organisational Features)

The above institutional arrangements “must” be accompanied by other best practices such as:

3. Participation of workers in the design of the equity-share scheme and its operating rules
4. Provision for female representation in the workers’ legal entity
5. Transfer of basic literacy, life and technical skills followed by continuous mentoring in financial, administrative and managerial skills to enable workers to perform their duties as office bearers and to ultimately establish/operate their own enterprises
6. Encourage financial transparency and accountability and adhere to broadly accepted procedures for reporting, conducting meetings and holding elections, including:
 - ⇒ A long-term business plan (especially one accepted by a commercial financier)
 - ⇒ Formal procedures for resolving labour disputes and protecting minority interests
 - ⇒ Incentive schemes for good performance
 - ⇒ An ethic of good management and labour relations

ANNEX: Variables

Performance Indicator Variables Observed in the Case Studies

Variable *	Definition of variables	Empirical construct
Dividend	Has the enterprise been in a position to declare dividends?	Performance indicators
Capgains	Have there been capital gains in the value of shares or assets since the enterprise was initiated?	
Wages	Is the lowest wage earned by a skilled worker-shareholder above the average for the case studies?	
Pvtfin	Has a private sector lender or investor provided finance for the enterprise?	
Collateral	Has a commercial bank accepted the enterprise's assets as collateral?	
Profits	Have worker-shareholders received dividend income or realised capital gains in share or asset values?	
Conditions	Have worker shareholders gained the benefits of being able to influence wages or working conditions and/or do they feel that their tenure or employment security has increased?	
Housing	Have worker shareholders benefited by receiving improved housing or more secure residential rights?	
Enterprise	Have the worker shareholders established their own business enterprise/s on the farm?	
Empower	Do the worker shareholders feel that the enterprise has empowered them, and were they positive about the enterprise and its impact on their lives?	

Institutional, Worker Empowerment and Management Quality Variables Observed in the Case Studies

Variable *	Definition of variables	Empirical construct
Groupsize	Is the size of the worker shareholder group below the median across the enterprises?	Institutional arrangements
Company	Is the enterprise operated as a company versus a CPA or Trust?	
Decpower	Do worker shareholders feel that the power they exercise in policy decisions is at least equal to their share of equity in the business?	
Noheirs	Shares cannot be bequeathed to multiple heirs	
Noout	Shares cannot be bequeathed to outsiders	
Exit	Shareholders must sell their shares if they exit the enterprise	
Propvote	Do shareholders receive proportionally more votes as their shareholding increases?	
Propprof	Do shareholders receive proportionally more profit as their shareholding increases?	
Nolimit	There is no limit on the number of shares held by a worker-shareholder.	
Moratorium	Shareholders cannot sell any shares, even on exiting enterprise, until the temporary moratorium on sales expires.	
Equity	Is the aggregate percentage of worker-shareholders' equity above the average for all case studies?	Worker empowerment
Skillsl	Have the worker-shareholders received training in basic life skills such as family planning, budgeting, dealing with alcoholism and domestic violence?	
Skillsg	Has a general transfer of technical skills taken place and was this training perceived to be at least adequate?	
Skillsf	Have worker-shareholders, or at least their trustees, received training enabling them to read and interpret financial statements relating to the enterprise?	
Skillsm	Have worker-shareholders, or at least their trustees, received training enabling them to serve as office bearers in their trust and the operating company?	
Partest	Did worker-shareholders participate in the establishment of the enterprise through attending workshops, discussion groups, visiting existing FWES etc?	
Partdm	Do worker-shareholders participate in decisions relating to the enterprise's operation (e.g. decisions regarding the expansion or diversification of the enterprise)?	
Femtrust	Were special provisions made to ensure that at least 50% of the worker trustees are female?	
Mgtqual	Was the quality of management rated as good or excellent by worker-shareholders in terms of its technical ability to make wise investment decisions?	Management quality
Labrel	Do workers rate management and labour relations as good or excellent?	
Busplan	Does the enterprise have a long-term business plan that management is implementing?	
Resolve	Are formal dispute resolution procedures in place?	
Extaudit	Are financial statements subject to annual external auditing?	
Future	Are there provisions to extend the percentage of shares owned by worker shareholders in a predictable way to make them majority owners in the future?	
Incentives	Is there a salary incentive scheme of worker shareholders?	

Notes: * For all variables, Yes = 1 and No = 0.