

Stuck in a Rut: Emerging Cocoa Cooperatives in Peru and the Factors that Influence their Performance

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Abstract

Agri-cooperatives play an important role in helping resource-poor farmers reach high-value markets. In addition to linking smallholders to markets, cooperatives provide their members with various services, such as extension, credit, input subsidies, and social programmes. While the literature contains many examples of success, there has been limited discussion on the often long and turbulent process by which cooperatives develop over time and the viable options for shortcuts. This study examines four emerging cocoa cooperatives in Peru to determine their overall business viability, the key factors that advanced their development, and their capacity to address the needs of their members. Our findings suggest that strategies for supporting cooperative development have largely failed to address major internal weaknesses and the challenges posed in the external environment. The cooperatives have received time-bound, uncoordinated, and often small-scale, interventions, which have focused on infrastructure expansion and technical assistance. Important areas related to business management and governance structures, trust relationships with buyers, and sufficient working capital have largely been ignored. Shortcuts may be achieved through improvements in access to business development and financial services, deeper engagement by private sector to support the development process, and commitment by stakeholders to monitoring and critical reflection for strategy refinement.

Key words: cooperatives, business performance, rural development, NGOs, cocoa

Introduction

Strong agri-cooperatives can play an important role in helping resource-poor farmers reach high value markets, such as those for certified coffee and cocoa. These markets typically offer attractive prices and more secure buyer relationships, but require that smallholders commit to deliver pre-identified volumes on time and in the required form and quality. Cooperatives realise economies of scale in processing and marketing and provide advisory and other services to help their members respond to buyer demands. Such services include technical assistance, training, and input and credit provision. Cooperatives also manage relations with downstream buyers, certification agencies, governmental entities, NGOs, as well as with farmers, who must perceive benefits from their participation. Many NGOs and governments support cooperative development because of its potential to help achieve poverty reduction and encourage members' sense of empowerment through stronger links to markets. Cooperatives are also considered to be effective options for advancing conservation goals (Kruijssen et al. 2009), promoting products of cultural and economic importance (Devaux et al. 2009), and discouraging the production of illicit crops (Spellberg and Kaplan 2010). Although cooperatives may not incorporate the poorest of rural populations (Bernard and Spielman 2009), they often include households of limited means that struggle to meet their basic needs throughout the year.

In recent years, the literature on cooperative development in Latin America has debated the role of cooperatives in value chains (Stattman and Mol 2014, Poole and Donovan 2014, Beuchelt and Zeller 2013) and in strengthening rural livelihoods (Bebbington 1996, Valkila and Nygren 2010, Donovan and Poole 2014, Bacon 2015). These studies present cases of one or more mature cooperatives engaged in an export market, which overcame adversity to evolve into a business organization able to offer attractive marketing terms and provide additional services to their members. Success is often attributed to external support, a strong market orientation, and the consolidation of democratic governance structures. Studies have also confirmed that cooperative development tends to involve considerable resources and development processes over prolonged periods, even under favourable external conditions (Donovan, Stoian and Poole 2008, Poole and de Frece 2010). Frequently, the process is marked by periods of growth followed by crises due to incompetence, corruption or bad luck, leading to prolonged periods of limited activity or dissolution (Kachule, Poole and Dorward 2005). Important questions remain about how to reduce the high costs and risks associated with building cooperatives into viable businesses. This implies an explicit strategy for supporting less-mature, or emerging cooperatives, which have weaker member fidelity and governance structures, smaller market volumes and fewer buyers, and may receive less support from governments and NGOs.

In Peru, government agencies and NGOs have considered cocoa cooperatives to be important partners in expanding the country's cocoa sector and have carried out numerous interventions

1 and programmes in support of cooperative development (del Castillo 2013). This study explores
2 the circumstances facing four emerging cocoa cooperatives in San Martin, Peru—the largest
3 cocoa producing department in the country. Despite having been organized for 10 years or
4 longer, they have yet to reach a critical ‘take-off’ point: in respect of membership number, level
5 of capital endowment and buyer contacts they are still ‘emerging’, unlike the more consolidated
6 group of cooperatives in Peru or elsewhere in Latin America. Section ‘Cooperative assessment
7 framework’ provides a brief overview of debates surrounding organizational performance and
8 introduces the framework for the assessment of the emerging cooperatives that was applied in
9 this study. Section ‘Case study background’ provides an overview of the cocoa sector in Peru.
10 Section ‘Methodology’ explains the methods used for data collection. Section ‘Results’ presents
11 the results of the assessment. The paper ends with a discussion of the implications of the
12 findings for the design of strategies to better support cooperatives, including potential shortcuts
13 for achieving sustainable cooperative development.

14 15 16 **Cooperative assessment framework**

17 Researchers have long recognized the “dual nature” of cooperatives—a result of being both a
18 member-controlled organization and subject to economic constraints similar to those of other
19 enterprises. However, developing-country cooperatives that are engaged in high value markets,
20 in addition to building appropriate governance structures, must often provide long-term
21 support, such as technical assistance, technology development, and credit, to their members
22 (Donovan et al. 2016). In many cases, cooperatives may represent the only source of support for
23 resource-poor members looking to expand their production and respond to stringent quality
24 requirements. The costs for service provision often are covered partially through subsidies
25 provided by projects, government agencies, and, in some cases, downstream buyers. In this
26 way, cooperatives have taken on a role similar to that of NGOs. At the same time, cooperatives
27 must build a successful business in an altogether difficult environment, from paying taxes and
28 competing with local buyers for raw material, to engaging with various buyers, service
29 providers, and support organizations. Below, we briefly review the discussion on performance
30 assessment for businesses and NGOs and then present a framework for assessment of
31 cooperatives.

32 33 *Assessing cooperative performance*

34 Researchers have applied financial-based metrics to study the performance of agri-cooperatives
35 in North America and Europe, based on the underlying assumption that cooperatives are a
36 variant of investor-owned firms. These studies assess performance (e.g. liquidity, solvency and
37 efficiency) based on financial ratios, where differences in ratios reflect differences in goals and
38 related strategies (e.g. McKee 2008). In the absence of good management and accounting data
39 they have also applied nonfinancial measures to assess cooperative performance. In the early

1980s, Babb and Boynton (1981) recommended the assessment of cooperatives based on household-level measures (prices received and access to services); investor-related measures (financial performance ratios and processing costs); and consumer/society-based measures (taxes paid, disposal techniques, and quality). Molnar et al. (2007) compared the performance of community-forest enterprises across countries based on production activities (e.g. volumes, sales, and employment), profitability, social, and environment benefits (e.g. improved forest management). Kachule, Poole and Dorward (2005) considered cooperative performance in terms of economic inclusion (ability to achieve scale, leverage of market power, and efficiency) and social inclusion (capacity building, democratic governance, and gender equity), and the influence of the business environment on performance. These are not easily measurable indicators. Various authors have also highlighted the role that social capital plays in determining cooperative performance (Sexon and Iskow 1988, Bernard and Spielman 2009). Where previous state intervention in cooperative organization has fostered a climate of mistrust among smallholders, Ruben and Heras (2012) boiled down cooperative performance to matters of bonding social capital (i.e. cooperatives' ability to establish and maintain trust, confidence, and commitment among members). In a similar vein, Uphoff and Wijayarathna (2000) identified bonding social capital as key to good performance and efficiency in farmer organizations in Sri Lanka. Arguably these performance dimensions are even less easy to measure.

