Farmers as Shareholders: A close look at recent experience

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One of the big challenges in achieving the Millennium Development Goals is giving rural communities access to economic opportunities in a global economy. Equally challenging is the question if it is possible for small-scale farmers in developing countries to co-own marketing and sales organizations in developed countries. Does this assure better income and development opportunities than other value chain models, such as contract production for multinational corporations?

At Agrofair, we have more than ten years of experience as a farmer co-owned fresh fruit import and marketing company in Europe. Agrofair has been successful in bringing the first fair-trade bananas to the European market and generating stable income and social premiums for small-scale farmers in several countries. Agrofair has seen its sales volumes reach the €60 million mark and most major supermarkets throughout Europe carry fresh fair trade fruit in their assortment. Most of our farmer cooperatives have become reliable and professional partners, complying with all the quality and logistic requirements of premium customers.

With more than 15 member producer organizations and ethical investors as shareholders, the influence on the company of each individual farmer is of course limited, but nevertheless real as long as the common objectives are concerned. Sharing dividends is particularly a token of sharing together the success and ownership of the company.

Of course, we have also firsthand experience with many issues and questions specific to a farmer co-owned company, some of which are also inherent to any cooperative organization. Should the company be open to new participants, when existing owners fear a dilution of their share? Is there enough coherence between suppliers of different products? Is the social aspect of the company not threatening the commercial success and financial viability at times? Can the company take decisions quickly enough if everybody wants to participate in decision taking? And perhaps the most important in times of economic adversity: Is the company competitive enough to face the discipline of the market?

I believe that it is possible to have practical solutions for these issues. Producer owned companies can and do play important roles. Perhaps the most important lesson is that they have to behave as real commercial and professional companies instead of as semi-development organizations with a “donor logic”.

Preface
It is certainly the merit of this bulletin that for the first time a serious effort has been made to pull together the experiences of four different producer (co-) owned companies and evaluate the significance from a commercial and development perspective. It is important reading for policy makers, programme officers of donors and ethical investors. The subject is even more interesting and relevant in the present time in which unbridled shareholder capitalism combined with excessive risk-taking have wreaked such socio-economic havoc.

The experiences presented in this bulletin should encourage us to think about how we can reshape a globalizing economy and distribute its revenues in a more equitable way.

Hans-Willem van der Waal
Managing Director, Agrofair
1 Introduction

Empowering farmers in value chains

Farmers and farm households around the globe are being increasingly affected by market dynamics. For example, the effect of large scale processing of maize into biofuels in the United States of America is increasing food prices in Mexico. Fertilizer prices rise with increasing prices for crude oil, making these inputs less accessible to farmers in Burkina Faso and other African countries. Prices between agricultural commodities become more and more connected, causing high volatility in both farmer and consumer prices.

Global restructuring in agrifood markets take place and the demand for food is increasing worldwide. Consumer diets and consumption patterns are changing quickly in emerging economies (e.g. China and India), imposing new demands that can hardly be met by supply. Procurement systems become more globalized in order to meet these demands. Sourcing is done beyond traditional boundaries and food has never been as ‘mobile’ as it is these days.

Such rapid changes in the structure and governance of national and regional agrifood markets in developing countries affect the ability of agriculture to contribute to economic growth and sustainable development. Small-scale agriculture, that supports the livelihoods of the majority of rural poor is poorly prepared for these changes (Berdegué et al., 2008).

Subsistence farmers often referred to in literature hardly exist in reality. Any farmer producing a little surplus that he or she sells to a local trader becomes part of a value chain. Value chains come in many forms and can be simple or complex. Farmers are the foundation of these agrarian chains and supply raw or primarily processed produce to the next actor in the chain. Farmers often play additional roles in a chain. They get organised, create alliances with other chain actors and advocate for better and more stable prices. In other words, farmers are not passive farmers but have many options to influence the value chains in which they are involved.

The book Chain Empowerment (Peppelenbos, 2007) identifies two basic strategies that groups of farmers use to improve their incomes: vertical and horizontal integration. Vertical integration means taking on additional activities going up the value chain: processing or grading produce, for example. Horizontal integration means becoming more involved in managing the value chain itself. This is done by farmers improving their access to and management of market information, increasing their knowledge of the
market, their control over contracts, or their cooperation with other actors in the chain (Peppelenbos, 2007).

Horizontal integration is about farmers exercising their influence on decision making processes with other actors in the chain. The level of influence remains relatively low in informal or non-formalized arrangements. In such cases, farmers' bargaining power is determined by the quality and volume of their produce, competition by other farmers, their level of organization and experience with deal making and other strategic decisions. In non-formalized environments, influence by farmers on value chain coordination remains weak, with unpredictable results in terms of advocacy of farmers' interests.

Formalizing horizontal integration is achieved through contracts between farmers and private enterprises, such as supply contracts and contract farming. These arrangements get ample attention in value chain development initiatives and the pros and cons for farmers are well documented. Contracts and contract farming generally reduce transaction costs, reduce imbalances in production and improve markets for credits, inputs and services. But negative side effects may occur including farmers' indebtedness and increased dependency on the contracting firms. In fact, influence by farmers remains restricted to the momentum of contract negotiation. Farmers have little formal influence once contracted. In times of dispute or dissatisfaction, farmers will often breach the contract and sell their produce elsewhere – referred to as side-selling. That side-selling occurs more frequently in situations were there are no formal procedures, or contracts, to guide decision making.

Systematic influence by farmers on decision making processes in value chains requires formalization of their voice. In contrast to informal, voluntary arrangements or ad hoc contracts where influence is weak, corporate level influence can be achieved through shareholding. Shareholding is defined as the holding of shares in a corporation (for more details see Annex 1. Answers to Common questions about shareholding and farmer organizations). Holding refers to ownership, which implies a legal right to influence corporate decision making processes, notably during shareholders' meetings. A shareholder is a part owner of a corporation whose ownership interest is represented by shares of stock in the corporation. Shareholders – also called stockholders – have rights conferred by state law, the bylaws of the corporation and by a shareholder's agreement, if one has been adopted. These rights include attending annual shareholders' meetings, voting during election of directors and receiving dividends.

In small businesses, owners often wear many hats – shareholder, director, officer and employee – with the result that distinctions between these legal categories become blurred. Shareholders have the potential to profit when the company does well, but also the potential to lose money if the company does poorly.

Ownership, entrepreneurship and voice

Ownership plays a crucial role in enterprise development. Specifically, ownership assigns residual rights of control and residual rights of income (Hansmann, 1996). We all consider entrepreneurship important for economic development, but little scholarly
attention has been given to the issue of entrepreneurship in firms that are partially owned by farmers.

Entrepreneurship is a function rather than an attribute of economic actors, and it is expressed through ownership and control over assets (Bijman and Doorneweert, 2008). The entrepreneurship function consists of three different roles: ownership, decision control and decision management. Decision control is about ratification and monitoring, while decision management concerns initiating and implementing activities. The three roles can reside in one person, in an enterprise with a single owner (such as a farm), or can be distributed over different people in a complex organizational structure, as shown in figure 1.

Figure 1  Entrepreneurship functions divided

<table>
<thead>
<tr>
<th>Ownership and control: (Owner/Manager)</th>
<th>Single Proprietor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership: Shareholders</td>
<td>Control: Managers</td>
</tr>
<tr>
<td>Decision control: Board of Directors</td>
<td>Decision management: Managers</td>
</tr>
<tr>
<td></td>
<td>Limited Liability Company (Ltd)</td>
</tr>
</tbody>
</table>

When decision control and decision management are divided between the firm's governing bodies, the owners have fully delegated decision management. This permits the managers to take decisions over asset deployment without bearing any financial risk. These managers will make decisions that favor the majority of shareholders' interests. However, management of decision processes becomes increasingly complex with increasing numbers of shareholders and diversity of interests. All kinds of procedures are introduced to enhance transparency and the ability of shareholders to evaluate the managers' decisions. Managers may deviate from shareholders' interests if control mechanisms are relaxed and shareholders are not able to assess management.

Through making structural linkages in decision-making between owners and managers, the entrepreneurship function will be brought together. In practice this is seen in the case of activist shareholders who demand influence over decision-making at the board room level. It also applies to cases where managers demand a mandate from shareholders for decisions that are fundamentally important to the firm (Bijman and Doorneweert, 2008).
Farmers as shareholders can therefore influence corporate decision making, but effectiveness of their influence depends on the organization of the firm and the complexity of shareholding. In complex organizations, farmers as shareholders will require a representation in the board to empower their voice. In case of complex shareholding, farmers will have to own considerable volumes of shares in order to claim a seat on the board. Structural linkages between the owners, board and management of the firm are key to the efficiency and effectiveness of entrepreneurship. These linkages, including the roles and responsibilities of all parties, have to be glass clear to everybody. Only then will entrepreneurship – essential to the performance of the firm – be properly embedded.

**Power to the shareholder!**

There is increasing debate regarding the way in which power should be allocated under corporate governance systems. Large corporations characteristically have a diverse group of shareholders who have little role in the day-to-day operation of these corporations.

The debate has received renewed attention due to recent proposals and commentary advocating a devolution of power from boards to shareholders. It is commonly accepted – usually expressed in written form in the constitution or charter of corporations – that the business of the corporation is to be managed by the board of directors. The board then delegates power to executives, who delegate managers, who give instructions to employees. There is an assumption that, because of the separation of ownership and control in the modern corporation, shareholders should settle for a risk-assuming role in the corporation, leaving it to the directors to control the management of the corporation. (McCovill, 2006).

But, contrary to this assumption that ruled corporate governance for decades, shareholders of many large corporations can exert more influence on corporate governance. They are concerned with general performance, corporate social responsibility, remuneration schemes for the board members and larger transactions affecting the integrity of the firm. Shareholder concerns played a part in dismantling apartheid in South Africa through divestment. In the past two years, several electric power companies in the US have bowed to shareholder requests of publishing climate risk reports.

According to Bebchuk (2004), providing shareholders with the power to intervene can significantly address important governance problems. In particular, shareholder power to make rules-of-the-game decisions, for example to amend the corporate charter or change the state of incorporation, would ensure that corporate governance arrangements change in ways that serve shareholder interests. Shareholder power to make game-ending decisions to merge, sell all assets, or dissolve would address managers’ excessive tendency to retain their independence. A regime with shareholder power to intervene could in principle improve corporate governance.

But shareholders may not always contribute to the long-term sustainability of a firm. Short-term, individual interests may prevail over long-term corporate sustainability. Shareholder influence must therefore be limited to strategic decision-making and refrain from intervening in operational management. There will always be a grey domain in the
governance of firms where tension can arise from conflicting views or interests between shareholders, boards and managers. Detailed references to the roles and responsibilities of different parties will contribute to resolving these tensions, but a specific conflict management procedure, defined at early stages of evolution of the firm, is helpful to enhance the stability of the firm.

Farmers as shareholders: cooperatives vs. corporations?

Facilitating farmers’ shareholding in agribusiness companies is gaining popularity among planners and practitioners of social corporate responsibility in enterprises. Published literature on the subject is, however, amazingly scarce. On the contrary, literature is abundant on issues such as farmers’ cooperatives and farmers’ marketing associations. These organizational structures differ from the concept of farmers as shareholders in several respects:
- Cooperatives and associations are fully owned by their members.
- They have a purpose of service delivery and not of profit making.
- Cooperatives and associations frequently benefit from membership fees, contributing to their financial sustainability.
- They are – in principle – democratic civil organisations and not corporate entities.

A cooperative is often characterized by three essential organizational elements: user-benefit, user-control and user-owned (Barton, 1989). Thus, in the classical cooperative, ownership is grounded in use transactions rather than in capital investments (Bekkum and Bijnam, 2006).

The classical cooperative distributes benefits on the basis of use. That is, even when a dividend is paid on shares, this dividend is not performance based. An example of this is seen in this book in the Cafédirect case. Bekkum and Bijnam (2006) argue that there is logic to this ownership arrangement. The controlling principle of any enterprise is that of pursuing owner interests. In the publicly listed company this is shareholder value; in the classical cooperative it is use value.

