

Rural Market Imperfections and the Role of Institutions for Collective Action to Improve Markets for the Poor

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BACKGROUND AND PURPOSE

Market institutions transmit information, mediate transactions, facilitate enforcement of property rights and contracts, and manage competition. They also address market failures that arise due to asymmetric information, high transaction costs, and imperfectly specified property rights. Without supporting market institutions, rural markets tend to be thin and imperfect, leading to high marketing and transaction costs.

Important market players fail to undertake profitable investments, leading to coordination failures that further hinder market functions. Associated shocks and market risks also worsen imperfections and transaction failures. Institutional innovations that reduce transaction costs and enhance coordination of marketing functions in rural markets—such as producer marketing groups (PMGs) that make use of collective action—can help overcome these problems.

PMGs can enhance market opportunities for small producers by coordinating production, facilitating access to better markets, reducing marketing costs, and synchronizing buying and selling with seasonal price conditions. However, collective action is critical to realizing this potential and is only likely to occur when expected gains outweigh the associated costs of complying with collective rules and norms.

This case study of PMGs in eastern Kenya identifies the potentials and constraints for rural institutions to provide market services for small-scale farmers. It analyzes the role of institutional and organizational innovations in improving the performance of rural agricultural markets in less favored areas with relatively poor market infrastructure, and highlights marketing outcomes and the potential causes of differential success of marketing groups in relation to marketing and other functions

DATA

Data were obtained from a baseline and follow-up survey conducted in Mbeere and Makueni districts of semi-arid Eastern Province of Kenya. These districts were selected because of the importance of dryland legumes in the livelihoods of the poor smallholder farmers and the potential to target these crops to reduce poverty and vulnerability. A baseline survey of

400 households was undertaken in 2003 before PMGs were formed. Households were randomly sampled from a list of all households in the sample villages, and the distribution of members and non-members was decided after the PMGs had been established on the basis of committed and paid up members. Baseline information involved poverty indicators, agricultural production, market participation, and adoption of agricultural technologies.

A follow-up survey in 2005 in the same districts collected multi-level qualitative and quantitative data on broader trends in demographic and resource use patterns, socioeconomic conditions, and overall economic profiles of targeted rural villages. Data obtained from PMGs included objectives and aspirations of the groups, group characteristics, asset ownership, credit access, grading and quality control, bulking and marketing, governance, and major constraints to collective marketing. At the household level, data were collected from randomly selected households comprising 250 members and 150 non-members. Information obtained included data on socioeconomic characteristics, assets, credit and savings, production, buying and selling, and participation in collective marketing.

RESULTS

Collective marketing and its outcomes

Consumers, PMGs, and schools respectively paid about Ksh 7, Ksh 6, and Ksh 4 over the prices paid by brokers/assemblers. This shows that PMGs can be attractive market outlets for small producers. Furthermore, farmers selling their produce at harvest earned about Ksh 1.5/kg less than those who delayed selling for four to five months. This shows that PMGs could exploit seasonal price differentials through bulking and storage.

The higher prices paid by the PMGs to member farmers came at a cost of delayed payments. In contrast, competing buyers paid on delivery or shortly thereafter. This may explain why cash-constrained farmers opted to sell through other channels. The average income lost by selling through the broker channel amounted to about Ksh 4,488/yr, or 7.4 percent of the poverty line income. However, in many cases, the imperfect rural



Producer marketing groups (PMGs) were able to improve market opportunities and enhance links to secondary and tertiary markets through better coordination of production and marketing activities.

grain markets often represent the only option for resource poor farmers to acquire cash in situations where local credit markets are either missing or highly imperfect.

PMG membership

A key question is whether resource-poor and smallholder farmers benefit from PMGs. The results show that they do: membership increases with per capita livestock wealth but decreases with per capita farmland. It also appears that ownership of communication technologies reduces the probability of participating in collective marketing, perhaps indicating that farmers who lack alternative sources of market information may view PMGs as repositories of such information. However, households with less contact with extension services were also less likely to join PMGs, as were those with less contact with NGOs (common providers of agricultural extension).