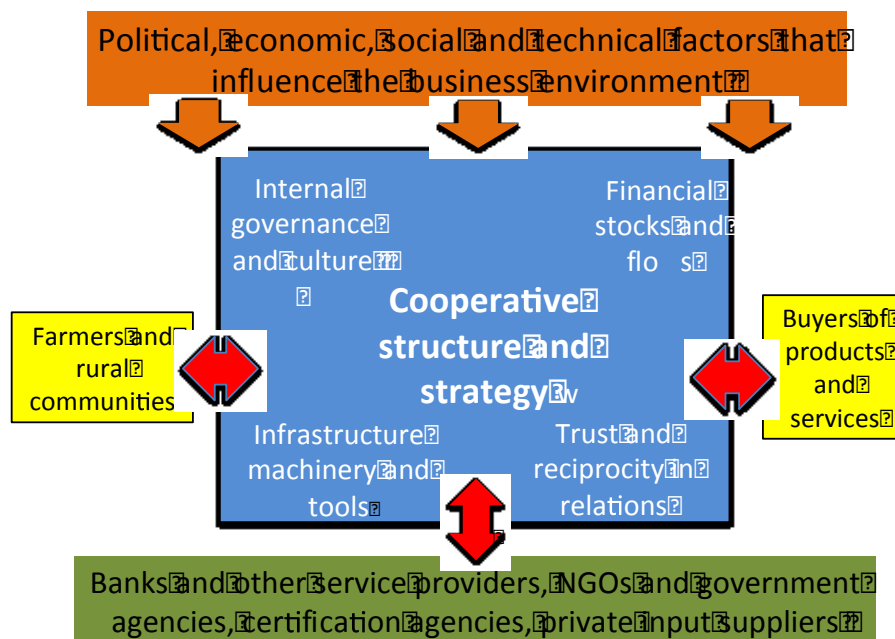
Assessing NGO performance

The organizational theory literature contains a rich debate on NGO performance, although applications are limited in number. Lusthaus et al. (2002) advocated a four-dimensional framework, focusing on organizational performance (effectiveness, efficiency, relevance); external environment (political-legal context and markets); motivation (history, culture, and incentives); and capacity (leadership, structure, human resources). Similarly, Lecy, Schmitz, and Swedlund (2011) conceptualized performance as revolving around NGOs' ability to achieve stated goals, mobilize resources, or garner favourable reputation, as considered by external informants and organizational stakeholders. Some have argued that NGO effectiveness is socially constructed, where the meaning of effectiveness changes over time and where different stakeholders judge effectiveness differently (Herman and Renz 2008). The openness of organizational boundaries implies that NGO effectiveness depends on the effectiveness of other organizations and people and the ways in which they are interconnected (Scott 2004). The use of such diffuse parameters may be a reason why economic sustainability has been elusive. Donors increasingly require NGOs to undertake assessment of their activities with quantifiable metrics. However, the dilemma facing NGOs is that current donor-imposed structures for performance impact monitoring and assessment have not encouraged organizational learning and capacity building (Newcomer et al. 2012, Stoian et al. 2012).

Framework for assessing cooperative capacity

No widely adopted framework has yet emerged which considers the unique features of cooperatives in developing countries, thereby limiting our ability to build on prior studies and highlight results that are complementary or contradictory. Our framework assumes that agri-cooperatives pursue three general objectives: (1) improve productive capacity and wellbeing among members, (2) build an economically viable and responsive enterprise; and (3) improve the broader environment in which members live (e.g. community development and environmental protection). While there is some overlap among the three objectives (e.g. meeting expectations at the household and community levels), each can be considered such a vital element of cooperative operations. Achieving these goals implies that cooperatives build their capacities across four domains (Fig. 1): (1) physical capital, such as infrastructure, machinery, and tools used to collect, transform and market agricultural products; (2) financial assets and flows, which include liquidity, the capacity to purchase raw material from members and meet long-term investment needs; (3) trust and reciprocity in relations, including those with members, buyers, government agencies, certification agencies, and NGOs; and (4) internal governance and culture, which captures issues related to leadership, strategy, and member involvement in planning and oversight. These goals determine cooperative capacity, which is measured by effective response to the needs of its stakeholders, namely smallholder members; the internal management dimension; and the value chain, comprising of upstream suppliers and downstream buyers. Various external factors also influence the growth and development of cooperatives, including political level environment, international market trends, and local competition for raw material.

Figure 1. Framework for cooperative assessment



Adapted from Poole and Donovan (2014)

Case study background

Only 20 years ago the Peruvian cocoa sector was in a state of near collapse. Over 50% of the national area under cocoa had been abandoned. Farmers faced serious disease problems (e.g. witches' broom, frosty pod, and black pod) and received limited state support. In addition, terrorism and social turmoil hindered investment in the sector. Peru had become a net importer of cocoa, unable to meet the needs of its relatively small domestic processing sector (Krauss and Soberanis 2001). However, around 2005, prospects began to change thanks to improved political and economic conditions at home and political turmoil in Côte d'Ivoire—the world's largest cocoa producing nation. These conditions provided strong incentives for cocoa buyers to reconsider sourcing from Latin America. Meanwhile, there was a growing urgency within Peru and among bilateral donors in incentivizing producers to abandon coca production in favour of alternative crops, including cocoa (Chauvian 2010). Large-scale interventions by the Peruvian government, the United Nations, and bilateral donors in the late 1990s and early 2000s became a major driver of cocoa expansion.

Between 2001 and 2013, cocoa production in Peru increased by over three fold, from 23,600 MT to 71,800 MT (table 1). During the same period, the area of cocoa production expanded and productivity increased, largely due to the wide availability of the high-yielding, disease-resistant cocoa varieties. With prices more than doubling, the total value of production (in nominal USD) increased 7.5 times. Peru's recent rise in the global cocoa market is strongly linked to third-party certification systems, such as Fairtrade, UTZ Certified and Rainforest Alliance. In 2011, Peru ranked as the second largest producer of certified cocoa in Latin America (following the Dominican Republic) (FAST 2012). In 2013, certified production accounted for nearly 35% of the nation's total production volume (Potts et al. 2014). As production expanded, so too did the number of cocoa cooperatives. In San Martin four cocoa cooperatives were founded in the 1990s by the United Nations Office on Drugs and Crime (UNODC) and hundreds more were created nationally by the USAID-led Peru Alternative Development Program (PDA) in the early 2000s. Many of these were relatively small in terms of membership and sales volume and relied highly on external support for carrying out basic operations (Cabiese 2010, Tenorio 2011).