The concept of farmers as shareholders implies that individual or organized farmers own shares in an agribusiness company. This company can be – for example – a farm input supplier, a processing company or a trading company procuring produce from the farmers (as described in Chapter 2, Case 1. Divine Chocolate). The farmer or farmers’ organisation exercises influence through the ownership of shares, be it during annual shareholders’ meetings or when elected in the Board of the business corporation. The latter will normally only apply in case of a large shareholding portfolio or majority shareholding.

The existing literature concerning farmers as shareholders reflects four potential advantages, though some of these need further documented evidence:

1 Influencing company governance and negotiating price policy
Shareholders are the ultimate owners of a company and have a right to vote over strategic decisions. The extent of influence by shareholders and principles of decision making through voting are defined by the articles of establishment of the company. In case of
significant shareholding, farmers or their organizations may claim a seat on the board of directors. Shareholders can use their right to vote during annual shareholders meetings on issues addressing the general price policy of a company, but they can not interfere in day-to-day operations. Negotiations are therefore limited to corporate policy issues. See the side box on North-western Bee Keepers Association for an example.

2 Benefit sharing
This means the profit of the company is reinvested in growth or distributed as dividends among shareholders in proportions equal to their shares. Farmers can benefit from dividends on their investments, which generates additional revenues. Returning to the North-western Bee Keepers example, the Association uses most of its dividends to finance its administrative and logistical costs. Another shareholder of NWB Products Ltd, the Uchimukula Trust, uses its dividends to support needy community development projects (e.g. rural clinics, community schools) and to supplement the funding of NWBA skills training activities (Source: personal communication).

3 Access to credits and other farm-related services
Farmers can obtain bank loans through deposits of their shares-certificates that are used as collateral. Access to credit for inputs as well as access to services can improve with shareholding, as the example of Kenyan tea factories below indicates:

Kenya has a successful smallholder tea sub-sector with over 350,000 farmers as of the year 2000. Together they contribute about 60% of total tea production in Kenya. As a result of liberalisation policies in agriculture, previously government owned tea factories were put in the hands of tea farmers whose companies undertake tea collection and processing. These tea factories are also responsible for procurement of inputs on behalf of farmers as well as the management of farmers’ proceeds from tea sales. By gaining ownership of the processing factories, farmers participate in profit sharing, are able to concentrate on better tea farming methods, confident that their tea business is in good professional hands. Other benefits include the availability of fertiliser on credit (Source: Santacoloma and Rottger, 2003)

4 Binding farmers to a procurement/marketing company, assuring quality control in the value chain
An agribusiness company that depends on the supply of produce from farmers benefits from farmers as shareholders because of their economic and technical interdependence. This potential advantage applies especially in open markets dominated by independent traders and where side-selling (i.e. sales to competitors) is common.

At this point, many readers may have questions about the specifics, benefits and possible risks of owning shares. For answers to the most common questions about shareholding, see Annex 1.

This bulletin is written for people who want to learn more about the challenges and opportunities of ‘farmers as shareholders’, that is, including small-scale farmers’ groups and associations in the ownership of companies that add value and market their produce.
Following the general overview of the issues and prospects presented in this chapter, Chapter 2 provides four detailed cases which examine the ‘state of the art’ in this complex area. The cases look at farmers’ organizations who produce cocoa, coffee, tea and organic cotton, in two Africa countries (Ghana and Rwanda) and Peru, in South America. The emphasis is on how they became shareholders in companies that market their product in the north, the challenges faced and benefits gained for the different parties involved. To round out the picture, brief examples of another marketing initiative in India known as Zameen, and additional background on the work of TWIN Trading are provided.

In Chapter 3, the authors provide a synthesis of experience and offer insights into the different motives for promoting shareholding by farmers. After presenting the perceptions of different stakeholders - the companies, the donors and the farmers' organizations - as described in the cases, a section is devoted to the all-important issue of sustainability (for shareholding by farmer organizations).

At the end, there are annexes that provide answers to several common questions on farmers as shareholders, and a list of selected websites where the reader may go to get current news on the many organizations and fair trade companies discussed in the book.

Farmapine Ghana Ltd (FGL) is located in Ghana’s main pineapple growing area and was formed in 1999 to cater for the technical, marketing and financial needs of the members of five pineapple growing cooperatives. Cooperatives own 80 percent of the shares of the company and the remaining 20 percent is owned by two former pineapple exporters. The company includes about 160 farmers and has contracted over 60 out-growers. In 2003 about 12,000 tonnes of pineapples were exported to Europe and the USA.

Farmapine ensures that farmers adopt good agronomic practices to enhance yields and fruit quality. With the assistance of the Directorate of Agricultural Extension Services, Farmapine trains farmers on planting, fertilizer and chemical application, pest and disease control and overall management of the plant to ensure that quality fruits are produced. Field visits are conducted bi-weekly to ensure that farmers are adopting good agricultural practices. As a result, the percentage of exportable fruits from farmers' fields has increased from 30 to 45 percent within two years. (Source: Alexandra Rottger (ed) 2004).
Case 1 Divine Chocolate Company: from fair trade start-up to mainstream player

Divine was set up in 1998 as the Day Chocolate Company by the Ghanaian Kuapa Kokoo Farmer's Union, producing fair trade cocoa beans, and TWIN UK, a farmer-owned membership organization dedicated to developing fair trade supply chains for cocoa and other commodities. Three other partners were involved: The Body Shop, Christian Aid and Comic Relief. On 1st January 2007, Day Chocolate changed its name to Divine Chocolate Ltd. On February 14th 2007 Divine Chocolate Inc. was launched in the USA.

Divine Chocolate Ltd. annual turnover grew in 8 years to nearly US$ 19 million in 2007. Divine has an average annual sales increase of 26%. In 2007 sales grew by more than 19%, making a pre-tax profit of US $1.3 million. Over the last 9 years Divine sold more than US$ 71.5 million worth of chocolate. In a highly competitive chocolate market these are excellent results for a new entrant.

Kuapa Kokoo Farmer's Union

In 1992, as part of the marketing reforms that were introduced in the cocoa sector in Ghana, the liberalization of internal marketing started. This resulted in the introduction of private licensed buying companies as competitors to the state-owned monopoly in buying cocoa from farmers. A number of leading farmers, including a visionary farmer representative on the Ghana Cocoa Board, Nana Frimpong Abrebrese, saw the opportunity to organize farmers to take on the internal marketing function. Supported by TWIN Trading with start-up finance plus operational and financial advice) they set up a farmer-owned buying company, Kuapa Kokoo Ltd.

In 1995 the Kuapa Kokoo Farmer's Union was established. This farmer's union is a democratically elected union of primary societies with an executive council of local leaders. It has grown quickly from the original 22 farmer groups, or village-based societies, with 2,200 members, to its current registered membership of 48,854.

Throughout the years the Kuapa Kokoo group developed into a complex organization, with a number of different bodies and committees managing key aspects of its operations and mandate (Figure 2).
A niche in the mainstream market

During an annual meeting in 1997, the Kuapa Kokoo farmers voted to invest in making and marketing their own brand of chocolate bar. The aim of the venture was to increase profits from their cocoa, and increase their knowledge of the [European] chocolate market. Such a venture would position the farmers’ union higher up on the value chain.

Rather than aiming for the niche market, where most fair trade products were placed, they would aim to produce a mainstream chocolate bar to compete with other major brands in the UK. A Divine milk chocolate bar, launched in October 1998, made it onto supermarket shelves by Christmas of that year.

Two years later, in 2000, the Department for International Development (DFID) guaranteed a bank credit line from a major UK commercial bank for £400,000 to Divine Chocolate. This was the first time this kind of financial instrument had been used by a UK Government department for development purposes.

The bank guarantee enabled Divine Chocolate to access start-up finance at a competitive rate. It also meant that Kuapa Kokoo could own a significant quantity of shares (33%) of the company, giving them Board representation, a say in how the company is run and a (greater) share of any profits.

The Body Shop used to own 14% of the shares, but donated these to Kuapa Kokoo when L’Oréal took over the Body Shop in 2006. As a result, KKFU owns nearly half (45%) of the company.
Governance

Divine’s Board consist of 13 seats divided between the shareholders: (KKFU – 2 seats, TWIN – 2 seats, Oikocredit – 1 seat, Comic relief – 1 seat, Christian Aid – 1 seat) and 6 independent board members. These independent board members have different backgrounds. Some come from the British chocolate manufacturing industry while others are people with a strong financial background. The independent board members bring added value to the board, e.g. the representatives from the chocolate industry offer their knowledge in strategic decision making, bringing vital business experience not present among the NGO’s, churches and the farmers.

KKFU is the major shareholder in the Divine Chocolate Company. Its representatives (the Chairman and Managing Director) are also involved in strategic decision-making and have seats in the Board. Managing a US $30 million business in Ghana means their input in Divine’s Board is appreciated. Divine’s London-based managing director has direct and regular contact with the Ghanaian shareholders.

Significant benefits for the farmers

Divine doesn’t just pay a fair trade prices for this cocoa it buys. Divine also invests 2% of the turnover in a support programme that has assisted the farmers’ organization and helped build their business. Equally important, for the past three years the farmers have enjoyed dividends from the brand they own.

KKFU receives a minimum price of US$ 1,600 per tonne of cocoa beans and also pays a ‘social premium’ of US$ 150 per tonne. In Ghana farmers are assured a fixed price. Kuapa Kokoo farmers have received part of the fair trade premium in terms of small cash bonuses.

During 2007 KKFU received US$ 338,000 in farmer support and US$ 213,000 in fair trade social premiums. The total tonnes of beans sold to Divine in 2007 was 1,420.

Box 1 Shareholder details for Divine Chocolate Company

The company started in 1998 and issued 99 ordinary shares and some preference shares which went to the international NGO Christian AID. Owners of the ordinary shares were:

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>KKFU</td>
<td>33%</td>
</tr>
<tr>
<td>TWIN Trading</td>
<td>52%</td>
</tr>
<tr>
<td>The Body Shop International</td>
<td>14%</td>
</tr>
</tbody>
</table>

In 2006 a shift occurred in shareholding when the Body Shop pulled out, donating its shares to Kuapa Kokoo Farmers Union. Presently the shareholders are:

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>KKFU</td>
<td>45%</td>
</tr>
<tr>
<td>TWIN Trading</td>
<td>42%</td>
</tr>
<tr>
<td>Oikocredit</td>
<td>12%</td>
</tr>
</tbody>
</table>
Box 2 Stakeholders and their role in Divine's success

Each of the initial and actual partners was chosen to increase market access for Divine and raise consumer awareness (e.g. among Christian Aid's 250,000 members in UK/Europe).

Third World Information Network (TWIN)
TWIN is known for setting up the fair trade beverage company Cafédirect (see Box 5). TWIN does not have an ‘exit strategy’ from Divine. Giving 100% ownership and control to KKFU is considered unhealthy and nor is this the ambition of KKFU. Selling it to a third party, e.g. a venture capitalist or a major chocolate maker, won't work either because their interests would be different and would harm the mission of Divine. TWIN’s intent is to stay in the business and continue be a catalyst in the venture.

Oikocredit
Oikocredit is today one of the largest financiers of the microfinance sector worldwide. They are also one of the few ethical investment funds which finances development projects in the South for the benefit of disadvantaged and marginalized people. Oikocredit gives loans instead of donations.

Since 2006, financial backing by Oikocredit and Lutheran World Relief is helping Divine expand in the American market. They are a shareholder (12%) and have a seat on the Board.

Divine's decision to enter the US market brought new financial risks and huge marketing challenges. Divine approached Oikocredit to discuss the financing of its expansion plans in the US. Oikocredit agreed to invest US$ 750,000 in the new US Company to fund management capacity, distribution, infrastructure and brand marketing. In addition Oikocredit agreed to invest a further US$ 850,000 in Divine UK for working capital essential to finance growth in the UK.

Body shop
Although the Body Shop, after it was taken over by l'Oreal, stepped out of the venture, they had a crucial role in the early success of Divine as a high-profile retail distributor. From the start, The Body Shop allowed Divine to sell its products in Body Shop's 256 stores.

