

**BEST PRACTICES IN CROATIAN AGRICULTURAL
COOPERATIVE DEVELOPMENT**



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EXECUTIVE SUMMARY

The focus of this paper is to summarize methodologies used in forming and strengthening farmers' associations and cooperatives in the war-affected areas of Croatia, and to recommend best practices for donors and organizations providing support to these organizations. Due to the importance of agriculture in developing Croatia's war-affected economy, thereby promoting the return of displaced populations, we encourage any future donor organizations working with this sector to follow the recommendations highlighted below as they have proved successful in the past three years. Given the potential size of this economy, however, there is still a long way to go. As the potential is developed and the region is more integrated with Croatia's economy, and that of the region, the methodology will change. At this point, though, the following recommendations still point to the best route for encouraging economic recovery.

Family farms are the foundation of Croatian production agriculture. These farms account for 80 percent of the agricultural land, 90 percent of the tractors, 90 percent of the agricultural workforce, and 45 percent of the Croatian population. In 2000, there were 600,000 private family farms, of which 9 percent offered full-time employment to at least one family member. However, these farms are small and fragmented (averaging 2.8 hectares on 8 plots). During the socialist era, agricultural enterprises (agro-kombinats and socially owned cooperatives) employed 40,000 and produced 35 percent of all agricultural products and dominated the agricultural processing sector and livestock trade. These enterprises were primarily responsible for integrating the small family farms into agricultural markets and in supplying them with inputs and services. Yet, with the introduction of a market economy, these enterprises have collapsed at an alarming rate during the past decade and are no longer reliable partners for small private farmers.

The following 31 recommendations are based on three years of working directly with farmers, farmer associations and cooperatives, and businesses involved in both the upstream and downstream activities related to these agricultural enterprises. Further recommendations have been summarized from work with US-based volunteers who assisted implementation of development work in the agriculture sectors of war-affected regions in Croatia. While not necessarily presented as a chronological methodology they highlight the steps necessary to successful cooperative development, key training issues for members, leaders and managers, and follow up advice necessary to sustainable operation of a modern, successful farmer cooperative in war-affected regions of Croatia.

INTRODUCTION

With liberalization in 1992, private entrepreneurs, trading companies, and newly privatized cooperatives quickly replaced the socially owned enterprises and cooperatives in providing inputs (mostly offered through government programs), and providing alternative marketing channels to small farmers. These private entrepreneurs and companies apply for government credit and subsidy programs to channel inputs of government-subsidized fuel, seed, and fertilizers to farmers. At harvest time, these intermediaries collect crops from farmers to repay government credit and other production credit provided by commercial and informal sources. Intermediaries are also required to pay income tax and have started charging higher commissions for their services. Due to these taxes, commissions, and fees, the final annual interest rate charged by most intermediaries channeling government credit and providing production credit to farmers has increased to more than 22 percent in 2000.

The lack of an alternative marketing and crediting infrastructure and the reduced presence of reliable traders constitutes one of the most important factors in the breakdown of the rural agricultural economy in the war-affected areas. These unreliable intermediaries have increased the cost of credit while also defaulting on payments to the government and farmers. Commercial banks are reluctant to provide credit to farmers because of the risks of defaults. In addition, fuel and fertilizer companies require payment in advance and have resisted government pressure to provide input material to farmers on credit. Since farmers have been cut off from their traditional sources of production credit and marketing channels, they now rely on these intermediaries to access credit and for marketing products.

During privatization and transformation of socially owned cooperatives, 100 percent of the shares from each cooperative (excluding land) were sold to current and former employees at subsidized prices. This transformation process has been completed in most areas, but this phase of the privatization process resulted in several problems. Croatian Serb employees and others displaced in 1995 did not participate in the transformation process. In addition, the employee ownership structure has created challenges for the Cooperatives to adapt to new market realities. They are characterized by low profitability, excess capacity, and over-employment. Members of these former socialist cooperatives are mainly employees (not farmers). Therefore, farmers have little influence on management and the type of activity undertaken. This conflict of interest persists in the cooperatives and results in poor management/farmer relationships. The participation of Croatian farmers as members in cooperatives is thus very low compared to the United States and the European Union. Cooperatives are also no longer able to effectively finance the purchase of raw materials and supplies, or the purchase and marketing of grains and livestock. As a result, many privatized cooperatives in the war-affected areas are insolvent and have collapsed.