Table 1. Cocoa in Peru, by volume and value, 2001-2013

Year	Production (mt)	Productivity (kg/ha)	Price (USD/mt)	Total value (1000s USD)
2001	23,672	517	1,088	25,764
2002	24,354	495	1,779	43,327
2003	24,214	486	1,753	42,449
2004	25,920	509	1,551	40,195
2005	25,257	502	1,538	38,847

2006	31,676	558	1,594	50,493
2007	31,388	525	1,952	61,275
2008	34,005	534	2,581	87,759
2009	36,804	555	2,889	106,317
2010	46,613	604	3,133	146,038
2011	56,500	671	2,978	168,269
2012	62,492	683	2,392	149,470
2013	71,838	736	2,690	193,244
% change 2013/2001	203.5	42.4	147.2	650.1

Source: MINAGRI, AGRODATAPERU

Methodology

Four emerging cooperatives in San Martin were selected for this study (Fig. 2). Each had existed for various years prior to data collection, but had exhibited relatively low membership levels and sales volumes. Interviews with key informants and cooperative representatives were used to select the cooperatives. All the cooperatives were initially organized with external support and had obtained third-party certification for cocoa. They also differed in important ways (Table 1) related to membership numbers, sales volume, and market orientation. The membership base of the cooperatives was similar. Most members were relative newcomers to cocoa production and maintained small cocoa plots of nearly three hectares, despite having much larger landholdings.

Data collection sought information on the context and cooperative

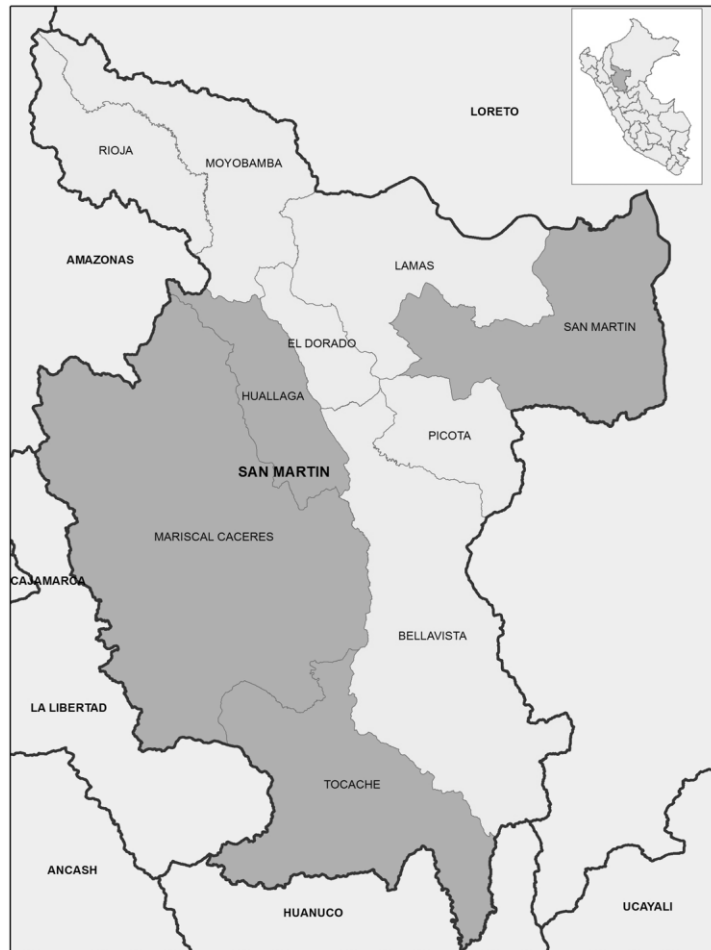


Figure 2. San Martin and its provinces, with sampled cooperatives located in shaded provinces

capacity through structured and semi-structured interviews with cooperative leaders and with actors such as members, NGOs, and buyers who maintained direct relations with the cooperatives. The multi-dimensional approach allowed us to target specific questions to those with direct knowledge of the issue at hand and to triangulate information provided by other actors. A three-person research team collected data from each cooperative in 2015 on specific aspects of cooperative performance and the context:

1. evaluation of financial performance, through interviews with managers, key employees, and accountants
2. governance structures, through focus group meetings with the board of directors, and semi-structured interviews with managers, cooperative employees, buyers, support agencies, government officials, and second-tier organizations
3. cooperative membership through structured interviews

The member households were selected using a stratified random sampling method corresponding to the geographic distribution of the members and weighted for gender to ensure women were deliberately selected. The interview data included socio-economic characteristics, farming practices, and participation in, communication with, services offered by, and member satisfaction with the cooperative. In total, 130 members, roughly 26% women, were interviewed with a minimum of 30 interviews in each cooperative.

Table 2. Characteristics of sampled cooperatives and their membership

Characteristic	Coop1	Coop2	Coop3	Coop4
<i>Cooperative level</i>				
Year established	2001	2008	2001	2007
Members (2014)	133	200	160	307
Major initial source of support	PDA	Church and municipal government	NGO	PDA
Direct export	No	Since 2013	No	Since 2014
Buyers of cocoa (2014)	2 national buyers (100%)	1 international buyer (50%) 1 national buyer (50%)	1 national buyer (100%)	1 international buyer (40%) 4 national buyers (60%)
Cocoa marketed (MT)	2012: 223 2013: 200 2014: 200	2012:150 2013: 250 2014: 425	2012-13: No data 2014: 210	2012: 220 2013: 250 2014: 280
Certifications	UTZ 2015	Fairtrade 2013 UTZ 2014 Organic 2014	Rainforest 2014	Fairtrade 2014 Organic 2014 Rainforest 2014

				UTZ 2014
<i>Membership level (average 2014)</i>				
Membership length (yrs)	8.9	3.8	4.4	5.3
Years producing cocoa	7.6	6.1	5.8	7.7
Farm size (Ha)	13.7	15.5	10.6	7.5
Land in cocoa production (Ha)	3.1	3.5	2.7	3.4
Cocoa productivity (kg/Ha)	565	672	687	631

Results

Coop1

Internal governance: Coop1's manager operates with little oversight from the board. The manager alone conducts the financial planning for the cooperative and has developed the strategic and operational plans, which the board approved without providing any inputs. To support the cooperative's transition to a viable enterprise, the regional government has paid the manager's salary, thus allowing for the manager to potentially have divided loyalties between the government and members. Several members and the board of directors indicated during the interviews and focus group that they trust the manager's capacity to lead the cooperative, despite the manager having little formal training in business management. Much of the members' trust in the manager is based on interactions when the manager served as an agricultural extensionist in the community. The board of directors lacks the business acumen to evaluate the manager's recommendations and provide strategic guidance. The board members readily admitted that they do not understand the cooperative's financial statements.