Comic Relief
Comic Relief is a British charity organization, also involved in pro-poor business. It is well recognized by consumers and commonly associated with something ‘positive and fun.’ The benefits of partnership with Comic Relief lies mainly in its positive connotation, brand integrity and its good connections with the BBC and network of British comedians. It supported Divine in marketing its product through advertising on television and celebrities’ endorsement of the product.

Christian Aid
The partnership with Christian Aid, an international aid agency, has been crucial for the success of Divine. Christian Aid is an advocacy agency of 41 sponsoring churches in Britain and Ireland, and is part of the world-wide church community. Christian Aid has 250,000 members actively supporting the organization, providing Divine access to a large and valuable network of consumers.
As shareholders, the farmers also receive a share of the profits from Divine’s booming chocolate sales. In 2007, having paid off all outstanding debt and offset the original set-up costs, the first dividend was paid to Kuapa Kokoo of US$ 82,250, with each member receiving direct payment of US$1. A similar dividend was paid in 2008. For the farmers, the fact that dividends have been paid each of the last three years has been very much appreciated and in their point of view the most important advantage of being shareholder at the moment.

The fair trade social premium has been allocated to the Kuapa Kokoo Farmers Trust (KKFT) which has used the money to fund activities such as the construction of water wells, schools, medical facilities and supporting women’s income-generating projects.

In the 10 years after Divine was established (1998 to 2007) it contributed more than US$ 1.22 million to a farmer support and development programme (see table below), managed by TWIN. The largest part of this funding has been allocated to Kuapa Kokoo in the form of a Producer Support and Development Programme.

### Table 1

<table>
<thead>
<tr>
<th>Year</th>
<th>Turnover (UK£)</th>
<th>Tonnes cocoa purchased</th>
<th>Value of cocoa (US$)</th>
<th>Premium paid (US$)</th>
<th>Divine support (UK£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998/99</td>
<td>103,590</td>
<td>18</td>
<td>28,736</td>
<td>2,694</td>
<td>1,450</td>
</tr>
<tr>
<td>1999/00</td>
<td>468,600</td>
<td>49</td>
<td>78,880</td>
<td>7,395</td>
<td>6,560</td>
</tr>
<tr>
<td>2000/01</td>
<td>1,014,946</td>
<td>109</td>
<td>174,096</td>
<td>16,322</td>
<td>14,209</td>
</tr>
<tr>
<td>2001/02</td>
<td>894,087</td>
<td>100</td>
<td>159,328</td>
<td>14,397</td>
<td>12,517</td>
</tr>
<tr>
<td>2002/03</td>
<td>2,138,142</td>
<td>258</td>
<td>412,304</td>
<td>38,654</td>
<td>29,934</td>
</tr>
<tr>
<td></td>
<td>1,832,476</td>
<td>245</td>
<td>391,264</td>
<td>36,681</td>
<td>25,655</td>
</tr>
<tr>
<td>2003/04</td>
<td>5,586,239</td>
<td>782</td>
<td>1,251,445</td>
<td>117,323</td>
<td>78,207</td>
</tr>
<tr>
<td>2004/05</td>
<td>7,673,293</td>
<td>997</td>
<td>1,594,704</td>
<td>149,504</td>
<td>153,456</td>
</tr>
<tr>
<td>2005/06</td>
<td>8,988,071</td>
<td>1,211</td>
<td>1,937,792</td>
<td>181,658</td>
<td>179,751</td>
</tr>
<tr>
<td>2006/07</td>
<td>10,702,500</td>
<td>1,420</td>
<td>2,136,000</td>
<td>213,000</td>
<td>214,050</td>
</tr>
<tr>
<td>Totals</td>
<td>39,401,944</td>
<td>5,189</td>
<td>6,028,549</td>
<td>777,628</td>
<td>715,789</td>
</tr>
</tbody>
</table>

Note: UK£1 = US$ 1.58

This commitment to assisting farmers reflects Divine’s underlying business model that recognises the importance of reinvesting in the farmers that have contributed to the development of the business and to secure the supply to Divine.

The general aim of this funding is to contribute to the development of Kuapa Kokoo in a sustained way, in line with the growth of Divine’s business, and specifically to strengthen key aspects of the organization. These aspects include governance and democracy, business efficiency – including planning and quality control – and member participation and empowerment, such as support to women’s groups.

In recent years the programme has funded the core costs of Kuapa Kokoo’s Research and Development department, which is responsible for farmer education and training.
promoting membership participation and women’s empowerment, and strengthening governance and democracy within the organization. This programme is therefore critical to the sustainability of Kuapa Kokoo’s business and organization and enables it to respond to the ever changing external business environment as well as the organization’s changing needs and priorities.

By starting out with a very strong roster of shareholding partners, sound financial footing (including a first-ever loan guarantee from DFID) and a powerful market entry for large quantities of cocoa butter (via the Body Shop), Divine Chocolate had many advantages that other (fair trade) start-ups should try to emulate. Not least of these is the very powerful Ghanaian cocoa producing partner – Kuapa Kokoo – which virtually guarantees an uninterrupted, and growing supply of top quality raw material. Divine further capitalises on this advantage with effective communications and a highly competent team of marketing experts, based in the UK and USA.

If you haven’t yet tried a Divine chocolate bar, you haven’t tasted real chocolate (see photo section).

**Case 2  Kuyichi: Breaking into the fashion jeans market**

**Company history**

Kuyichi is a Dutch fashion brand that designs, produces and distributes organic and fair trade jeans and fashion clothing. Kuyichi was launched in 2001 and has contributed to an increase in organic farming and improvement of social awareness in textile factories.

The mission of Kuyichi is to be an innovative and global brand that designs, produces and distributes fair trade jeans and fashion. Kuyichi showcases their ‘Style Conscious’ concept to other brands. Kuyichi is proving that fair trade products can be successful, in respect to style, quality and design.

Stores offering Kuyichi clothes (see photo section) are primarily found in Europe, while shifting to global availability. In 2007, in Lelystad in the Netherlands, the first Kuyichi outlet was opened. Kuyichi jeans are now available in more than 650 shops in 13 countries worldwide.

Solidaridad, a Dutch NGO and founder of O ké Bananas and Max Havelaar coffee, has been the initiator of Kuyichi. The idea was to introduce organic cotton in the European clothing market. Having experience with developing fair trade organic coffee and fruit businesses in Latin America, Solidaridad was concerned about extreme use of pesticides, and poor working conditions/very low wages in the cotton industry, causing pollution, serious health effects, and poverty amongst the indigenous population and factory workers. Solidaridad attempted to change this by convincing the big players in the Dutch fashion industry to use organic cotton, in order to improve living and working conditions in developing countries. However, none of the major brands was interested, so Solidaridad started its own fashion brand. This is how Kuyichi was born.
**Breakthrough**

The four founders of Kuyichi, which include Solidaridad, Foundation Stimulans, Triodos and the Association of Kuyichi Producers, started out each owning 25% of the shares. The start-up capital of US$ 670,000 was raised among Foundation Stimulans, Solidaridad, and Icco/Oikocredit. Triodos Innovation Fund and Cordaid provided a second round of equity, of another US$ 670,000 in 2004.

The ambitions of the founders turned out to be too high. Management problems made the first years for Kuyichi very difficult. Another major oversight was the extended time required to position a new brand in such a competitive market, which is in fact rather normal in the apparel industry.

To keep the company solvent, additional capital was needed, requiring new investors to be brought in. An important turning point in this respect has been the involvement of the Triodos Innovation Fund. When Triodos Innovation Fund became a new investor they demanded an accountability report and screening of the whole company. Triodos also appointed a financial director. The financial director is responsible for the internal organisation, initiating an internal auditing system, long-term financial analyses and transparency towards shareholders.

Kuyichi is now owned by six partners (see table 2) who share the vision of stimulating trade (instead of giving aid) to help reduce poverty. Three of the shareholders are Dutch NGO’s, two others are (ethical/social) investment funds and the sixth one is a farmers union called the Association of Kuyichi Producers.

Two unique selling points of Kuyichi are organic cotton and smallholders being shareholders of the company. Kuyichi encourages farmers and processors to become share-

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Role</th>
<th>% shares owned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Solidaridad</td>
<td>Dutch non-governmental foundation, with expertise in the fields of fair trade and the environment. Solidaridad is known for introducing other fair trade products such as Max Havelaar coffee, Oké Bananas and Eko-O ké fresh tropical fruits. Solidaridad is the catalyst and founder behind Kuyichi.</td>
<td>33%</td>
</tr>
<tr>
<td>Triodos Innovation Fund B.V. and Triodos Ventures B.V.</td>
<td>Triodos Bank is an independent European bank registered in The Netherlands. Their funds are invested in enterprises that are environmentally friendly, socially responsible and/or use innovative business approaches.</td>
<td>Triodos Innovation Fund: 32% Triodos Ventures: 5%</td>
</tr>
<tr>
<td>ICCO</td>
<td>Dutch foundation for development cooperation.</td>
<td>9%</td>
</tr>
<tr>
<td>PPM Stimulans</td>
<td>Dutch social financing foundation.</td>
<td>5%</td>
</tr>
<tr>
<td>The Association of Kuyichi Producers/ Cordaid</td>
<td>See description below.</td>
<td>16%</td>
</tr>
</tbody>
</table>
holders. Their belief is that shared responsibilities and profits make business relationships more durable.

Kuyichi seeks out cotton farmers such as Oro Blanco (see box 3) and small-scale processors as shareholders. The aim is for such farmers and processors to become members of the Association of Kuyichi Producers (AKP), which holds shares on behalf of its members. This Association was initially allocated 25% of the company’s shares.

**Screening new members via the ‘waiting room’**

Kuyichi was reluctant to accept new members immediately because of uncertainties. Would they be able to supply good-quality cotton? Would they turn out to be good business partners? Kuyichi also plans to bring in other groups of farmers and processors. Allocating all the shares immediately would reduce Kuyichi’s flexibility and tie it to a particular group of suppliers - who might turn out to be unreliable.

To address these concerns, Kuyichi created a ‘waiting room’ for aspiring shareholders who are expected to join the Association once they prove their worth. In the AKP identified potential future shareholders are ‘parked’ and given an opportunity to prove themselves as strong, structural partners of Kuyichi. After a certain time and after demonstrating their capability they will be accepted as official shareholders after investing their capital.

This waiting list now includes Oro Blanco, which is a group of smallholder cotton farmers in Peru, and Fashion Company Sahel, a jeans factory located in Tunisia. The aim is to have 5 or 6 members within two years. These new members will be from other major cotton-producing regions such as India, China and Turkey.

**Selection of AKP members**

As mentioned the members are farmer cooperatives, sewing factories or suppliers of fabrics. Members are not only individual cotton farmers.

The three steps to achieve membership are:
- **First step**: stable business relation with Kuyichi for at least one year, this means suppliers have to be able to deliver both quality and volume.
- **Second step**: use of certified organic cotton in yarn and fabrics used in garments.

It is important that the motivation to get certified comes from the members themselves. In principal Kuyichi supports the aspirant member in the certification process.

The AKP owns 16% of the shares (in 2009) which are held in trust by Cordaid. Purchase of the shares was financed by Cordaid, a Dutch development organisation, with a loan of US$ 770,000. The AKP is expected to repay the loan, at 6% interest, over a 10-year period with instalments from dividends. In years when there are no dividends, no
Box 3 What is Oro Blanco?

Launched in 2000, Oro Blanco is part of Solidaridad’s global initiative to produce and market organic, fair trade cotton products. Solidaridad hopes Oro Blanco will be a business model for the sustainable production and commercialization of organic cotton.

Oro Blanco is a joint venture of Solidaridad and small farmers in the Cañete Valley, 150 km south of Lima, Peru. The farmers grow organic cotton of high quality on a small scale, with a total of 260 hectares under organic management. The cotton fibre is transformed into yarn and the entire production process meets European Union regulations for organic cotton. The yarn is marketed through Oro Blanco. Oro Blanco farmers get a higher price for their produce because of the premiums paid to them for organic and fair trade cotton.