Farmers have quickly learned that their personal economic situation will not improve by marketing their products individually to buyers or by accessing expensive credit. However, farmers in the war-affected areas are currently isolated from the market and from accessing production credit. Donors continue to play an important role in the coordination of efforts to provide marketing assistance and production credit to overcome these problems. There are still opportunities to spur development and encourage return by providing these services and items in certain municipalities where the market is not well developed.

Best Practices in Croatian Agricultural Association and Cooperative Development

Since we started the process of forming farmers' organizations in the war-affected areas, tremendous growth has occurred in the number of agricultural associations and cooperatives in Croatia. Numerous NGOs, donors, and the Government of Croatia have also initiated programs to sponsor and support these associations and cooperatives. The focus of this section is to summarize our methodologies used in forming and strengthening farmers' associations and cooperatives in the war-affected areas, and to recommend best practices for donors and organizations providing support to these organizations in the future.

1. *There must be a strong personal financial interest for farmers joining together.*

The initial focus of our efforts in any municipality of village has been to survey the current capacity of production and needs of the producers to determine a personal reason for farmers to come together. The most common need has been access to markets.

2. *Modern cooperatives must be formed incrementally.*

Farmers are initially reluctant to join an organization, since many had negative experiences with socialist era cooperatives. Forming an association first, instead of a cooperative has proven the best initial first step for marketing the concept of a independent farmer organization.

3. *The strongest associations are those having a single purpose from the beginning.*

Associations formed for solely "economic" purposes grow and expand more rapidly. Leaders with this purpose, focus on business activities from the beginning. NGOs should be careful to avoid developing associations with multiple purposes (economic, social, political, etc.) which will result in members dropping out as soon as their primary interest is not given top priority. The primary goal for any such farmer organization is to increase the welfare of its members and to concentrate on the further development of its business activities.

4. *Initial marketing initiatives should be simple and limited to a single commodity.*

The first joint marketing initiatives have concentrated on selling the product that was most difficult for farmers to sell on their own. This activity is simple, but requires NGOs to assist with locating the buyer, surveying and estimating the volume of products on the individual farms, negotiating price and quality, assembling the product for delivery, arranging for collection of payment, making sure the farmers are paid and retaining a small margin for the association. This successful activity has laid the foundation for larger and more challenging operations in the future, and has laid the groundwork for our USAID-funded grant programs.

5. *More complex projects can be developed after an initial marketing success.*

Once an initial marketing activity has demonstrated success, more complex programs can be designed with the farmers' support and involvement, such as obtaining credit from buyers and adding consistent deliver dates instead of a single delivery.

6. ***Operations can expand to include non-members and new returnees.***

Non-members of associations were invited to participate in marketing projects, which benefited the entire community by providing an outlet for products. New returnees have immediate access for marketing products through existing associations and did not have to be founders to participate.

7. ***Business activities should focus on market demand and profits.***

Farmers in transition economies experience challenges surviving in a demand driven market economy. Many farmers continue to plant crops and raise livestock that were traditionally produced without considering market demand and expected returns per hectare. NGOs need to assist with market research and cost-benefit analyses for crops to demonstrate new market realities.

8. ***The level of development determines the activities an association can successfully complete.***

NGOs need to recognize the stage of development of the farmer organization they are assisting and help them engage in activities in which they can succeed and which contribute to their development. Farmers almost always recognize needs that are real and pressing that either require resources the association does not have or that the association is not capable of managing. All communities want new tractors, grain storage, delivery vehicles, etc. The NGO community often finances these items before the association has developed to a level where it is capable of managing the new services and resources profitably. Failures can be avoided with careful feasibility studies of the association's abilities, the market of interest, and upstream and downstream activities, inter alia. Failures mean that resources are lost, NGOs are held responsible for the failures, and further development of the association is hampered or even nullified.

9. ***Large and complex projects are difficult to design for a single association.***

The scale of production in many villages and municipalities is not large enough to attract larger processors and more reliable buyers. A single truckload is initially advantageous. However, the fixed cost of organizing single truckloads is higher than a larger scale delivery schedule that will provide a stronger negotiating position with the buyer and other economies of scale. The goal is to obtain the best price from a reliable buyer. Credit or financing also requires groups of associations instead of a single association because of the economies of scale in lending and loan supervision.

10. ***Processing requires a higher level of organization.***

Before introducing value-added processing services, associations need to be transformed into modern agricultural cooperatives. Processing and other value added projects require a significant commitment of funds. For that reason, feasibility studies should be mandatory (including a financial analysis). The level of detail should depend on the level of complexity for each project. The potential of introducing value-added processing also provides an impetus for the formation of cooperatives.