Member relations: Coop1 membership is primarily comprised of indigenous tribes (90%) whose primary livelihood activity is fishing. Since the peak fishing time coincides with the cocoa harvest, they tend to have limited labour available for managing cocoa plantations, which has impacted the productivity of the farms. In Coop1, the members' cocoa plantations are the least productive of the four sampled cooperatives, with output at 565 MT of cocoa per hectare on average. Nearly all members stated that their engagement with Coop1 was motivated by the perceived benefits from the services Coop1 provides. In 2015, Coop1 offered technical assistance, organic certification, payment advances and organic fertilizer. Members expressed a

1 sense of loyalty to Coop1 because of their long history of interacting with the cooperative. The
2 members on average had belonged to the Coop1 for nine years—roughly twice the average
3 length of membership in the other cooperatives, extending back to when the farmers began
4 growing cocoa. Coop1 provided 96% of the farmers with the resources to establish their cocoa
5 plantations.

6 *Infrastructure, machinery, and tools:* In 2012, Coop1 constructed seven collection centres
7 supplied by the smaller, neighbouring communities to dry and ferment cocoa. These
8 investments have lowered transportation costs by providing centralized collection points and
9 have allowed Coop1 to ensure high quality product. PDA and the regional government provided
10 nearly all the material at a cost of around 225,000 USD for construction. In addition, the regional
11 and local government donated the land for the collection centres. The only property purchased
12 by the cooperative with its own funds is its administrative office, which is valued at around
13 12,000 USD. In 2014, Coop1 received donations from the anti-drug agency of the Peruvian
14 government to purchase chocolate-making equipment worth about 23,000 USD. The machinery
15 has yet to be used. The rest of the operational equipment used by the cooperative, computers,
16 electric scales, a motorcycle, and cocoa quality measuring tools were purchased using a loan of
17 4,500 USD provided to the cooperative from its first buyer in 2011.

18 *Buyer relations:* Since Coop1 began selling cocoa it has sold to two large brokers and Coop2.
19 Relations between Coop1 and one of its brokers terminated when Coop1 failed to fully repay the
20 buyer-provided loan in 2011. The cooperative still sells cocoa to the remaining broker, although
21 the broker has voiced frustration with Coop1 in failing to meet deadlines and delivery quotas.
22 However, the buyer prefers to purchase cocoa from cooperatives, as the middlemen are even
23 less trustworthy and supply poor quality cocoa. Coop1 does not have certification and has faced
24 a disadvantage of competing with local intermediaries in the low margin commodity market.
25 However, starting in late 2015, it was expected to be able to market UTZ certified cocoa, as the
26 farmers will have completed the four-year transition period. In the focus group interviews, the
27 board of directors of Coop1 expressed hope that their ability to obtain price premiums from
28 certified cocoa would allow them to fully cover their costs and pay members higher prices.

29 *Financial assets:* The regional government pays the salary of the manager and accountant and
30 PDA also pays for the extensionists, organic certification, and organic fertilizers provided to the
31 farmers. External funding was so critical to Coop1's survival that it stopped buying cocoa for a
32 period in 2013 when these funds were temporarily unavailable. Coop1 faces difficulties to
33 service its outstanding debt of nearly 400,000 USD. Cocoa buyers provide Coop1 with much of
34 its operational capital, which is repaid when the cooperative delivers cocoa to the buyer. In
35 2010, Coop1 received a loan from a long-time buyer, but chose to sell its cocoa to an
36 intermediary that offered a higher price, never paying back the original loan of 195,000 USD. It
37 has only been able to pay the interest on this original loan. Since then, Coop1 has taken out a
38 loan in 2013 worth 125,000 USD from the other international buyer, which it has since repaid. In

2014, it received three loans totalling 189,000 USD. One worth 34,000 USD was provided by an NGO, another for 38,000 USD was from Coop2, and the third was given from a local lending agency for 117,000 USD. To help repay its delinquent loan to the international buyer, Coop1 was considering selling its administrative office that it owned, the rest of its infrastructure having been given in concession.

Coop2

Internal governance: Over the last three years, Coop2 has gone from near bankruptcy to exporting cocoa with plans to become profitable in a year or two. According to its members, board of directors, local governmental officials, the fortunes of Coop2 changed in 2012 when the cooperative hired a new manager who had experience working in one of the largest cocoa cooperatives in San Martín. Because of this history, the members of Coop2 trust the business judgement of the manager. Even though the cooperative has a capable board of directors, which included a retired teacher, a banker, and a former extension provider, almost all the recommendations made by the manager are accepted; and he makes all the operating decisions. The board knows that the membership will back the manager in any disagreement. The manager feels like he has taken the role of ‘training’ the board members in their roles and how to run a cooperative. This reality of a mentor/mentee relationship has made the cooperative heavily dependent on the manager.

Member relations: Following a financial crisis (see discussion on financial assets), the manager insisted that the cooperative generate sizable revenue streams before investing in social programmes. However, this plan was not well received by members. Some believed that since the cooperative experienced improved financial conditions it should invest in services and pay dividends, even though Coop2 remained unable to recover costs without external subsidies. In fact, 47% of the membership in Coop2 thought it needed to provide more services, which was nearly double the response, 24% of the membership, in the other three cooperatives. The manager and president of the board of directors explained that one of their greatest challenges was helping the members understand the financial statements. Despite concerns over benefit distribution, none of the members interviewed in Coop2 planned to leave (between 10% and 20% of the members in the other cooperatives were planning on leaving). These members also sold over 70% of their harvest to the Coop2 in 2014. This fidelity can be attributed to the great turnaround the cooperative had made and the hope that Coop2 would become more profitable in the future. Several others expressed support for the cooperative because of its potential role in rural development.

Infrastructure, machinery, and tools: Coop2 lacked adequate infrastructure and equipment, limiting its potential to expand. While the other cocoa cooperatives in the area had new offices, storage facilities, and post-harvest equipment, fermenting and drying facilities, provided mainly by donors, Coop2 rented a cramped office and warehouse. The only infrastructure given to

1 Coop2 by donors, PDA and local governmental institutions, was five collection centres in the
2 villages at a cost of nearly 65,000 USD. However, the fermentation bins built in these centres
3 were poorly constructed and rotted within a few years of being built. Now, Coop2 is diverting a
4 portion of its income to rebuild these centres. The administrative and warehouse building is
5 small, which limits its ability to purchase larger volumes of cocoa. Since it rents the building, it
6 has no incentive to expand and improve it. The only renovation the cooperative undertook was
7 to replace a leaky roof. It lacks the assets it needs to transport the cocoa from the buying station
8 to its warehouse. It only owns a cargo motorcycle and an off-road motorcycle, bought with its
9 own funds at a cost of nearly 5,000 USD. The municipal government provided the rest of the
10 equipment, computers and other office machines and laboratory tools, at a cost of nearly
11 25,000 USD.