Governance of marketing groups

An important aspect of governance of PMGs are the rules defining the norms of operations, roles, and responsibilities of various organs and members. All the PMGs have written by-laws governing the running of their groups. The by-laws put more emphasis more on the obligations of the members to the group but are relatively silent on the obligations of the group to members. For example, the by-laws require that members sell their grain through the PMG, make requisite payments and/or contributions, prioritize farming of marketable crops, and contribute actively to the development of the group. Fair and transparent elections are not also consistently practiced, reducing the confidence of members in the group leadership.

Performance of collective marketing groups

Are groups with higher degree of collective action also more effective in providing marketing functions? Six indicators were identified for the levels of cooperation within PMGs: the number of elections since formation, share of members respecting bylaws, attendance of meetings, annual member contributions, cash capital, and annual subscription fees. An analysis of these indicators reveals that the level of collective action varies. Total assets built over time and total volume of grains traded provided indicators of marketing outcomes. The aggregate performance rankings were correlated with higher levels of collective action.

Constraints to collective marketing

The three most important constraints to collective marketing were cited as lack of credit, price variability, and low volumes. Given the low level of market development and lack of service providers in many rural areas, PMGs are unlikely to prosper in a "business as usual" policy environment. Policies that spur PMG growth would include an enabling legal framework, improved access to market information, support to strengthen business skills, and access to essential finance and credit facilities. In Kenya, PMGs are registered as self-help groups (SHGs) but lack legal status as business enterprises, which restricts access to essential credit. Lack of legal standing also means that PMGs can neither be sued nor sue in case of any liability. This drastically diminishes the incentive for financial institutions to do business with PMGs.

PMGs would benefit from a legal framework that facilitates their transition to cooperative societies and a policy framework that seeks to promote, guide, and discipline the operation of markets under the liberalized environment. This may include laws dealing with adoption of quality grades and standards, good agricultural practices, and environmental and consumer protection issues.

CONCLUSIONS AND POLICY IMPLICATIONS

With imperfect markets and limited institutions to support market functions, liberalization strategies have failed to integrate smallholder farmers in less favored areas into the market system. This analysis has shown that PMGs were able to pay higher prices to members and improve opportunities for resource-poor farmers to benefit from markets. PMGs improved market opportunities by bulking, storage, grading, sorting, and selling the produce. The links to secondary and tertiary markets were enhanced through better coordination of production and marketing activities. The PMGs do not benefit only wealthier farmers. On the contrary, the incentive for joining seems to be higher for those with less farmland.

Nevertheless, only relatively successful PMGs were able to exploit this potential. The challenge is to mobilize farmers in participatory governance, provide start-up capital to PMGs, and provide training in business skills. In addition, PMGs need to be supported to transition into legal business entities to facilitate increased access to financial and other services from the formal sector.

The effectiveness of the PMGs was hampered by their lack of cash capital to pay in time for produce deliveries. Cash-constrained farmers found it difficult to delay cash payments, even when future prices would be higher. The ability of the PMGs to access working capital through access to credit is therefore critical. One strategy would be to explore the use of crop inventory as collateral for financial credit. Another option would be to pay farmers a portion of the grain value at the time of delivery so that they can meet immediate needs while benefiting from better prices by delaying full payments.

In addition, the establishment of a "union of PMGs" for expanding horizontal and vertical coordination of production and marketing activities may help address the problem of low volumes and price variability and make the groups economically attractive to financial institutions. The seasonal price differentials may also be exploited further through bulking and storage during periods of excess supply and selling when prices improve. These strategies should be pursued together with alternative options for smoothing supply through investments in drought mitigating and water harvesting techniques that would enable farmers in drought-prone areas manage production risk more effectively.

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