11. *Transformation of associations into modern cooperatives should be encouraged and supported with technical assistance.*

Transformation of associations into cooperatives should be encouraged and groups unwilling to make this transition should be abandoned or their assistance turned over to other donors. We have often encountered associations that were organized to exist for unclear reasons or just to obtain a donation. Rather than organizing to achieve a common business objective to benefit the group as a whole, which could only be achieved by group action, their interest in staying together appeared to focus on lobbying for donor grants. NGOs should be encouraged to study possible economic activities with these groups that will be feasible and profitable. Once associations are unwilling to focus on group economic activities, NGO efforts with them should cease. NGOs should then consider encouraging the association to seek assistance from another NGO that focuses on funding communities rather than providing economically related technical assistance.

12. *Organizational and Business training is essential at the early stage in association and cooperative development.*

Training in organization and management is crucial to insure that the farmer members understand the democratic control principles of the cooperative and the lines of responsibility. Lack of control and accountability of elected Board Members is often weak and leads to dissension and the eventual breakdown of the organization.

13. *Modern cooperatives are focused on marketing specific products with high profit margins for their members*

Many association members quickly adopted the concept of shifting production towards select products, which offered the largest margin and were in demand on the Croatian market. Once leaders are capable of managing their proposed activities, an Agricultural Cooperative Model can be introduced to the members. This model is designed for farmers who want to specialize their production activities and to begin providing value-added services and processing. Cooperative models and principles from the United States and Western Europe should be introduced and pursued. These models are based on farmer owned and managed cooperatives that provide patronage refunds to members and operate at cost. This model varies significantly from the current model in Croatia, in which farmers are not sole owners, patronage refunds are not paid to farmers, and cooperatives do not operate at cost. The creation of modern marketing cooperatives in Croatia is embryonic and has been endorsed by the Croatian Government.

14. *Flexibility of membership must be encouraged.*

Associations and cooperative members must learn that membership is an active process not static. They will become more successful by taking on new members, where feasible, and eliminating non-productive members. There is a reticence in many organizations towards taking on new members or, where family or community bonds are strong, in eliminating current members. Some members of the community did not initially join the association or others recently returned to the community. Others abandoned the associations once they realized, for example, grants were not immediately forthcoming. Founding members are right to think that new members need to contribute to the association, but should always accept and seriously consider new applications for membership. From the point of view of

NGOs, working with larger groups is less costly and increasing the size of the association is desirable. Most importantly, ethnic differences exist in many of these communities and it is possible to overcome these differences by combining the groups into a single association or cooperative.

If returnee farmers are initially reluctant to join the organization or do not have the resources to pay membership fees, the farmers' organization should offer production contracts to the non-members. This option allows returnees to immediately market their products through the organization. As they accumulate income from the sale of their products, the returnees can then submit applications and pay membership fees.

15. *Both production and marketing are key elements to success and should be developed in tandem.*

In Croatia, international NGOs started providing assistance during an emergency situation and their initial task was to feed, clothe, and house returnees. Subsequently, NGOs provided farmers with what they needed to get back into primary agricultural production that existed before the conflict (seeds, hand tools, equipment, etc.). Recently, however, an increasing demand has emerged for marketing assistance as the farmers they are working with find difficulty in marketing products, in part a success of NGOs in production assistance is responsible for creating the surpluses farmers now have difficulty marketing. These NGOs have responded by exploring marketing assistance for these associations.

16. *Cooperative development requires time.*

We estimate that cooperatives need to be accompanied with a consistent level of technical assistance for up to five years as a reasonable period. Farmers understand the simple concept of coming together to sell a single truckload of products. The leadership of cooperatives will come to understand more complex operations after a number of years of detailed technical assistance in modern management techniques.

17. *A major component of association building and cooperative development is the development of secondary and higher level associations.*

The key to sustainability for farmer organizations lies in the development of secondary level associations. The development of these higher-level organizations will take time. Higher level organizations are still embryonic or do not exist in Croatia. Their development is crucial for the long-term viability of the organizations. These higher level organizations are the ones that will lobby on relevant issues and will serve as a window to the international community. These higher level organizations can be a force to help obtain other things the community needs and in helping manage stores and grain elevators and in helping the community for community-managed projects such as wells, road maintenance, etc.

18. *Coordination with outside donors needs to be maintained by the NGO assisting a specific association or cooperative.*

It is necessary to understand the stage of development of an organization and to keep well-meaning donors from drowning the association or cooperative with resources before they are able to manage them. To avoid discord, donor coordination through an umbrella organization should be utilized. This will avoid one donor being played off against another donor; it will

also insure that associations and cooperatives are able to obtain the resources that they are able to handle and contributes to their growth.