12 *Buyer relations:* The previous manager did not have well-established relationships with the
13 buyers, which limited his ability to enter into contracts with the buyers. At one point Coop2 had
14 its warehouse full but had failed to establish timely contracts with buyers to provide the money
15 it needed to finance its loans. It nearly defaulted on its loans even though the value of the cocoa
16 in store was more than enough to cover its payments. The cooperative now has developed
17 strong relations with buyers and creditors, which has created the level of trust they need to
18 work with Coop2. All the buyers interviewed explained the main motive for buying from Coop2
19 was that they trusted the manager. The largest buyer of the cooperative explained that even
20 though the cooperative did not always meet contract deadlines the manager communicated
21 well and could be counted on to eventually deliver the product. This difference in the
22 relationship the cooperative had with its buyers was a principal factor in why the cooperative is
23 now financially stable.

24 *Financial assets:* Coop2's inability to sell cocoa combined with high interest loans from local
25 credit institutions to secure working capital proved nearly fatal. Coop2's first loan in 2010 was
26 from a local credit union for 40,000 USD. However, the cooperative defaulted on this loan in
27 2011. The former manager and president of the board of directors took out formal loans in their
28 own name in 2011 of nearly 10,000 USD (3% monthly interest rate) to cover operating expenses.
29 When the new manager took over, he secured informal loans, which added up to nearly 20,000
30 USD for 6 months (5% monthly interest rate). The manager also worked to have the 2010 loan
31 refinanced; however, the 2011 loan taken out by the previous manager was no longer
32 recognized by the cooperative. By 2013 access to finance improved when credit was obtained
33 from three of the cooperative's largest buyers for a total of nearly 200,000 USD without
34 interest, which was repaid in cocoa. By 2014, having paid back the buyer-provided loans, the
35 cooperative gained access to international lenders, securing 100,000 USD with an 11% annual
36 interest rate. Coop2 has also greatly increased the amount of cocoa it markets from 130 metric
37 tons in 2012 to 425 metric tons in 2014. In fact, in 2014 it made a profit of 250,000 USD (from a
38 loss of 10,000 USD in 2010), which was used to pay for organic certification and eliminate past
39 debts.

1

2 *Coop3*

3 *Internal governance:* Coop3 stopped purchasing cocoa at the end of 2014. It started purchasing
4 cocoa again in mid-2015 after replacing its management and leadership. The NGO that has
5 supported the cooperative and its major buyer demanded the manager be changed as a
6 condition of maintaining a relationship with the cooperative. The membership also chose a new
7 board that no longer consisted exclusively of farmers but was made up mostly of teachers from
8 the local school. The members hope that the new directors would be able to provide greater
9 oversight and guidance to the manager. The board of directors basically manages the
10 cooperative and has been integral in establishing operational procedures. The board has taken
11 charge of external relations with funders, and participates in the strategic planning of the
12 cooperative. The new manager is not from the community nor has worked there. Even though
13 he understands the Peruvian cocoa industry, he lacks the social capital necessary to engage
14 effectively with members: management-member relations are effectively governed not by the
15 manager but by the board.

16 *Member relations:* The manager and board of directors admit that the cooperative needs to
17 build trust first with its members and second with the buyers and the institutions that support it
18 in order to become sustainable. Some of the members interviewed in remote communities were
19 unaware that Coop3 remained active in the cocoa sector. Even with all the recent problems,
20 84% of the members interviewed still planned to participate and sell to the cooperative once it
21 started buying again. The members felt that the cooperative paid higher prices, so it was in their
22 interest to sell to it when they had the opportunity. There was a general expectation that the
23 cooperative would be successful now that the cooperative had new leadership, even
24 anticipating that the cooperative will soon be exporting. One common member comment was
25 that "...with the new board of directors and manager, things are going to change".

26 *Infrastructure, machinery, and tools:* Coop3 possessed facilities to process up to 50 metric tons
27 of cocoa a month, more than twice the capacity it marketed in 2014. The local government gave
28 the cooperative the building and land. The post-harvesting infrastructure in the headquarters
29 and three collection facilities in the outlying communities were provide by grants from the local
30 and national governments and PDA totalling 75,000 USD with an additional 5,000 USD provided
31 by its members. The scales and cargo motorcycle worth 3,000 USD were provided by the
32 national and local governments. PDA gave Coop3 11,000 USD worth of chocolate making
33 equipment that it has used only infrequently.

34 *Buyer relations:* Since Coop3 has been selling cocoa in 2012, it has sold to six buyers. In 2014, it
35 sold 200 metric tons of cocoa to a national buyer and 10 metric tons to a specialized organic
36 trader. The cooperative is trying to re-establish relationships with some of its earlier buyers.
37 However, buyers are waiting to see if Coop3's new management can be trusted in ensuring the
38 cooperative meets its contractual arrangements with its current national buyer, who was the

1 exclusive buyer of the 2015 crop. One of the largest Peruvian cocoa cooperatives, which in 2012
2 was the primary buyer from the cooperative, is assessing Coop3's performance and quality
3 control before entering into a renewed business relationship. Even with these challenges, Coop3
4 has maintained its current buyer, who not only pays a premium for certified cocoa but also pays
5 for the certification.

6 *Financial assets:* The cooperative in late 2014 had defaulted on nearly 20,000 USD of debt, half
7 of which dated back to 2012. At that time a neighbouring cooperative provided an interest free
8 loan worth nearly 33,000 USD that was supposed to be repaid in cocoa. When the new
9 management took over, 8,000 USD of this debt still had not been paid and an additional loan of
10 10,000 USD with a monthly interest rate of 3% provided by a local credit union in early 2014 was
11 in default. Each member in late 2014 was required to pay Coop3 nearly 150 USD to cover
12 administrative costs. After discontinuing marketing in September 2014, this infusion of capital
13 allowed the cooperative to once again begin to purchase cocoa by the end of March 2015. Even
14 though Coop3 was able to make a margin on the cocoa it marketed, the former manager did not
15 keep records of the administrative and marketing costs, so the actual profit or losses for the
16 cooperative are unknown. The new management reported to have redoubled its efforts to
17 maintain good records, as input for more effective marketing strategies and financial planning.

18 19 *Coop4*

20 *Internal governance:* Like Coop2, Coop4 stands out for achieving a degree of commercial
21 success: it has been able to market a significant volume of cocoa although it has yet to become
22 financially independent. Its former manager, who had previously worked for a PDA program,
23 played a leading role in the cooperative's organization and elaborated its strategic plan. He
24 made nearly all decisions with little oversight from the board of directors. The new manager,
25 who started work in 2013, does not have this history with Coop4. Thus, the board has adopted a
26 more prominent role in decision making, especially in developing operational policy and
27 financial decisions. The board members have had accounting training, which has allowed them
28 understand the cooperative's finances, but have made little input on Coop4's strategic plan.