In 2006, 30% of company shares were transferred to the organic cotton farmers. Solidaridad, as co-owner of Oro Blanco, still owns 70% of the shares.

In 2008 Oro Blanco sold 9 tonnes of cotton yarn to companies who produce clothes for Kuyichi. During the previous six years (from 2001 to 2007) a total of 30 tonnes of cotton yarn was sold. Equally important for Oro Blanco are the agreements of number of items they will sell to Kuyichi.

Oro Blanco guarantees its farmers a minimum price and the purchase of all the harvested cotton. The minimum price is significantly higher than the average price offered on conventional cotton market. During the last four years of operation, Oro Blanco paid farmers between 25 to 35% more per quintal [1 quintal equals 100 pounds] of cotton than for conventional cotton. Farmers also receive management advice from Oro Blanco on organic agriculture methods and how to operate within competitive markets. With a guaranteed return on their investments and increased technical skills, the farmers earn more stable incomes and become self-reliant.

In addition to higher prices, farmers also receive:
• Regular technical assistance.
• Access to cash and inputs.
• Assistance with quality control.
• Support with marketing, development, and sale of products.

instalments have to be paid. If AKP is not able to fully repay the loan, an extension might be considered. Cordaid can also decide to take back the shares.

Gonzalo la Cruz, managing director of Oro Blanco, is the president of the AKP and has represented the Association since October 2005. He believes that within Kuyichi, small-holder interests are a lower priority than environmental issues and promoting the organic cotton clothing market. Kuyichi is still in process of reducing costs in order to compete in a difficult market. Organic cotton from Peru is more expensive than both conventional and organic cotton from India and Turkey. Manufacturing costs in Peru are also much higher than in Tunisia or Turkey for example.

To stay in business, Kuyichi has been obliged to source cotton from growers other than Oro Blanco, and produce it’s clothes in other countries. Although this policy is not in the best interest of Oro Blanco as a shareholder, from the company’s perspective it is necessary in order to be competitive. However, because Oro Blanco is a shareholder, Kuyichi still sources 10% of its cotton from them.
Although AKP is not yet fully operational, the value of the association is significant. Aside from potential profits (they have just reached the break-even point so no dividends have been paid to date) other benefits are:
- members are part of an exciting international brand;
- members learn about new innovations and technologies;
- exchange of experiences.

One key lesson from this case is the great importance of starting off with a strong management team and good business practices in place. Lack of these brought problems with Kuyichi’s initial development. A positive point is the value of experimenting with new ways to assess, and encourage potential shareholding partners – the ‘waiting room’ concept – which is unique to Kuyichi. Taking a long-term view, and making the necessary commitment in the difficult process of making major changes to the global cotton growing industry is also key to Kuyichi’s eventual success.

While Oro Blanco continues to improve its production, there is optimism on the Kuyichi side that pricing of organic clothing from Peru will become low enough to compete with other regions. One important lesson – for all involved – is that one does not jump into a highly competitive market [like fashion jeans] without ‘deep pockets’ i.e. enough capital to set up a strong marketing campaign to win a healthy market share. This is something that TWIN was more successful in doing with Cafédirect and Divine Chocolate. However, it must be said that, fair trade coffee and chocolate bars are not in the same consumer bracket as high-priced fashion blue jeans.

**Case 3 Cafédirect: taking on the competition**

The collapse of the International Coffee Agreement in 1989 sent market prices plunging, putting the livelihoods of millions of smallholder farmers around the world in jeopardy.

In response, three coffee growing communities – in Peru, Costa Rica and Mexico – each shipped a single container of coffee, lent on trust, to the UK. The beans were roasted and sold through church halls, charity shops and at local events. Cafédirect was born!

Cafédirect is the innovative result of a decision by Oxfam, Equal Exchange, Traidcraft, and Twin Trading to bypass the conventional market and buy coffee directly from disadvantaged growers in developing countries. Today Cafédirect works with 39 grower organizations in 13 developing countries, encompassing more than 250,000 farmers (see photo section).

Cafédirect has been a pioneer in ethical business practice. They began trading three years before the Fair Trade Foundation mark was first used in the UK and they were the first coffee brand to carry the mark.

Cafédirect’s largest sales channel is via the major UK food retailers, accounting for nearly 65% of their total sales. The strongest growth however is in the out-of-home sales sector, which grew by an average of 33% per year to £5.6 million in 2008. Cafédirect’s turnover in 2008 was £22.3 million, up 1% on 2007. The company’s profit before tax improved from £705,000 in 2007 to £901,000 in 2008.
Together, Oxfam, Equal Exchange, Traidcraft, and Twin Trading founded Cafédirect. Until 2004 they were the only shareholders, each owning 25% of the company's shares. The coffee cooperatives were coffee suppliers of Cafédirect. Their numbers grew rapidly to around 30. In order to scale-up promotion/marketing for the brand, money was needed. The money was raised through a public share offering.

Currently Cafédirect's market share is under pressure from an increasingly competitive environment. Consumers with ethical concerns have come to see fair trade products as a brand, rather than a certification, and seem to assume that all fair trade companies and products are similar.

### Cafédirect goes public

In 2004, Cafédirect successfully executed a big public share issue (thus becoming a publicly listed company), raising £5 million from 4,500 investors. The decision to issue shares was guided by a wish for more inclusive ownership. The opportunity enabled coffee growers, consumers, employees and founders to buy shares in the company. Grower cooperatives now play a key role in every aspect of Cafédirect, from governance to product design. They own part of the company (4.9%\(^1\)) and have 20% representation on the Cafédirect board. Not all the cooperatives have the same amount of shares.

#### Table 3 Ownership of Cafédirect shares

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Number of shares</th>
<th>% of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Twin Trading Ltd</td>
<td>907,500</td>
<td>10.1</td>
</tr>
<tr>
<td>Traidcraft plc</td>
<td>905,000</td>
<td>10.1</td>
</tr>
<tr>
<td>Equal Exchange Trading Ltd.</td>
<td>903,000</td>
<td>10.0</td>
</tr>
<tr>
<td>Oxfam Activities Ltd.</td>
<td>903,000</td>
<td>10.0</td>
</tr>
<tr>
<td>Cafédirect Producers Ltd.</td>
<td>440,000</td>
<td>4.9*</td>
</tr>
<tr>
<td>Rathbone Nominees</td>
<td>322,650</td>
<td>3.6</td>
</tr>
<tr>
<td>Consumers (Public)</td>
<td>3,813,967</td>
<td>51.3</td>
</tr>
</tbody>
</table>

* the Board is considering increasing this proportion to 25% or even 30%, to give farmers more ownership of the business.

No other shareholder owns more than 3% of the company's shares. The company limits the number of shares in which a shareholder has an interest to a maximum of 15% of the company's ordinary shares.

Cafédirect's shares are traded on a 'matched-bargain' basis where buyers and sellers who have registered are matched when shares become available. The share price is agreed between buyers and sellers via Brewin Dolphin.\(^2\) The most recent price paid for Cafédirect shares was £1.10.

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1. 4.9% equals 440,000 shares (valued at £1.10 each), divided between 39 cooperatives.
2. Brewin Dolphin is the UK’s largest private client investment manager, with approximately £20 billion under management. People interested in trading Cafédirect shares must contact their registrars.
Of the 440,000 shares, 110,000 are held in trust by the company founders. These shares are reserved for new cooperatives that are invited by the board to join Cafédirect. The most important criteria is the added value of the coffee variety to the product portfolio of Cafédirect. In practice, cooperatives rarely buy or sell shares.

Financial gains are not considered, because dividends have never been paid. Nor are there any rights related to the number of shares the farmer organizations have. They all have one vote. Between them they decide where to allocate the money from the Producer Partnership Programme such as the cooperatives with the highest needs for capacity building.

**Governance**

At the time of the public share issue in 2004, a new board structure was put in place and consists of:

- Non executive chair
- Chief executive
- Finance director
- 2 Independent non executive directors
- 2 Producer directors
- 1 Guardian nominee director
- 1 Consumer director.

**Box 4 Profile of a Cafédirect supplier**

COCLA* is a member organization of the Cafédirect Producer Ltd. It owns 33,000 shares. A Peruvian, Raul del Aquila, is COCLA’s president. The farmer organizations appointed him as one of their two representatives in the Board. Re-elected to the Board twice, Raul del Aquila earned the members votes because of his broad knowledge and many years of experience in the coffee sector. Raul de Aquila states that most of the farmer organizations do not aspire to own more shares because owning more shares does not necessarily mean more financial benefits. Dividends have never been paid.

For COCLA the most important reason to be a shareholder is the prestige they get at their local home market in Peru. By being part of Cafédirect, they must comply with the quality of Cafédirect’s Gold Standard which opens marketing channels to other countries. The membership also gives COCLA access to funds and bank credit.

Meetings with the other farmers organizations is an excellent opportunity to exchange ideas, experiences and market information.

COCLA’s member coffee farmers main concern is producing and selling more quality coffee for which they get a better price selling through Cafédirect. Other reasons to be a shareholder are to have a representative on the board, to be aware of what is going on in the company and to have some decision making power in the future of Cafédirect.

* Central De Cooperativas Agrarias Cafetaleras Cocla Ltda’ (see list of websites)

**‘Guardians’ share**

In Cafédirect there is one ‘Guardians’ share, held by the Guardian Share Company Ltd. This company is equally owned by the four founders of Cafédirect (Equal Exchange
Box 5  TWIN leads the way

Established in 1985, TWIN (Third World Information Network) is the leading alternative branding company in the UK. TWIN is a farmer driven membership organization owned and guided by its farmer partners and individual experts, combining their expertise and experience to realize fair trade goals.

TWIN’s membership includes 24 farmer cooperatives in 8 countries, encompassing a grassroots network of over 1000 co-ops, which represent more than 163,000 farmer families. Additionally, there are 13 individual members with wide experience in the world of business and development.

TWIN develops new businesses that capture greater value for its members - both financial and as well as political. To capture value in the global supply chain, farmer partners need to have much greater visibility and awareness among consumers. Recognizing this, TWIN has been instrumental in developing the leading fair trade brands in the UK. By reinventing the business rules TWIN has had a significant influence on changing UK attitudes to food sourcing policies and helped establish and grow the fair trade market in the UK.

TWIN’s first venture with a fair trade product and ethical retailers was Cafédirect, launched in 1991. The coffee which was produced and marketed through Cafédirect was the first quality fair trade product to reach a mainstream market in the UK.

In 1998 TWIN launched the Divine Chocolate Company, to create a fair trade brand for cocoa farmers in West Africa. In the 1990s TWIN supported the development of Kuapa Kokoo, a cocoa farmer organization in Ghana. The members of Kuapa Kokoo have become shareholders of the Divine Chocolate Company. TWIN’s third venture was through collaboration with the Dutch fair trade partner Agrofair. This resulted in the set-up of Agrofair UK in 2001 to market fresh fruit to retailers in the UK. TWIN’s latest venture is the Liberation Nut Company, a 100% fair trade nut company.

TWIN’s involvement in these businesses helps to ensure a continuing balance between challenges at the farmer and at the consumer level; on the one hand the companies have to be competitive in the consumer market, raise awareness and build consumer support for fair trade, while on the other hand they need to follow the standards by which fair and conventional trade is judged.

TWIN works closely with their brand partners and supports them by delivering contractual responsibilities, effective communication through the supply chain and support for investment in farmer organizations. TWIN’s work has four essential components:
- strengthening farmer organizations by their Producer Partnership Programme.
- marketing and market access of fair trade products for farmer organizations.
- networking, information and knowledge generation to influence policy debates and to increase market awareness amongst farmer partners.

What makes TWIN’s model unique and key to its success, is TWIN’s long-term relationships with farmer organizations. Unlike many other traders, farmers do not see TWIN as just a client. For them TWIN is a trustworthy partner which has earned its reputation for working with farmer groups in both good and challenging times.