19. *Women's participation needs to be enhanced.*

Women's participation should be encouraged to a greater extent than has been observed in the past. Women should be invited to attend meetings, to become members in their own right, and to develop a more direct role in the management of the organizations. At present, they are often represented by their spouses who either do not fully understand what has transpired at a meeting or fail to communicate what was discussed. Also, associations, cooperatives, and NGOs should use part of their resources as loans to women who have non-agricultural microenterprises. This will lower the risk of having all resources exposed to primary agriculture production and will provide working capital to viable enterprises that do not have access to working capital via traditional commercial lenders.

20. *As funding for cooperative development projects diminishes, NGOs should focus their funding on the further development of cooperatives already in operation in order to make a larger impact.*

As funds for association and cooperative development become more and more limited, NGOs should concentrate on the sustainability of previously established organizations. A tremendous amount of time, education and financial resources are needed to organize farmers into a cooperative and bring the cooperative to the level where it can operate efficiently and manage production effectively. Therefore, NGOs should continue to support the further development of established cooperatives, where the resources can make a larger impact in a much smaller time frame. Otherwise, by commencing a project with a new group of farmers, NGOs run the risk of not having the time or the resources to develop the organization to a sufficient level of sustainability.

21. *US-funded PVOs and NGOs should be encouraged to set up European subsidiaries and encouraged to attract funding from non-US sources.*

US-funded PVOs and NGOs need to attract funding from alternative sources, which could substantially add to their core funding. Many donors are currently limited to a single source of funding to working with European or US funding agencies. Since EU funding is substantial, as well as funding from individual European countries, it's within the interest of US-funded NGOs to set up European operations or subsidiaries in Croatia in order to be eligible for this type of funding.

22. *The time for NGO direct intervention and funding for seeds and other basic inputs is ending.*

NGOs should provide more resources and technical assistance in marketing primary agricultural products. The days of gift seeds and fertilizers will be over soon in most areas. Retail stores, including those operated by new cooperatives, link their members with wholesalers and should provide farmers with these items. The situation is different in several municipalities in the former sectors North, South, and West where the market is not well developed, particularly in terms of credit and equipment. There are still opportunities to spur development by providing these items in the areas with recent returnees. These items can

also be provided through NGO credit programs and payment terms should be at market rates and terms to avoid distorting the market for commercial capital.

23. *The association or cooperative itself is responsible for the choice of activities in which it wishes to participate.*

Cooperative and association leaders are ultimately responsible for the choice of activities in which to participate and in which to invest their energy and resources. NGOs can guide the organizations but should avoid making decisions for them. If the organization decides to adopt a business service that we do not endorse, we still dedicate resources to helping the organization make that project a success.

24. *A basic accounting system and tax compliance training is a must for new associations and cooperatives.*

A basic accounting system is a must for new associations and cooperatives and periodic monitoring by NGOs contributes to the development of the accounting system, enabling it to carry out additional and more complex operations in the future. NGOs should emphasize the importance of having transparent bookkeeping and accounting systems. Local trainers can provide seminars for multiple clients for a reasonably low cost to the NGO. Technical assistance and training should be provided to the members on the purpose and benefits of registering as individual taxpayers in order to be included within the Croatian VAT system.

Avoid Running into Deadends with Grant and Credit Programs

The driving force behind each of our grant projects with farmer organizations has been the ability to market products and to reduce the risk of not being paid by buyers. NGOs need to avoid certain risks such as speculative production and producing without forward contracts. Increasing production on family farms without contracts and reliable marketing options risks losing limited grant and donor funding and, more importantly, risks losing the farmer's investments. A summary is provided for several best practices and recommended methods for lowering the risks of donor grant and credit funds.

25. *Forward contracts need to be signed with reliable buyers.*

Forward contracting production is a relatively new concept in Croatia. Processors, traders and integrators are initially reluctant to sign forward production contracts. Credit reports can be requested from independent agencies to rate the payment history for many possible buyers. Buyers with the most reliable history should be targeted for signing contracts. Cooperatives are often forced to sign contracts with unreliable partners and should always protect their revenues with bank guarantees or collateral, regardless of the reputation of the buyer.

26. *Contracts between farmer members and the cooperative reduce risks for the cooperative and screen the less serious farmers from participating in projects.*

Cooperatives should sign contracts with members obtaining credit or producing for a forward contract. This will screen out the less serious farmers and will reduce the risk of the cooperative not meeting obligations contained in the contracts. Cooperatives should require members to provide collateral or guarantees for production credit provided to meet any forward contract.