29 *Relations with members:* Although Coop4 did not receive noticeably higher prices from local
30 buyers, there was a consensus that engagement with the cooperative forced other buyers to
31 pay higher prices for their cocoa and apply fair trading practices (e.g. use of correct scales). Even
32 with the intense competition, the members still sold 62% of their harvest to the cooperative.
33 One of the founding members clearly demonstrated this loyalty to support Coop4: "We need
34 the cooperative so that we can receive fair prices. Its competition ensures that the middlemen
35 cannot cheat us". To become financially self-sustaining (see discussion on financial assets),
36 Coop4 must increase cocoa sales by adding members or capturing more cocoa from its current
37 members. They hope to double the amount of cocoa marketed in 2015 to 500 MT and then to
38 1000 MT by the end of 2019. However, being able to commercialize this amount of cocoa will

likely be a challenge considering that Coop4 faces a very competitive environment. Every major cocoa broker in Peru has a buying station in the community where it operates. The competition is so fierce that major buyers offer Coop4 members above market prices in an attempt to gain their business.

Infrastructure, machinery, and tools: In 2012, Coop4 built new offices and storage facilities and purchased processing equipment and vehicles. PDA and local and national government paid 170,000 USD for the buildings and the cooperative provided the additional 90,000 USD. Coop4 took out a loan from a local credit union to finance the project. Additionally, between 2009 and 2013 PDA and regional government paid over 100,000 USD for 2 trucks, 3 cargo motorcycles, and 3 off-road motorcycles. Coop4 contributed around 10,000 USD to supplement the grants in purchasing this equipment. An additional 10,000 USD was donated by PDA to purchase computer equipment. Like many cooperatives in the region Coop4 has been given chocolate-making equipment. While much of this equipment has fallen into disuse because of the difficulty in making chocolates and the lack of markets and expertise, Coop4 has seen this equipment as providing a real opportunity to sell into a value added market. It received a grant from PDA to hire a chocolatier to train members in making the product.

Relations with buyers: This intensively competitive environment may be a factor in Coop4's poor relationship with buyers. At times, Coop4 has not met its contractual obligations, especially deadlines, and does not communicate well with the buyers. The awkward sales relationship is demonstrated by the fact that even though one buyer explained that it would no longer purchase from Coop4 the manager still said that the cooperative was actively selling cocoa to this trader. The change of management may have also strained these relations, as the former manager made contracts the new manager found disadvantageous. Furthermore, the leadership of the cooperative believes that it can now directly export cocoa and no longer needs to be dependent on the large buyers. So, they have little interest in maintaining and building these relationships.

Financial assets: The large amount of support it has received from PDA and the Peruvian government has helped the cooperative maintain financial stability. Nearly all of the staff, except for the accountant, were paid from grants. To cover all these administrative costs, the management estimated that it would need to market 520 MT of cocoa, much more than the 280 MT marketed in 2014. The leadership is hopeful that it can meet this target by 2017. Coop4 like the other cooperatives has faced challenges in servicing its debts. Its original loan with a regional credit union to purchase land and help construct its main buildings totalled 115,000 USD with a 2% monthly interest rate. In 2013, Coop4 borrowed an additional 18,000 USD from a different credit union with a 2.2% monthly interest rate for working capital. In 2014, a large national coffee and cocoa cooperative lent Coop4 100,000 USD and in 2015 130,000 USD for working capital that would be paid off with cocoa sold to the larger cooperative. In 2014, Coop4 was unable to pay off its original loan for its land and buildings and has been working to

1 refinance the loan. Because of the high interest rates, the debt has increased from 115,000 USD
2 in 2012 to 130,000 USD by mid-2015.

4 *Looking across the cooperatives*

5 Figure 3 presents the primary motivation reported by members for joining their cooperative. In
6 some cases, the primary motivation strongly reflected the influence of the external
7 organizations that led the process that established the cooperative. For example, Coop1—where
8 members showed a strong interest in access to production inputs—was started by PDA with the
9 intent to expand smallholder cocoa production. Similarly, organizers of Coop4 explicitly aimed to
10 provide cocoa growers with an alternative to unproductive trading relationships with local
11 buyers, thus the relatively strong interest in better prices. Interestingly, Coop4 is the only case
12 where access to better prices did not feature as the most important reason for cooperative
13 participation, likely reflecting the strong influence of NGOs in promoting cocoa expansion over
14 business development. Furthermore, the cooperatives are likely to face difficulties to change
15 expectations in the near future: the inability of the cooperatives to purchase their members'
16 cocoa ranked as the most important reason for members of Coops 2-4 and the second most
17 important reason for members of Coop1 (Fig. 4) to sell cocoa outside their cooperative.

18 Table 3 compares outcomes for each cooperative across the five parameters. The cooperatives
19 had most advanced in their expansion of infrastructure, equipment, and tools. This could be
20 expected given that external interventions prioritized their support to cooperatives in physical
21 capital. The parameter where the cooperatives least advanced was in the consolidation of buyer
22 relations. Major issues existed related to noncompliance with contracts and weak trust between
23 buyers and cooperative managers—issues that, left unaddressed, are likely to severely impede
24 the development process. Mixed outcomes resulted for the remaining three parameters. The
25 governance structures varied considerably in practice. The board itself took critical decisions in
26 Coop3 while managers with limited member involvement administered the other three
27 cooperatives. Evidence suggested that limited business skills, specifically in Coop1 and Coop4,
28 contributed to weak partnerships with buyers. Overall, the cooperatives were able to retain
29 members, particularly by offering their members access to services, and in some cases, higher
30 prices than those paid by the intermediaries, and more transparent purchasing practices.
31 However, the cooperatives' dependence on external funding sources will likely challenge their
32 capacity to meet demands over time, at least for services such as technical assistance. Across
33 the cooperatives financial capacities appeared frail. On one hand, they secured funds through
34 buyers and lenders. Contracts with buyers, expanding cocoa production, and overall favourable
35 world cocoa have encouraged lenders to provide credit to the cooperatives, which is used to
36 purchase members' cocoa. On the other hand, the level of credit for operations was insufficient
37 and the cooperatives lacked their own capital, leaving them with limited capacity to purchase
38 members' cocoa.