Trading Ltd., Oxfam Activities Ltd., Traidcraft plc and Twin Trading Ltd.) and Cafédirect Producers Ltd., and has the right to nominate a director to the company’s Board. Its consent is also required for the appointment of the Chair of the Board and for any changes to the company’s Gold Standard.
Benefits to growers

Cafédirect provides a social return as well as a financial return to its farmer cooperative shareholders. For example, in 2006/2007 the company paid nearly £1.0 million above the market price (financial benefit) for the coffee, tea, and cocoa they delivered. Growers also received £1.3 million via the unique Producer Partnership Programme, including £0.7 million of matched funds raised by the implementation partners, Twin Trading and Imani Development.

The Producer Partnership Program (PPP) consists of business development training programmes tailored to the needs of the farmer organizations which supply Cafédirect. The training covers marketing, quality control, crop husbandry and crop diversification projects. The company invested £0.6 million in PPP programmes during the year 2007. During three years following the public share issue, Cafédirect invested a further £1.9 million (or 60% of its profits) in the PPP. This is a discretionary investment by Cafédirect aimed at strengthening the farmer organizations to enable them to meet the Cafédirect’s Gold Standard. It ensures Cafédirect product quality is second to none, and even exceeds Fair Trade Foundation standards.

What then are some of the key lessons from this case? Remaining competitive requires constant effort and new investment to keep ahead of the big coffee sellers. So far, Cafédirect has succeeded in this by developing new products and diversifying market outlets, such as out-of-home sales. Another vital strategy has been to maintain superior quality by reinvesting profits in continuing training and strengthening farmer associations.

Perhaps most significantly (for other fair trade companies) Cafédirect has shown that it is possible to raise large amounts of money for marketing and promotion campaigns by providing a public share issue. This has also helped the company broaden its community of shareholders.

Case 4 Nshili Tea Corporation: bringing processing closer to home

Rwandan tea sector overview

The world tea market is in a phase of over production and low prices. Despite this, demand for high quality tea has been growing, resulting in a price premium for quality teas, such as Darjeeling and Assam teas from India and some Sri Lankan and Kenyan teas. Since Rwandan tea is considered among the very best in the world this offers great opportunities for the tea sector. Crucial for the production of premium quality teas are good climatic conditions, high soil fertility, adequate pruning and harvesting techniques and correct processing of tea leaves in the tea factory.

Since its introduction in Rwanda 1952, tea production has increased steadily, from 60 tons of black tea in 1958, to 19,000 tons in 2009. Over 90% of the production is exported, but Rwanda’s share of 1.2% million of the global market (1.4 million tons)
is small. The Rwandan state agency O C I R - T h é plays an important role within the tea sector. It owns 8 of the 10 tea processing factories and several large plantations. Each of these plantations, of between 300 and 1000 hectares, is integrated with a tea factory that employs wage labour. Rwanda also has privately owned tea plantations, which tend to have yields that are twice as high, and plantations owned and managed by cooperatives.

In Rwanda tea is also grown by smallholders, who typically have 0.2-0.25 ha under tea bushes in family holdings which they work in addition to other crops. Often smallholders are united in tea growers associations which sell their tea to nearby O C I R - T h é factories. Tea helps reduce poverty because even at the low price paid by O C I R - T h é it provides a regular source of cash income.

In order to increase the income for smallholders, the quality and quantity of processed tea needs to be improved so that it can fetch higher prices on the world market. Access to inputs, most notably fertilizer, proper harvesting and pruning techniques and a system where higher prices are paid for quality to the farmers are crucial, as well as prompt processing in the tea factories.

**Nshili Tea Corporation**

Due to ideal climatic conditions, the N shili District in Rwanda has the potential to produce high quality tea leaves. Tea is produced on a large O C I R - T h é plantation, as well as by thousands of smallholders. However, because the nearest factory is four hours away, the harvesting time on the plantations is limited to a few hours to avoid leaves arriving after closing time at the factory. Even with these precautions many leaves arrive after factory closing time and are thrown away, causing losses of up to 40%.

After the war in 1994, the Rwandan government asked the International Fund for Agricultural Development (IFAD) to fund a new tea factory amidst 1,000 ha. of existing tea plantations. These plantations support 4,000 families who earn their living as tea harvesters. The stable market demand for high quality teas and the potential for better incomes for smallholders were attractive to IFAD.

IFAD proposed to fund the construction of the tea factory and the development of the plantation, but on the condition that the tea company is fully owned by smallholders. By setting up a trust fund, IFAD would pre-finance the smallholder’s shares in the factory and hold them on their behalf. Any dividends on those shares would be used to repay the IFAD loan and transfer shares to the organization representing the smallholders.

**A trust fund to pre-finance shares for smallholders**

To enable the smallholders/farmers to acquire the equity capital of the N shili Tea Corporation, IFAD would lend the funds necessary to purchase the shares. The shares, issued in the name of the participating smallholder societies, would be deposited in a trust fund with the Rwanda Development Bank, opened on behalf of the smallholder societies.

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1. Office des Cultures Industrielles du Rwanda.
The trust fund was supposed to be established with the understanding that the shares will eventually be purchased by the smallholder societies through a mortgage on future dividends paid by the company. The cooperative societies would also acquire control of the company when full payment for all the shares deposited in the fund has been completed.

By this procedure, the smallholder society obtains formal ownership of the company, but the related right to control it must be earned through the cooperatives’ full participation in the efforts of the company to make profits. As the payment of sufficient dividends to buy back the shares would take several years, the IFAD project would have time to provide training in business management to the smallholder society members and their leaders. Training for the management staff of the new company is a major objective of the project.

During the interim period, when the shares of the primary societies are kept in the trust fund of the Rwandan Development Bank, the smallholder society and the Nshili Tea Corporation will be controlled by the board of directors. The bank participates in the board, on behalf of the smallholders but is also accompanied by these smallholders. This set-up only lasts until the shares are paid for and are fully in the possession of farmers. During this interim period, representatives of farmers societies attend the board meetings but do not have voting rights.

The actual project set-up

All of the project plans described above were made with the intent of smallholders playing an important role. Unfortunately, the Rwandan government preferred that business people from their personal networks become shareholders, and not the farmers. Conflicting interests between IFAD and the government lead to the expulsion of the IFAD project manager from Rwanda. When, in 2004, the government designated the entire plantation to private sector investors, IFAD withdrew all support for the project.

But the story does not end here! No local private investor was interested in the enterprise because of the extremely high cost of connecting the factory to the electricity grid (an estimated US$ 10 million). Unable to move ahead with the project, the Rwandan government returned to IFAD for support in 2005. This time the government presented a South African-based Rwandan millionaire, who was not part of the local elite, as a major investor. After negotiations between IFAD, the Rwandan government and farmer society representatives, a new financing plan with these key elements was developed:

1. The government pays for connecting the factory to the electricity grid.
2. US$ 4 million to be borrowed from commercial banks and international organizations including IFAD.
3. The private investor provides US$ 1.4 million in exchange for 70% of the shares. A new locally-owned company – Smallholders Financial Holding Ltd. – capitalized and managed by smallholders’ associations, invests US$ 0.3 million and receives a 15% stake. As before, IFAD agrees to pre-finance these shares through a loan. The dividends on those shares will be used to repay the loan. The remaining
US$ 0.3 million to be invested by Gikongoro, who will buy the balance (15%) of the shares.

- The farmers will contribute labour for the development and extension of tea plantations in their home gardens (valued at US$ 0.61 million), and a cash contribution to the smallholders' financial holding (representing US$ 0.46 million).

In the event of a future sale of shares, the shareholders' agreement states that Smallholders Financial Holding Ltd. has priority over other shareholders or investors.

The construction of the factory and planting of tea bushes started in 2007. The tea-processing/packaging factory has been completed, and the first of three production lines became operational in early 2009. Sri Lankan experts have also been brought in to manage the factory (see photo section).

**The role of smallholders**

As shareholders of the Nshili Tea Corporation, the smallholders society has a representative in the board of directors, through whom they can influence the price they receive for their tea. They will also receive dividends in the future, which may be used as additional income, or reinvested in new tea plantations or expanding factory capacity.

Although the smallholders society currently owns 15% of the shares, they have yet to operate as regular shareholders. Owning part of the factory has been a source of pride and motivation for them, but they are not yet confident enough to take on the role of an active shareholder. They speak about ‘their’ factory, but they rely almost exclusively on their representatives to influence the company policy, supervise the factory management and explain the company policy to them.

The largest challenges (from IFAD's perspective) are to raise awareness among farmers of the benefits of shareholding, help smallholders understand their role and responsibilities as shareholders and encourage more active involvement in the company. The farmers especially need to understand their responsibilities when big decisions are taken in the future, for example, whether profits should be used for paying dividends or reinvesting in the business; and setting higher prices for their tea.

What is interesting about this case is the proposed trust fund. Box 6 below, describes another approach in India, where a cotton marketing organization, Zameen, uses a more direct method of funding shares for small-scale cotton farmers.

As we can see, there are major differences in the approach between formation and establishment of Nshili Tea Corporation in Rwanda, and the other shareholding societies described in earlier cases – Kuapa Kokoo, Oro Blanco, and the in the next case described, Cafédirect. The final chapter will look at these differences and draw out some of the

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4 MIG is a limited company registered in 2004 with 1,600 shareholders of whom around 400 are natives from the Gikongoro region but living elsewhere and the remaining 1,200 are mostly farmers living in Gikongoro province.
important learning points and issues that need close attention when bringing farmers’ organizations into the shareholding fold.

### Box 6  Zameen, India

**Small-scale cotton farmers pay for shares through sales price premiums**

Just like their counterparts in Africa, small Indian cotton farmers find it increasingly difficult to compete with heavily subsidized farmers in the US, and rural poverty is an increasing problem. In addition, cotton farming takes a heavy toll on the environment. With only 5% of India’s agricultural production, cotton farming accounts for 50% of total pesticide use.

Zameen is a marketing organization for 6,000 farmers in Southern India, producing around 2,000 tonnes of pesticide-free and fair trade certified cotton fibre per year. Zameen has 15 full-time staff, but its backbone is formed by 30 clusters of farmers organizations, who each have a professional manager.

Zameen charges a fixed premium of US$ 0.67 on every kg of fibre used for garments sold in Europe. For example, if a T-shirt consumes X kg of fibre the premium charged is US$ 0.33. This premium provides a more direct and transparent method of funding shares for small farmers than the trust fund approach IFAD uses in Rwanda.

Agriculture and Organic Farming Group (AOFG) is a service provider to small farmers in India, provided the start-up capital of US$ 268,000 for Zameen in 2006. AOFG is funded by two Dutch donors: Cordaid and ‘Het Groene Woud’. When additional capital was needed, shares were sold for US$ 400,000 to Aavishkaar, an Indian social venture capital fund.

Currently AOFG holds 43% of the shares, Aavishkaar 33% and the farmer’s organizations 7%. Zameen’s earnings from cotton sales in 2007 were used to buy the 7% of shares from AOFG and Aviscar and transfer them to the farmers organizations. The remaining 17% of the shares remain unissued, but are reserved for future bonuses of the personnel of Zameen (10%), and ‘sweat equity’ (7%) for the founders, which is a reward for the hard work put in and the personal risks taken by them.

Over the next four years Zameen aims to transfer an additional 44% of the company’s shares to the farmer’s organizations, so that the farmers will eventually own 51% of the company. It intends to raise the US$ 938,000 needed to buy out AOFG and Aavishkaar by charging a direct premium to the end customer. For this purpose it has established a unique partnership in the value chain with Alok, one of India’s largest textile mills, and a network of supply chain ambassadors targeting end customers including well known brands and retailers. The premium that these brands collect from the consumers will be directly transferred to Zameen.

On a standard cotton shirt costing US$ 33 a consumer will pay US$ 0.44 extra to finance buying the shares for small farmers. This is only 1.3% of the price, and therefore not a disincentive for most consumers. Out of these 44 cents, 11 cents are paid directly to the farmer, 11 cents go towards village development (education, health care), 11 cents are needed to cover organizational costs, i.e. training to farmers, and 11 cents to transfer shares to smallholders.