27. *Feasibility studies, cash flow forecasts and market research should be completed before committing funds.*

NGOs should thoroughly investigate business plans and proposed activities to eliminate farmer organizations existing solely for the purpose of lobbying for grant funding. If an organization appears to have a clear objective, NGOs should conduct a comprehensive feasibility study and market analysis to confirm the feasibility of the proposed project. If the results of the study and analysis show that the organization's proposed activities are not feasible, NGOs should not solicit a new proposal, but should keep the door open. Projects that are solicited by donors are doomed to failure.

28. *Technical assistance should be provided to members and to the farmer organization before and during the implementation of grant projects.*

NGOs should focus on providing technical assistance to members and the farmer organization before and during implementation of grant projects. Project success depends on the quality of production delivered from the members and the quality of the marketing organization. Local advisors and consultants are available in Croatia and should be used alongside US and European advisors to develop a cadre of qualified local consultants.

29. *NGOs should refrain from directly managing the organization and grant project.*

NGOs should always concentrate training resources to support and develop the managers and leaders of the organizations, and should avoid acting as managers for the organization. The leaders will ultimately be held responsible for choosing and implementing its business activities for members.

Alternatives for Continued Assistance

30. *A national association of independent cooperatives can lobby for reform in taxation, legislation and economic policy in the interest of the farmer members.*

Continued assistance should be provided to support the creation of a national, independent association of agricultural cooperatives. A national association of independent cooperatives is needed to address regulatory and legislative barriers preventing the rapid development of the embryonic agricultural cooperative movement in Croatia.

31. *An inventory credit program can address the grain marketing problems and limited access to production credit for farmers.*

A national association of cooperatives is an ideal partner for introducing an inventory credit program in Croatia. Since many cooperatives and their members do not have access to commercial lenders, an inventory credit program will enable them to use the grain stored in licensed warehouses as collateral for debt financing from commercial banks.

Firm Level Advisory Group (FLAG)

The Firm Level Advisory Group (FLAG) is an initiative to develop Small and Medium-sized Enterprises (SMEs) and farmer organizations as part of the US strategy to support the return of displaced persons and refugees to the war-affected regions of Croatia. The project is financed by a cooperative agreement from the United States Agency for International Development (USAID) and is implemented by FLAG International LLC under a management agreement with the University of Delaware. Since June 1997, more than 90 US volunteers and consultants have provided technical assistance to SMEs and farmer's organizations in Croatia. FLAG International LLC is responsible for managing and coordinating the delivery of services and managing the program in Croatia.

Training and technical assistance programs are individually designed to assist SMEs and farmer-owned associations/cooperatives to improve internal and financial management, increase output and revenues, strengthen marketing, improve profitability and create sustainable employment and income for populations returning to or remaining in the war-affected areas. We have supported the formation of 33 agricultural associations and cooperatives to service the war-affected areas. These organizations provide benefits to more than 12,500 members.

In 2000, we introduced a grant-component to the ongoing technical assistance program, which is a USAID-sponsored fund to capitalize existing association and cooperative clients. In 2000, twelve grant projects totalling USD 800,000 were designed and implemented to capitalize cooperatives and associations with livestock and equipment. More than 650 farmer members were provided meaningful employment and average annual net income per farmer equalled USD 1,956. The grant projects were leveraged with USD 316,000 in donations, short-term loans and infrastructure reconstruction projects funded by other donors including the Lutheran World Foundation (LWF), Arbeiter-Sammeritar-Bund (ASB), UNDP, Stiftelsen Jaeren Produktutvikling, ICMC, UNOPS, NOA, and IRC. In addition, in CY2000, our expatriate, local staff and consultants completed 16 market surveys and 17 feasibility studies, and organized 52 seminars with 1,116 participants. Twenty-one US Volunteer Advisors and 36 Croatian Consultants completed technical assistance assignments with 54 SME clients and 38 Association and Cooperative clients.

We initially introduced our farmer association model in the former UNTAES region in 1997 and expanded the project and introduced the model to the former UN protected sector North and South in 1999. As the farmer organizations expanded and started to develop more complex projects, the Association Model evolved into a traditional Cooperative Development project. To distinguish the new model from the socialist era cooperatives, we refer to "western style or modern" cooperatives during training, technical assistance, and education programs. In 2000, seven additional cooperatives were organized and registered to specialize in one primary production activity and to begin providing value added services for members.