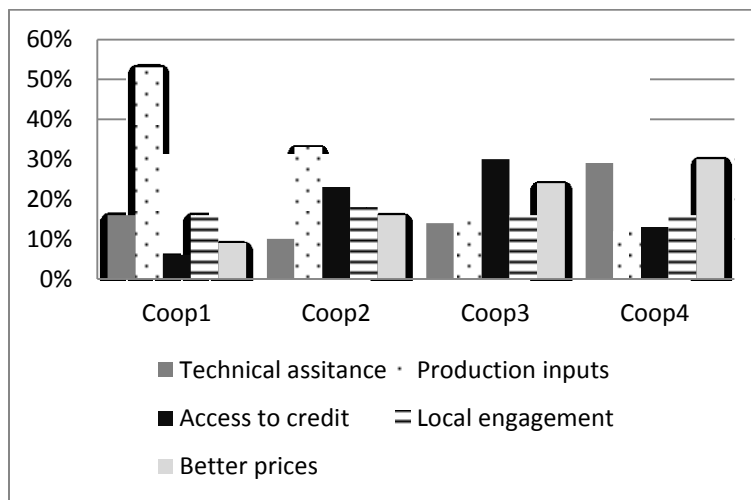


Figure 3. Primary motivation of members to join cooperative

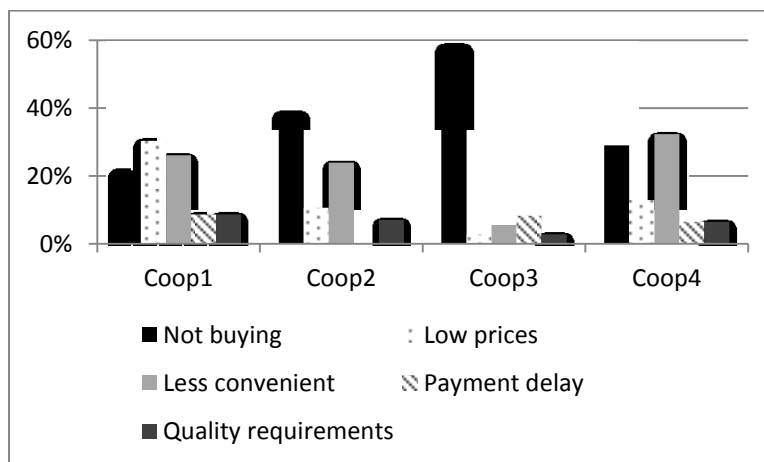


Figure 4. Primary motivation of members to sell their cocoa outside the cooperative (2014)

Discussion and Conclusion

Mature cocoa cooperatives have emerged that are able to provide a range of services for their members, with important implications on rural livelihoods and rural landscapes. They have positioned themselves in global value chains, able to interact over time with international buyers eager for access to certified and otherwise high value cocoa and other commodities. Extensive support from NGOs and donors, and in some cases international buyers, has played an important part in the success of these cooperatives. As noted by Bebbington, Quisbert, and Trujillo (1996) in their study of the cocoa cooperative “El Ceibo”, “the achievements of Ceibo

1 have not come cheaply, and remind us that building capacity in a campesino [sic] organization
2 require significant and sustained investment of resources” (p. 203). Similarly, the Ghanaian
3 cocoa cooperative Kuapa Kokoo was an early participant in certified cocoa markets and received
4 significant support from NGOs and international cocoa buyers over many years (Nelson et al.
5 2013). Both these cases depict a pattern whereby development organizations and buyers picked
6 a favoured cooperative supported ‘their organization’ over time, through thick and thin. The
7 pattern is not unique to cocoa, and has endured despite the risks, as even well-established
8 cooperatives face critical operating vulnerabilities (e.g. departure of key staff, and limitations to
9 broaden their impact by incorporating new members and gaining critical mass in terms of
10 marketed volumes (Poole and Donovan 2014). However, such an approach falls short in a
11 context characterized by expanding cocoa production and buyer presence and the emergence of
12 dozens, if not hundreds, of small cooperatives looking to expand membership and participate in
13 markets for products that are certified or otherwise of high quality.

14 This study examined four emerging cooperatives in the rapidly expanding Peruvian cocoa sector
15 in an effort to understand the circumstances that have shaped their development and gain
16 insights into options for improved strategies for supporting cooperative development. Each
17 cooperative had a set of strengths and weaknesses, and the precise analysis differed from one
18 organisation to another—with none of them exactly alike. In general, however, the cases
19 analysed here fell way short of meeting performance objectives. These findings reinforce the
20 significance of key elements of cooperative structure and strategy depicted in Figure 1 of
21 human, social, physical and financial enterprise assets: a common performance failing is the
22 difficulties of financial management, which are handled differently by each of the cooperatives.
23 Working capital and access to affordable finance affects capacity to provide advance payments
24 to members and provide services to members over the long term, and thus impacts on
25 stakeholder relationships, particularly members and buyers. It is evident also that the
26 expectations of members vary between the different cooperatives, but whatever part other
27 objectives play in members’ participation, the cocoa price matters. Secondly, governance
28 models are a significant performance dimension, in particular the different levels of respective
29 skills and the power relationships between the boards of directors, the management and the
30 membership. The consolidation of governance allows for building good relationships with
31 external buyers in competitive product and finance markets. Finally, trust and good
32 communication are key factors in building bonding social capital. In the face of intense
33 competition from independent cocoa buyers, cooperatives will grow and consolidate their

1 Table 3. Summary of viability assessment across cooperatives (+++=strong capacity; ++emerging capacity; +weak capacity)

Cooperative	Governance	Member Relations	Infrastructure, Equipment & Tools	Buyer Relations	Financial Assets
Coop1	Assessment: + <ul style="list-style-type: none"> Lack of business training or experience of leadership Externally paid manager (regional government) makes all major decisions Board has little knowledge of operations 	Assessment: ++ <ul style="list-style-type: none"> Expectation of future benefits motivates participation & sales Weak sense of ownership of the cooperative 	Assessment: +++ <ul style="list-style-type: none"> Adequate buildings to store and process cocoa Lack of transport for cocoa purchases from members Access to office space, but lack of title prohibits ability to use buildings as loan guarantee Underutilized equipment for production of processed cocoa 	Assessment: + <ul style="list-style-type: none"> Failure to fulfil contract requirements particularly timely delivery at times never fulfilling contracts 	Assessment: ++ <ul style="list-style-type: none"> Access to credit through international provider, but difficulty with repayment In default on a loan backed by a major buyer
Coop2	Assessment: ++ <ul style="list-style-type: none"> Externally paid manager, selected and paid by projects Deference to the managers' decisions Board of directors knowledgeable on daily operations, but limited impact on strategy 	Assessment: ++ <ul style="list-style-type: none"> Members are content with the cooperative having seen its financial turn around Expectations of more benefits as cooperative becomes profitable 	Assessment: + <ul style="list-style-type: none"> Rents a main building that does not have adequate space Rural buying stations were built by donors using substandard wood Limited transportation and processing capability 	Assessment: +++ <ul style="list-style-type: none"> Trust the cooperative because of its manager who has established a relationship with the buyers due to his history working in the industry 	Assessment: ++ <ul style="list-style-type: none"> Manager has been able to obtain credit buyers & in international markets Still lacks sufficient working capital
Coop3	Assessment: ++ <ul style="list-style-type: none"> Externally paid manager (buyer) unfamiliar with the cooperative / unable to make strategic decision Board effectively manages the cooperative while nearly hired manager learns his position 	Assessment: ++ <ul style="list-style-type: none"> Even though the cooperative had stopped buying for some time, most members are hopeful for the future & appreciate the extension services they receive 	Assessment: +++ <ul style="list-style-type: none"> Secure access to office space, excess capacity in warehouse and post harvesting space Underutilized equipment for production of processed cocoa Limited transportation capability 	Assessment: + <ul style="list-style-type: none"> Commercial relations with only buyer; with history of incomplete contracts Buyer purchases conditioned on hiring buyer selected manager 	Assessment: + <ul style="list-style-type: none"> No access to working capital (credit) due to default and weak administration Dependent on current buyer & an NGO to provide funds Income from carbon credits are restricted
Coop4	Assessment: ++ <ul style="list-style-type: none"> Board understands the operations Newly hired, externally paid manager (project) has limited experience with the board 	Assessment: ++ <ul style="list-style-type: none"> View cooperative as necessary to control prices & ensure fair practices Side selling because of lack of price difference 	Assessment: +++ <ul style="list-style-type: none"> New and more than adequate buildings, processing, and transport equipment Only cooperative fully utilizing its chocolate making equipment 	Assessment: + <ul style="list-style-type: none"> Extensive competition in the area has made the cooperative sceptical of buyers Failed to meet contract commitments 	Assessment: ++ <ul style="list-style-type: none"> Extensive support from donors Difficulty in paying loans with high interest rates