The reason that a few cents can make such a large impact for farmers lies in the fact that cotton fibre accounts for only 2% to 6% of the retail price. Furthermore the partnership with other actors in the value chain reduces the mark-up on the fair trade premium. With an average of 7 links in any clothing value chain, this is a significant cost savings.
3 Analysing the experience, drawing out lessons

Based on evidence from literature and review of practice a trend emerges: fair and organic trade oriented businesses invite their suppliers to become shareholders in their company. Donors readily promote the idea and positively review any corporate initiative that includes farmers as shareholders. Looking at actual cases, as well as the general opinion on the issue, clearly some degree of mystification is evolving. The idea of farmer-shareholding appeals to many people, but few people refer to evidence when making up their opinion.

Evidence presented in this book shows that with farmers as shareholders investment and governance processes become more complex. Shareholding is based on a set of formal rules and related investment behaviour. Investors also share commercial interests. It is only recently that activist shareholding emerged on the investment scene, introducing ideological conflicts and opposing interests during shareholding meetings. Venture capitalists may sometimes remember with a degree of nostalgia the days that all investors pursued a common goal of optimizing their investments.

Farmers as shareholders is not a concept for promoting investment activism, but is based on improving value chain coordination merging stakeholder interests. Though public opinion is positive about the concept, little is known about its implications, benefits and success factors. Better understanding of the concept is required to demystify it and give it a real chance to sustain and prove itself. The four cases presented in the previous chapter are evidence of genuine efforts to involve farmers as shareholders. The initiators of these efforts, as well as other shareholders besides the farmers, have been confronted with major challenges and constraints. They have followed a long and winding road instead of choosing the direct route of project approach or public investment.

This chapter reveals some of the lessons learnt from each of the cases presented earlier. We also highlight the key aspects among these lessons which have value for replication or careful consideration by those who wish to invite or support farmers as shareholders.

We will start with a review of interests and leitmotiv for stimulating or welcoming farmers and shareholders. This review focuses on the ultimate objective of farmers as shareholders: who benefits and what benefits can be expected? These questions are answered from the perspective of corporations, as well as farmers and donors. Secondly we will address the issue of financing farmer shareholding and its implications for the transfer of ownership. Finally we will present some lessons learnt on the sustainability of shareholding by farmers and identify critical steps towards a stable shareholder structure.
Scenes from Ghanaian cocoa grower Kuapa Kokoo, the cooperative that co-owns Divine Chocolate

After fermenting, the cocoa beans are dried in the sun
© Kim Naylor

Co-op member's raw beans are weighed and recorded before processing
© Kim Naylor
The final product, proudly presented
by Adwoa Asiana
© Kim Naylor

Women farmers participate in the 2008
Annual General Meeting
© Divine Chocolate Ltd.
The rolling landscape of Nshili District, Rwanda and the newly-built Nshili Tea Corporation factory, surrounded by tea plantations.

Workers take a break from tending the tea nursery.

IFAD photo by Claus Reiner
Recently planted tea seedlings follow the contour, reduces erosion and allow easier harvesting.

IFAD photo by Claus Reiner

Tea pickers (who are part owners of the new factory) deliver the day's harvest.

IFAD photo by Claus Reiner
T ea processing uses large quantities of fuel wood – providing work for tree plantation workers and wood cutters too

Looking over the main production room, with one of the automated tea leaf processors in the background

Tea processing uses large quantities of fuel wood – providing work for tree plantation workers and wood cutters too

Fermented and dried, the black tea leaves pour over a conveyor into the packing plant

Scenes from the new Nshili Tea Corporation factory
The final product being packed in bulk, ready for export
IFAD photo by Claus Reiner
A bale of organic cotton cloth is compacted and tied, ready for shipping.

At a cotton mill, owned by Oro Blanco.
Raw organic cotton being spun into yarn.

Scenes from Oro Blanco
Workers put finishing touches on T-shirts destined for distant markets

Harvesting organic cotton in the Cañete Valley, South of Lima, Peru
Knowing she will receive a 25% premium for her crop puts a smile on this farmer's face.

Delivering the harvest to the mill. A guaranteed return on investments and fair trade pricing means farmers earn more and become self-reliant.
The mission of Kuyichi is to be an innovative and global brand that designs, produces and distributes fair trade jeans and fashion. In 2007, in Lelystad in the Netherlands, the first Kuyichi outlet opened.
Kuyichi jeans are now available in more than 650 shops in 13 countries
Coffee beans spread out to dry before bagging

A coffee farmer and Cafédirect shareholder displays the end result of his hard work.

Scenes from Cafédirect
A coffee tasting session to ensure highest quality beans are selected.
Kilimanjaro Press Master
Consumer awareness – a key element of Cafédirect promotion efforts
Corporate investors, corporate boards or CEOs pursue other interests when inviting farmers as shareholders, than farmers themselves or public donors. We will review these motives from each of these perspectives.

The corporate perspective

From the perspective of the (trade) companies, having farmers on board as shareholders can make sense for four reasons. First of all, there is often a genuine interest in the development of the suppliers. “If we make good profits, we want our suppliers to benefit as well by letting them share in our profit. We are in this together.” Since farmer organizations normally lack the means to invest in the company, this normally translates in shares being granted to the farmers. We can call this the altruistic motive. Second, there is the motive of self-interest. Making suppliers shareholders in a company assures that they will sell their products to that company rather than ‘side-selling’ to a competitor. We will call this the secure sourcing motive.

Thirdly, and this is also a matter of self-interest, having farmers as shareholders tells a good story to the company’s clients. “Our suppliers are our shareholders. In fact, the products you buy come directly from our farmers.” We refer to this as the branding motive.

Finally, a company may seek local co-ownership for reasons of social protection. This refers to the hypothesis that a company that is co-owned by members of a community enhances its social capital. The relationship between the company and farmers organizations thus becomes more personal than contract farming or other one-dimensional business relations. The company increases its social capital through farmer shareholding and may benefit from social and political protection. We call this the social capital motive.

None of the four cases described in the previous chapter have been set up 100% by private companies. In the Nshili Tea Corporation case a private investor was involved at the start up stage. The altruistic motive, in combination with the secure sourcing motive has been leading here.

In the Kuyichi case and more so in the Cafédirect and Divine Chocolate cases, the branding motive (farmer co-owned) was predominant and key to the latter two companies successes. These are good examples of successful fair trade product branding strategies that can actually strengthen the original ethical interest of a fair trade venture. In the Divine Chocolate case, the fact that they paid dividends to the farmer shareholder for the first time in 2007 was given high-profile coverage by the press. The media focused on Divine Chocolate’s unique farmer ownership model, the impact on cocoa farmers’ lives and the “bean to bar” story.

The farmer perspective

Farmers pursue totally different objectives with shareholding from the companies and their investors. We will discuss three categories of benefits of shareholding for farmer organizations: first – financial benefits, second – improved access to information and
increased chain transparency and, third – enhanced value chain empowerment/farmer influence.

Prominent among the financial benefits are the premiums (fair trade, organic) paid to farmers who are shareholders. Market access and secured sales are also very important benefits observed by farmers. Having a marketing channel that structurally pays a better price for their products (cocoa, coffee and cotton) is the most valued financial benefit for farmers in these three case studies. Farmers are very motivated to supply all their produce to these companies because of their attractive pricing regimes.

Dividend payments also belong to the financial benefits. Only in the Divine Chocolate case study has a dividend been paid to the farmers. In 2007 the dividend received per farmer was US$1, or a total of US$ 47,000. In comparison to the premiums paid, ($ 213,000) and social benefits ($ 260,000) received by farmers in the same year, this amount is not that relevant. However the symbolic value for the farmers has been significant, because it was the first time to receive such a reward for co-ownership in the company.

Shareholding is instrumental for farmers who need bank credit (for purchasing inputs), as seen by the increased eligibility among the cases reviewed. However, in none of the cases reviewed was the objective of owning shares to then sell them (for financial gain). This distinguishes the businesses in the cases presented from business models of other companies.

**Access to information and chain transparency**

In Divine, Cafédirect and Kuyichi the smallholder farmer organization as shareholders have access to corporate information which provides them with insights in the governance and management of the company. In Kuyichi, for example, that's the reason why the smallholders accept the fact that the company is sourcing most of its cotton somewhere else in stead of from it's own shareholder farmer organization. Oro Blanco, the smallholder farmer organization, is aware of the difficult situation in which the company finds itself at the moment and accepts the high level of independent decision making of the management team.

In the Cafédirect and Divine cases we see the same. The smallholder shareholders recognize the capacities of both female managing directors who are qualified professionals doing a great job for the companies. They make the companies grow. They look for new markets and share their vision with them. With shared visions they work on joint action plans, to strengthen the chain even more. In Divine Chocolate's case, the company and the farmer organization – Kuapa Kokoo – jointly undertake marketing campaigns. In Cafédirect the management, the Board, and the farmers work together to introduce new coffee varieties for specific market segments. Such joint efforts assure reliable and growing markets for the farmers, which have positive impacts on their livelihoods.

The Producer Partnership Programmes of the Divine Chocolate Company and Cafédirect are million dollar programmes with an important role for TWIN (see box 5). Capacity
building for farmer organizations is the priority while innovation and the introduction of new technologies are other important aspects of this programme. These are important indirect financial benefits to farmers who have increased production and/or improved the quality of their produce. Yet another aspect that the farmer organizations of Cafédirect highly appreciate is the opportunity to exchange experiences with other farmer groups during annual shareholding meetings.

Interestingly, none of the cases specifically mention any problems with the supply. One possible reason for this is the transparency seen in all of the cases. Farmer organizations generally highly value this transparency, which contributes to building trust and confidence between farmers and the companies.

Access to, and understanding of global markets is a key route for small-scale farmers out of poverty. The governance structures of the farmer cooperatives and companies described in the case studies strive to provide such access. These structures mean that farmer members own shares in the marketing companies, that they have influence over the end product in the marketplace and develop an excellent understanding of the value chain. Their profiles in marketing communications of the companies establishes an (inter) national reputation as a successful business. Raul de Aquila, board member of Cafédirect, states that this reputation makes it possible for his farmer organization, COCLA, to access bank credit.

**Chain empowerment and farmer influence**

Shareholders are the ultimate owners of a company and have a right to vote on strategic decisions in shareholder meetings. In case of significant shareholding, farmers organizations may hold seats in the Board of Directors. As shareholders they can use their right to vote during annual shareholders meetings to influence business policies, for example addressing the price policy of a company, but they can not interfere in day-to-day operations.

The extent of influence by shareholders and principles of decision making through voting are defined by the articles of establishment of the company. What, then, is the relation between the numbers (and percentage) of shares smallholders posses and the number of seats they have in the company board? Do smallholders really care about or value the percentage of shares they have in the company?

Table 4 shows an overview of the percentage of shares the farmers have in the different cases, as well as the number of seats held in the different Boards.

**Table 4** Levels of ownership/representation among farmer organizations

<table>
<thead>
<tr>
<th>Case</th>
<th>% shares</th>
<th>% Seats on board</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kuyichi</td>
<td>19%</td>
<td>None</td>
</tr>
<tr>
<td>Divine</td>
<td>45%</td>
<td>2 seats out of 13 (15%)</td>
</tr>
<tr>
<td>Cafédirect</td>
<td>4.9%</td>
<td>2 seats out of 10 (20%)</td>
</tr>
<tr>
<td>Nshili Tea Corporation</td>
<td>30% (2 times 15%)</td>
<td>2 seats out of 5 (40%, 2 times 20%)</td>
</tr>
</tbody>
</table>
In Kuyichi the smallholders (represented by the Association of Kuyichi Producers and Oro Blanco) have no say or control through the Board. The shares they own do not entitle them to decision-making/voting power in the Board. Even though a representative of the farmers participates twice per year in the Board meetings, he does not have voting power and is only there to remain informed of the developments within the company (the information and transparency motive). The role of the farmer association so far has been limited. Kuyichi opted for a management team that has far-reaching decision making power and responsibilities. This team is put together by the investors who kept Kuyichi solvent as described in the previous chapter.

In Divine Chocolate there are 6 independent board members with as much voting power as the remaining 7 board members (the shareholders). The independent members' strengths (in finance, chocolate industry expertise) is fully acknowledged, so their greater decision making power has not been an issue. Conflicts are rare. At the same time, the contribution of the farmer leaders whose experience includes running a million-dollar company and thus know how to do business, is seen as very important.

Illustrative is the opinion of one of the representatives of the farmers in the Board of Cafédirect, who said that the coffee farmers often do not know how many shares they have. Owning shares is less important for these farmers than growing the best quality and largest volume of coffee and selling it at premium prices through Cafédirect. They see the company as a marketing channel. In the cases of Kuyichi and Divine Chocolate the same applies.

In reviewing the four case studies we conclude that there is no direct correlation between the number (percentage) shares and control or a say in decision making, nor between the capital invested and degree of control. The farmer representatives in the boards of Kuyichi, Divine Chocolate and Cafédirect stated that there is almost always consensus at the board meetings. This corporate harmony probably has more to do with the type of business, where the ethical, social, cooperative spirit is prominent. The general interest they serve is that of the farmers. That's the most important thing. These are companies in which the shareholders have greater commitment and are not short-term thinkers who seek return on investment (and therefore have an interest in decision making power (large percentage of the shares) in the Board.

Ethical business is not just about price premiums but primarily about changing the relationship between farmers and consumers into one that is more balanced – i.e. based on a “relationship between equals.”

When there are no significant dividend payments, or exit strategies profit-taking (i.e. selling shares in order to make money) the farmer organizations are not concerned about how many shares they own or seats they have in the board. Even 1% of the shares is enough as long as it guarantees a seat in the board which enables them to get informed of and involved in the decision making process of the company. They are involved in price negotiations, in decisions about how and where to spend the social benefits.
The donor perspective

Why should donors consider capitalizing farmer shareholding? To measure the impact of shareholdership by farmers on poverty relief there is a need for strong monitoring and evaluation of the cases. This goes beyond this study.

Donors support the businesses described in the case studies not only because they have a pro-poor aspect, but also to have an influence on the consciousness of the consumer and ultimately on how the industry works to raise living standards in the developing world.

After several years, Divine Chocolate and Cafédirect show themselves to be viable business models, achieving both their social and business objectives. Kuyichi is reaching its social objectives and is close to the break-even point. In the Nshili Tea case factory we see an interesting combination of public, private and donor money. But we must wait to say anything about the impact on the livelihoods of Rwandan smallholders relative to the donors investment.

On the other hand, donor money invested in Divine Chocolate and Cafédirect has achieved definite results: increasing numbers of farmer families are benefitting from doing business with the company, improving their incomes and livelihoods (see figures on Divine in table 1). The number of farmers participating in the companies through their organizations has grown steadily to impressive numbers: 39,000 farmers in Cafédirect and 46,000 in Divine Chocolate.

This impact is less visible in the Kuyichi case, where the number of farmer/shareholders is still very small (60 farmers). However Kuyichi's potential impact on sustainability and the cotton industry is huge, even though it faces major challenges (e.g. an extremely competitive market, and continuing government subsidies for northern cotton farmers).

Financing farmer shareholding

Smallholder farmer cooperatives and individual farmers generally lack financial means to buy shares. Shares are most often granted to them by the other shareholders in the trading company, as we have seen in Kuyichi and the Divine Chocolate cases. An alternative method is for the cooperative to apply for a loan to purchase the shares. However, lending money to buy shares is a high risk venture. Shares can lose all or part of their value, thereby complicating repayment of the loan. In the case of investments in relatively new companies risk is extremely high and is in fact a form of venture capital. Besides the risk of shares loosing their value, the shares are also non-liquid. There is no open market where the shares can be sold in case of the need to convert shares into cash. It is therefore generally recommended that farmers' organizations do not take loans to buy shares.

The four cases show very different approaches to achieve ownership for the smallholders. Ownership (or its transfer) takes place gradually or immediately at the establishment of the company. Donors may opt to finance farmer shareholding through a grant as a form of social investment. But farmers may also gradually gain ownership over shares through a reimbursement system. When speaking of gradual ownership, the more common
approach is via a trust fund. Nshili Tea Corporation uses such a structure, which allows the farmer organization to buy the shares over time. The farmer organization does not have to own equity to buy shares.

When grants from donors to buy shares outright are not available, the trust fund is also a good option. Several constructions are possible. At Nshili Tea Corporation (NTC), the dividends on the farmers’ shares are used to pay off the loan from IFAD and transfer shares to the organization representing the smallholders. IFAD pre-financed the smallholder shares. The smallholders got a loan from IFAD through the national bank of Rwanda. In box 6, we see that in the Zameen, India case, a fixed premium is levied on sales prices to the farmers with which the farmers pay the shares reserved for them. Here there is no donor organization involved that puts a guarantee for a loan through a local bank to the smallholders.

In the Zameen case, the company works with farmers’ organizations they have already known for a long time. Remember that, (after a false start due to disagreement with the Rwandan government), the Nshili Tea Corporation is just getting going (having opened its tea factory in early 2009). This helps explain the different strategies with regard to pre-finance and creating a trust fund for the shares to be transferred as the business generates revenue in the future.

We should summarise how the company handles representation in the board meetings; In NTC farmers can participate in board meetings without voting rights until they fully own the shares. The farmers are assisted by ‘observers’ appointed by IFAD, as a form of training and to gain experience with governance. Another option is for farmers to be represented by the bank which holds their shares in its trust fund. The bank participates in the board, on behalf of the smallholders. During this period, representatives of farmers join them in the board meetings. This continues until the shares have been paid for.

In the case of Kuyichi the business idea came from the donor organizations. They had possible smallholders as future shareholders in mind, but were unsure if these pre-selected smallholders organizations were the ‘right’ shareholders and if more smallholder organizations were going to join the company. Kuyichi created an instrument for potential shareholders who can join the Association after demonstrating their capability.

In other words the Association of Kuyichi Producers is like a “waiting room” were identified potential future shareholder are parked and giving an opportunity to prove themselves as strong, structural partners of Kuyichi. After a certain time and after proven capability they will be invited as official shareholder. However, after 8 years, only a single prospective member has become a full partner of the Association of Kuyichi Producers. This situation is a result of two factors; the difficult start of Kuyichi as well as the high demands that are made on the prospective members. The reserved shares are bought with a loan from a donor (in this case Cordaid), which holds them in trust until the time arrives to transfer them to the APK members. Whether and how these shares will be distributed in the future is not yet clear.
In the Cafédirect case, ownership was built in from the very beginning. At present there are 48,000 farmers who own shares, affiliated with 39 farmer organizations/ cooperatives. These farmer organizations own 4.9% of the company's shares, which they have partly paid for and partly obtained as grants. New farmers organizations either receive or purchase shares from a trust fund consisting of 110,000 shares made available by the four original founders of Cafédirect.

Cafédirect's shares are traded on a matched-bargain basis, meaning buyers and sellers who have registered are matched when shares become available. Farmer organizations are free to buy or sell their shares, although this has not happened that much. The most recent price paid for Cafédirect shares was £1.10. In comparison the price at the time of the share issue was £1.

The Divine Chocolate Company was established by the farmer organization Kuapa Kokoo, and received 33% of initial shares. Scaling up production and marketing was made possible by an investment of Oikocredit. Kuapa Kokoo's equity subsequently increased to 45% when it received a 14% block of shares held by the Body Shop, which withdrew from ownership in 2006. However, Kuapa Kokoo is also the sole provider of cocoa beans to Divine, which gives them a very strong marketing position.

Based on the above discussion, we propose the following decision model for financing shares by farmer organizations.

**Table 5 Decision model for financing shares by farmer organizations**

<table>
<thead>
<tr>
<th>Does the farmer organization possess private equity?</th>
<th>Yes</th>
<th>Finance shares as regular investment opportunity including assessment of risks and return on investment (share value and dividends).</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Does the farmer organization have access to public subsidies?</td>
<td>Yes</td>
<td>Obtain shares through a grant application.</td>
</tr>
<tr>
<td>No</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Can a trust fund be established for the purpose of shareholding by the farmer organization?</td>
<td>Yes</td>
<td>In time, buy the shares from the trust fund using dividends.</td>
</tr>
<tr>
<td>No</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is the farmer organization eligible for obtaining a bank loan?</td>
<td>Yes</td>
<td>Apply for a loan, buy the shares and refund the loan with dividends (note that interest will be paid on the loan).</td>
</tr>
<tr>
<td>No</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The farmer organization is not eligible for buying shares.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Sustaining farmer shareholding

Two of the four companies described in this book are now profitable (Divine Chocolate and Cafédirect). Kuyichi is just breaking even after a long start-up phase. The fourth (Nshili Tea Corporation) started in 2008 and has yet to prove its profitability. For Divine Chocolate and Cafédirect, the business idea came from the farmer organizations. The concepts appealed to, and were readily supported by, donor organizations. TWIN Trading played a catalyzing role in building both companies. The genesis of Kuyichi came more from a donor-driven angle in which Solidaridad played the leading role. Nshili Tea Corporation also emerged from a donor initiative, wherein the original plan came from the African Development Bank and IFAD picked it up and put it into practice.

Cafédirect and Divine Chocolate achieved almost immediate success, at least break-even and making small profits, mainly attributable to the involvement of partners that could market the products. Divine's chocolate and Cafédirect's coffee found its way to consumers in the network of the charity institutions before going mainstream in the supermarkets. It is also important to mention that professionals from the private sector were recruited. Both companies are run by business professionals with an understanding of corporate management and governance. This was initially not the case with Kuyichi. The company contracted professional managers only when serious constraints were encountered. Since then the company has managed to break-even.

The start-up of one of the four companies was fully funded by donor parties (Cafédirect). In Kuyichi’s and Divine’s cases there was a mixture of donor money and social investment banks either working with or without guarantees of donor organizations. Divine Chocolate’s business plan was so convincing that a commercial bank was willing to provide finance. However, the role of DFID was important, because it guaranteed the bank loan. Meanwhile, Divine repaid the entire £400,000 loan.

In almost all cases there are clearly two (or more) phases we can distinguish. The start-up phase, in which the farmer organizations and donors play an important role, and then a second expansion phase where new financial investors come on board or investment funds are raised. Capital investment is needed for scaling up or to give a financial injection to allow the business to move forward. In the case of Divine Chocolate this was a social investor (Oikocredit) which also became shareholder. They provided working capital and made it possible to launch Divine Chocolate in the USA. Cafédirect chose a more conventional approach, by offering shares to the wider public they quickly raised the 5 million pounds needed. Now, five years later, the shares are freely traded, under certain conditions.

In the case of Kuyichi a social investor came on board (Triodos Innovation Fund). Similar to the Divine Chocolate case, the new investor became a major owner of shares (32%). Unlike the other cases however, and to Kuyichi’s advantage, the new shareholder claimed a major role in company management as a condition for investing.
Success factors in the start-up and expansion phases

There are certain key factors that we can extract from the cases that lead to early success, or profitability of the company. One of these especially in the start-up phase is the composition of the shareholders in the business. Looking back at the Divine Chocolate case, the principal problem facing a new fair trade chocolate company was the highly competitive environment prevailing in a sector dominated by large corporations with brands built on decades of expensive advertising. Divine met the challenge of gaining distribution by bringing in the national high street retailer The Body Shop in the ownership structure. The Body Shop allowed Divine to sell its products in its 256 stores from the start.

Christian Aid, with their active network of consumers, and Comic Relief, with their strong brand recognition and innovative marketing approach, assisted in raising consumer and retailer awareness of the fair trade chocolate. This was an effective way to overcome the limits a low marketing budget in such a market sector.

Communicating the human element of sustainability is one of the key challenges for ethical companies. Divine and Cafédirect offer examples of how to communicate this human element (see websites listed after References). A key is the ability to communicate the unique story of the companies (fair trade, farmers, farmer-ownership) and achieve good media coverage!