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	• Still developing strategic plan				
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operations by providing members with attractive prices and useful services. Engagement by cocoa cooperatives in multiple certification systems (e.g. Fairtrade, Rainforest Alliance and UTZ Certified) reflects, in part, interest in diversifying their buyer portfolio and providing more attractive terms to members.

In all cases, external organizations, mainly local and regional governments and PDA-supported NGOs, played a major role in the formation of the cooperatives. However, they failed to fully address the critical needs of obtaining access to financial assets, building healthy commercial relationship and improved governance structures. External support targeted a few needs: infrastructure development and covering costs for administration, technical assistance and the provision of inputs to members. Buyers had supported the cooperatives by facilitating access to credit (either directly or by providing collateral); however, the cooperatives likely represented a high level of risk for deeper and broader support.

Services provision

The coops remain weak business organizations, but dependency relationships are not entirely asymmetrical. The public objective of licit agriculture such as cocoa production requires viable commercial production; and the international market needs assured supplies of high quality product, particularly as climate change is likely to affect global production. But real challenges remain in order to wean the coops off government and NGO supports which underwrite underperformance. Value chain partners need a stronger commitment to build the 'soft' assets associated with human skills of management and governance. Soft asset formation may continue to be necessary for years after the technical assistance, infrastructure, and financial support have been scaled down. A sectorial dialogue is necessary to ensure that the design and delivery of these services are aligned and harmonized between government policy, the approaches of development agencies, NGOs, research and training centres, and most of all, closer collaboration, communication and coordination in the value chain among cooperatives, buyers and processors. Among promising – and replicable - initiatives interlinking smallholders and collective organisations with commercial input suppliers, credit provision, output marketing and even management services are the multistakeholder partnership approach supported by the UN World Food Programme,¹ and the scheme for inclusive value chain model of Standard Bank Group (Stanbic) in Africa.²

Governance

Well-qualified leadership is not only necessary to make critical decisions and develop a coherent strategy. The abilities of manager and directors are also important to build good relations with members and with buyers. These cases bring to light the overall lack of business leadership in

¹ <https://www.growafrica.com/groups/patient-procurement-platform>

² <http://www.inclusivebusinesshub.org/project/project-profile-stanbic-agricultural-banking-in-nigeria/>

1 rural areas and the tendency for leaders to acquire their skills through lengthy learning-by-doing
2 processes, at times supported by training and technical assistance interventions. All the buyers
3 commented that a key factor in choosing to do business with a cooperative is their confidence in
4 the manager and to a lesser extent with the board of directors. This relationship with the
5 leadership is so important that it has critically affected the survival of all the cooperatives
6 included in this study. In Peru as in many other markets, there is a relatively small group of
7 businesses that export cocoa. Buyers for these businesses share information on cooperative
8 performance among themselves and are likely to 'blacklist' cooperatives and their managers
9 who have shown to be unreliable business partners. Several cocoa buyers mentioned they would
10 reconsider purchasing cocoa from Coop2 if it changed managers. Coop3's buyer would only
11 continue purchasing from the cooperative once the buyer installed its own manager. The leaders
12 of Coop1 and Coop4 have failed to establish and maintain good business relationships, which has
13 greatly limited their ability to market cocoa. In countries like Peru that have weak institutions,
14 especially weak courts to enforce contract laws, the need for strong relationships between the
15 buyer and the cooperative is even more critical (Hoskisson et al. 2000).

16 17 *Finance*

18 One characteristic shared by relatively large, successful exporting cooperatives, irrespective of
19 the principal crop, is the amount of outside support, especially financial support, received during
20 the incubation stage that allowed them to grow and compete. Clearly, these emerging
21 cooperatives were unable to either offer extension services or pay for a large staff when they
22 were first formed. The challenge lies in determining how long funding should be provided and
23 how best to target resources. While cooperatives are likely to welcome donations and subsidies
24 for the expansion of physical capital, including large-scale processing equipment, such
25 investments should be made with caution unless based on sound financial planning (e.g.
26 investment capacity for repair and expansion) and marketing strategies. The provision of
27 chocolate-making equipment to emerging cooperatives in remote areas makes little sense in a
28 context where the recipient cooperatives are struggling to consolidate basic business operations.
29 Most importantly the cooperatives will not grow their membership or consolidate their
30 administration unless they have affordable access to working capital. An effective and trusted
31 leadership is more likely to gain access to affordable credit. However, even the most trusted
32 manager faces challenges finding credit to make purchases because of thin credit markets in
33 these remote settings. A coordinated effort between private industry and the government loan
34 guarantees - as in the Stanbic case cited above - is needed to foment and subsidize these credit
35 markets.

36 This study, carried out in a context where cocoa cooperatives participate in a rapidly growing
37 cocoa sector with considerable competition among local buyers, highlights the need for local
38 stakeholders to investment in the formation of bonding social capital from the beginning of the
39 cooperative development process. . The challenges presented here are relevant in other

contexts where efforts in cooperative building are expected to contribute to revitalizing the cocoa sector, for example Papua New Guinea (Garnevska, Joseph and Kingi 2014) and Ghana (Donovan et al. 2016). Cooperatives need strong partners along the way who understand their needs and circumstances. Government agencies and NGOs will continue to play a key role; however, there is need for deeper engagement to design monitoring systems with feedback loops for joint reflection and learning. Greater coordination with the private sector is needed to better understand the options for coordinated interventions and joint risk-sharing. For emerging cooperatives, value chain partnerships for building governance and leadership capacities will be critical. A future research and development challenge is to better understand and manage the economic incentives that drive the relationships between buyers and cooperative suppliers in value chains such as cocoa in Peru, in such a way that commercial partners rather than external donors are willing to commit the financial resources that hitherto come from donors and the public sector. Finally, new forms of collaboration, such as cooperative-cooperative business schools, may also work for newly formed cooperatives if more mature cooperatives are willing to share experiences and skills.

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