Again, in the first phase it is important to contract a qualified management team, preferably from outside the donor world. In Divine’s and Cafédirect’s case the Managing Director’s role has been very important. Another key factor is the composition of the Board where shareholders representatives are present along side independent board members with a relevant background.

And then we have the level of organisation of the farmers’ organisations which is key to success. We see this clearly in the Divine case where Kuapa Kokoo is well organised and a strong partner. The waiting room (Kuyichi) and trust fund construction (Nshili Tea Corporation) are also examples of tools to strengthen the farmers organisation during the first years of the company.

Shareholding in good and bad times, more questions than answers

Farmers as shareholders is not a typical business model that can be replicated in every situation. The concept distinguishes itself from conventional business-as-usual through the specific motives of farmer organizations to obtain shares, or investors to welcome farmers as shareholders. These motives can be complementary, but may also introduce conflicts of interest. Shareholder management and assistance to farmer organizations, in terms of capacity development, should therefore feature prominently in any initiative that promotes farmers as shareholders.

A more difficult question is how to finance new investments. Growth needs further (and often large) capital injections. Who provides that? The evidence shows that small-scale farmers generally have minimal or no spare cash to raise the ‘big money’ needed. Now
another set of questions arise: How willing are the other shareholders to increase their investment? Which new investors should be invited to buy shares? How many shares have to be issued? This last question implies that the shareholding farmers see their stake getting smaller. If however a fixed percentage of shares has been allocated to the farmers, then they will need to invest in order to maintain their percentage at the agreed level. Farmers can appeal to donor organizations to provide additional capital for expanding their shareholding. But this process takes time and appeals for more capital to acquire additional shares may not be eligible for subsidy. As such, this method of further capitalization will impose constraints on the expansion of the company or significantly change shareholding balances.

In bad times, such as when strong competition develops or sales prices drop, the company sees its market share decline and may even lose money. This could happen to Cafédirect, which faces growing competition on the fair trade coffee market in the UK. A company's decreasing performance may also result from bad management, which impacted the start-up phase of Kuyichi. Here, the farmer-shareholder model is put to the test. Another, more challenging series of questions must be addressed when agreed production volumes cannot be sold and the company must reduce its procurement. How swiftly can the company management react and what will be the response from the board? How will farmer-shareholders react to a company strategy to mitigate negative financial results? Will farmer-shareholders be allowed to start selling to a competitor, a phenomenon that previously was considered as highly undesirable?

Bad times may not only be a question of market difficulties or poor management performance. They can also originate from the farmer side. Some farmers may face quality problems. Farmers might lose loyalty to their cooperative if they can get better prices elsewhere. With soaring commodity prices and fierce local sourcing competition this is the reality of today. Here we reach the limits of the secure sourcing motive. The board of a smallholder farmer organization might be loyal to the company, their farmer members may not be. For them, receiving better prices or earlier payment elsewhere is critical. They do not have the luxury of letting the long term value of fair trade relationships and shareholding prevail over their daily struggle for survival. Having farmers as shareholders in a company is certainly no guarantee they will supply under all circumstances. The situation may come to a point where the fair trade company has good performing and bad performing farmers. Now what to do? It would make normal business sense to discontinue sourcing from the bad performers and seek new suppliers. But taking such a decision may be difficult. Poor performers also have voting rights and although they may not be in a majority position, neglecting their vote is - certainly in a socially oriented company - not easy to do. Also, an escalating conflict between the company and some of its shareholder-farmers may create a reputation problem. The branding motive now happens to have a downside.

Does the above mean that the smallholder-shareholder model is simply not sustainable from a company's perspective? No, that is not our conclusion. But we do conclude that one should think through this model in all possible future consequences before embarking on it.
Manage expectations; discuss the pros and cons of the model thoroughly with all (potential) shareholders before implementing it. Be clear about each others roles and responsibilities: a farmer must deliver products in the right volume and quality and a trading company has to market and sell them. Make clear rules about what happens if one no longer performs his/her function’s properly. Agree on procedures beforehand.

Shares represent value. Giving out shares (as a kind of grant) may be justified from a social point of view, but the practice violates general corporate thinking and reduces the respect of other investors. Granting shares in difficult times makes little sense and might jeopardize the continuity of the company.

Donor organizations can play an important role in supporting shareholding, but must change their practice from granting shares to enabling innovative financing modalities that are accessible to smallholders. Donors should spend their money on strengthening farmer organizations, so that they develop business management competence and achieve strong internal organization. Through these competencies farmer organizations will become real shareholders, exercising all the related rights and gaining the full benefit.

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Annex 1

Answers to common questions about shareholding and farmer organizations

The following six common questions and recommendations are based on a literature review and an analysis of several cases of farmer organizations that have experience in obtaining shares.

Farmer organizations contemplating the purchase of shares must be well-informed as to what they are entering into. They must evaluate the advantages and risks of shareholding, communicate these risks to their members and allow time for thorough discussion amongst members of the risks. In addition to financial risks, a farmer organization buying shares is entering into new territory – for example, governance of the company – and faces challenges such as how to handle the dividend. It is only through a better understanding of the issues at stake that shareholding becomes an asset to farmer organizations, empowering them as actors in the value chains on which their income and livelihoods depend. Shareholding may give farmers more influence on their destiny and increase their share of the added value generated through their commodities.

What is shareholding?

A shareholder is an individual or business that legally owns one or more shares in a company. Collectively, shareholders own the company in which they hold shares. Thus, such companies strive to enhance shareholder value. Shareholders are granted special privileges, such as the right to vote (usually, though not always, one vote per share) on matters like: elections to the board of directors; the right to propose resolutions; the right to share in distribution of the company's income; the right to purchase new shares issued by the company; and the right to a company's assets during liquidation. However, a shareholder's rights to a company's assets are subordinate to creditors' rights. This means that shareholders typically receive nothing if a company is liquidated after bankruptcy.

Directors and officers of a company are bound by their duty to act in the best interest of the shareholders. Shareholders play an important role in raising capital. Companies typically provide all necessary evidence to shareholders to convince them that they are investing in the right business. For example, accurate audit figures from income statements and balance sheets that indicate overall performance.

How is a joint stock company5 governed?

A board of directors is a body of elected or appointed persons who jointly oversee the activities of a company or organization. The body sometimes goes by a different name, such as board of trustees, board of governors, board of managers, or executive board. Often it is simply referred to as “the board.” A board's activities are determined by the power, duties, and responsibilities that are delegated to it or conferred on it by an outside authority. These matters are typically detailed in an organization's bylaws.

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5 A joint stock company (JSC) is a type of business entity: it is a type of corporation or partnership. Certificates of ownership or stocks are issued by the company in return for each contribution, and shareholders are free to transfer their ownership interest at any time by selling their stocks.
Bylaws also specify the number of members of the board, the board member selection process, and how often and when aboard must convene. In a stock corporation, the board is elected by the shareholders and is the highest authority in the management of the corporation. Its responsibilities include governing the organization, selecting the manager/CEO, approving annual budgets and accounting for the organization's performance to stakeholders.

In summary: shareholders elect the board and have annual shareholder meetings to review performance and propose resolutions of general nature. The board of directors governs the organization and appoints or supervises the manager/CEO. The manager/CEO is responsible for the day-to-day management and performance of the company.

What are the advantages of shareholding by farmer organizations?

Farmers as shareholders implies that individual or organized farmers own shares in an agribusiness company. This company can be - for example - a farm input supplier, a processing company or a trade company procuring produce from farmers. Chapter 2 provides different examples of these. The farmer or farmers' organization can exercise influence through the ownership of shares, be it during annual shareholders' meetings or when elected to the Board of the business corporation. The latter will normally only apply to significant shareholding portfolios or majority shareholding. Four advantages of shareholding for farmer organizations are mentioned in Chapter 1.

What are the risks of shareholding?

Shareholders in a limited company are not personally liable for any company debts apart from the value of their investment in that company. Although a shareholder's liability for the company's actions is limited, the shareholder may still be liable for their own actions. For example, the directors of small companies (who are frequently also shareholders) are often required by lenders to give personal guarantees. They will then be liable for the debt should the company be unable to make the repayment.

Boards are fully responsible for company actions, including financial performance but also internal and external corporate conduct. For example, boards can be made responsible for a company's respect for labour rights or the pursuit of a fair price policy.

Managers of a firm are only responsible for the application of the corporate strategy and financial performance based on approved work plans and agreed projections.

For farmer organizations, the risks of shareholding are limited to:

1. Financial risks of participation: farmer organizations can lose their capital if a company goes bankrupt. Investments may yield little or no dividend if there is poor financial performance.
2. Risks to reputation and public relations: if a company fails to act in a socially responsible manner that benefits farmers, then farmer organizations that are shareholders may be made responsible both by members and the general public.
3. Risks of internal instability: shareholding by farmer organizations requires intensive communication and accountability to members. For dividends, transparent management of financial assets is necessary. Owners may have unreasonably high expectations of shareholding which are not possible to satisfy in practice.

What are the requirements for effective shareholding by farmer organizations?

Shareholding as an instrument to share in the benefits of a company or influence its corporate policy is only effective if the legal power obtained through shareholding is supported by knowledge and capacity. A farmer organization may own shares but fail to reap the benefits and exercise its rights. Critical requirements for effective shareholding include:
1. Legal status of a farmer organization: in order to qualify as a shareholder, a farmer organization must be able to provide equity capital. Often access to a bank loan or trust fund is needed in order to provide equity for the purchase of shares. A farmer organization will therefore have to be eligible for a bank loan or trust fund, which requires a formal legal status that includes member liability.

2. A farmer organization needs its members to represent the interests of the organization at shareholder meetings. Where there is significant shareholding by farmers, the farmer organization may be invited to have representation on the board. These representatives must have a background and sound understanding of corporate governance in order to be effective.

3. Internal transparency and good communication among members of a farmer organization are critically important for effective shareholding. While the leadership of a farmer organization may be convinced of the benefits, individual members may be unaware or may not agree with shareholding. A farmer organization must share information and address potential conflicts prior to becoming a shareholder.

4. Internal stability: shareholding comes with risks, which may affect the internal stability of a farmer organization. Shareholders lose their capital if the company goes bankrupt. For farmer organizations this impacts on planned investments that are meant to benefit members. On the contrary, dividends paid to farmer organizations sometimes cause disharmony and conflict around how they should be used. A farmer organization must therefore have a clear policy for risk mitigation and dividend use.

**How can farmer organizations finance shareholding?**

Farmer organizations that are contemplating the purchase of shares have several financial modalities available. Those with access to equity—obtained from revenue—can buy shares directly. A decision to use equity for this purpose should include a careful balance of investment options. Is shareholding a top priority to the farmer organization? What are the expected returns on investment proposed by the company and supported by business facts and figures?

There are three options for obtaining shares in cases where a farmer organization has no revenue generating equity. The first option is to seek a grant from a public or non-governmental source. This option poses minimal risks to the farmer organization. However, such grants are only possible for farmer organizations that pursue developmental goals that match public or civil society goals. The farmer organization will therefore be compelled to argue its impact on, for example, the livelihoods of resource-poor people through shareholding. The rationale for shareholding in situations where grant applications are made, tends to be more ‘activist’ or development-related than commercial.

A second option is to establish a trust fund. Capital can be held in a trust; that is, property held legally by one party (the legal owner) for the benefit of another party (the equitable owner). The legal owner, or trustee, has the right of possession and the right of property use, but must exercise those rights to the benefit of the equitable owner, or beneficiary, such as a farmer organization. The goal of the trust fund can be to facilitate the purchase of shares for a farmer organization. These shares will be gradually bought from the trust fund by the farmer organization, for example through dividends. The advantage is that the farmer organization is not exposed to financial risks, does not have to pay interest rates and buys shares when financial revenue allows for it.

A bank loan is the last and least attractive option. Few banks provide loans for buying shares. A farmer organization will need considerable collateral and therefore runs significant risk in terms of losing its assets. Moreover, interest must be paid to the bank even when dividends have not yet been paid. A farmer organization will need revenues to pay for the interest or transfer those costs to individual members.
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