



Agricultural Associations and Supermarkets

Contracting and Regulation of the Producer – Retailer Relationship

Authors: Cornelia Alboiu,
Alexandra Toderiță

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Introduction

How do Romanian farmers get in supermarkets in Romania? They hardly do and sometimes at unfair prices. Thousands of other farmers and farmers with

*“Supermarkets don’t buy en detail”
Former Minister of Agriculture in
Romania*

quality production remain out of the game - from the farm gate to, at best, food markets. This reality of the Romanian agri - and commodity market, has however some common causes, identified here, which can be resolved. This report stresses the contracting issue - with an emphasis on the vegetables – fruit chain. **The authors have undergone a field assessment which included over 300 vegetables producers, with or without legal personality, they discussed with representatives of 25 of the 34 producer groups in this branch, as well as with representatives of four retail chains in Romania.**

Romania’s agricultural sector is confronted with major problems related mainly to scarce farmers’ market organization and their slow adaptation to the mechanisms of modern retail formats. These formats entail large production volumes of a homogenous quality, which can only be obtained in the presence of a modern and functional infrastructure – collection centers,, greenhouses, deposits, silos. All of these represent investments which, most of the times, surpass the financial capacity of a single farmer, even of a medium size. The many weak or inexistent links in the Romanian agricultural/foodstuffs chain contribute to the stifling of the frail associative pursuit of Romanian farmers. When producer groups sell directly in the marketplace¹ with a cash register instead of negotiating mutually beneficial contracts with large retail networks, it is obvious that the mechanism is not functioning.

Romanian products are still in the phase of a weak presence on the shelves of large retail chains. In this respect, we are well behind Western countries: out of the ten most important hypermarket chains in the US, seven had stands and acquisition programs dedicated to local producers, while the top retailer, Wal-Mart, registers procurements worth 0.4 billion dollars in this system.

The present report raises the complex issue of formalizing the relationship between farmers and wholesalers and retailers. Field data indicates a very low level of formalization – very few written contracts. These relationships are further complicated by retailer practices that

¹ Information obtained from representatives of the Agency for Payments and Intervention for Agriculture (APIA)

producers consider unethical. On the other hand, shops complain about the lack of consistency and the inability of local producers to meet the necessary standards.

The media is full of examples in recent years where big retailers impose conditions difficult to fulfill by the producers, mostly tax - related, as sometimes they can amount up to 50% of the shelf-value. A notorious example is the Topoloveni jam, whose shelf price is 23 lei, out of which the producer receives 9 lei.

In 2009, the Ministry of Agriculture was involved in negotiations with major retail chains and has formulated a Code of Good practice which should govern the manufacturer-dealer relationship. It eliminates a whole bunch of unjustified charges, it established negotiation limits. At this point, very few of the provisions of that code are respected de facto. Clearly, the Ministry of Agriculture can not intervene in a competitive market. The idea of MARD making major retailers include a special area for Romanian products has been publicized. Beyond the political PR exercise, European competition law does not allow this.² But there are ways to support small producers Romanian widening access to markets, in particular by fostering resolution of structural problems: lack of association.

Based on field research and analysis of the problems mentioned above, this report makes a number of recommendations aimed at supporting small producers access' to large retail chains

Contracting on *the food chain*: help or burden?

The food retail sector is experiencing a profound transformation and development due to the significant emergence and growth in the number of large chain stores, but also due to the rapid development of the processing industry. In this context, the contract becomes a tool used to facilitate commercial transactions between farmers and large chain stores, retailers and processors. A question arises : how well prepared are Romanian farmers to use the contract, and how stimulating is the use of contracts in agriculture?

Currently, 77% of urban consumers do their grocery shopping using modern formats of commerce. The market share for these modern formats has increased significantly in recent

² "A corner of Romanian products in each hypermarket" Gazetadeagricultura.info, accessed on April 16, 2013

years, accounting for nearly half of total retail sales for the overall population. Thus, hypermarket sales represent 26%, supermarkets account for 9% and discount stores for 9%³

However, we are still far from countries in Northern Europe, where the share of sales via major food chains amounts to 70% - 90% of total sales, a trend that will be maintained well after 2013.⁴

On the other hand, the agricultural sector is facing problems mainly marked by the farmers' poor ability to organize in order to commercialize their products and a slow structuring of their commercial behavior. In the cereal sector, for instance, out of a total production of 12,698 tons in 2012, only 10% of the quantity was contracted, according to industry representatives interviewed by the authors and researchers of the Institute of Agricultural Economics. In the milk and dairy sector, out of a production of 5.4 million tons, only about 22% was contracted, while in the fruit and vegetable sector, out of a production of 3.5 million tons, approximately 20% was sold on the basis of written contracts or to large chain stores or to processors.

Therefore, we ask ourselves the question: what are the causes of such low levels of contracting through the Romanian agricultural chains?

The institutional causes determined by land restitution in the '90s and agricultural policy incoherence up to 2007, which not only led to land fragmentation, but also to agri-food chain division (production-distribution-marketing), only add to farmers' reluctance to form associations (which is still a reminiscence of the collectivization era). The situation is all the more unfortunate as on the other side of the barricade (processors and retail chains) a strong degree of concentration is the case.

There is an imbalance between the negotiating power of farmers and their commercial partners, but also an inequity regarding market power – the downstream segment is concentrated, while producers cannot manage to organize themselves. Other causes add to this mismatch:

- Non-uniform taxation;⁵
- Disloyal competition, manifested through imports that sometimes lack proper fiscal or health safety controls;
- Lack of clear facilities for different associative entities;

³ Website Euromonitor.com, last accessed 5 april 2013

⁴ Website Copa-cogeca.be, last accesssed 13 april 2013

⁵ See previous report in this series: "The new fiscal measures and the association of small producers. Chain broke weaknesses in charge of agriculture?" CRPE Policy Memo no. 35 January 2013

- Insufficient promotion of measures regarding farmer organization (absorption rate of approximately 30% of funds dedicated to measure 142 of the current National Rural Development Program, “Producer groups formation”⁶).

In theory, the main reasons why the contract is regarded as a tool to improve trade relations are: it increases channel effectiveness (boosting benefits for farmers as a result of increased productivity, improved technology transfer, better coordination), production planning and farmers’ investment, it enhances vertical integration, helps meeting consumer requirements - food safety, animal welfare, environmental protection – leads to increased transparency, risk sharing.

Problems searching for solutions

While there are plenty of reasons and benefits for which contracting seems to be necessary and useful, there are still some constraints few farmers manage to cope with:

- Quantity, quality, frequency of deliveries;
- Duration;
- Confidentiality and exclusivity clauses.

To these difficulties we can add other issues that have been systematically raised by farmers and their representatives during research interviews:

1. High transaction costs on both sides

For farmers, it is difficult to find a customer, but also to monitor compliance with contract terms, while for large stores chains, processors and merchants it is costly to sign contracts with a large number of producers (supply atomization).

2. High degree of risk and uncertainty in agriculture

Large variations in climate conditions have direct consequences on crop stability and therefore on price volatility. Price volatility and the need for immediate liquidity determine farmers to sell off contract. In addition, demand for agricultural products is continuous, while the offer is seasonal. This feature leads to an increased variation in prices of vegetables and fruits, the

⁶ The situation of projects under the RDP session on 04.25.2013, site of the Ministry of Agriculture and Rural Development

fruits and vegetables chain becoming even more problematic as the number of warehouses becomes insufficient.

However, there is a paradox in the sense that even if they have been built, they are being used as storage areas for imported goods: for instance, the apple warehouse in Voinesti stores apples imported from Poland, with producers claiming that the price they receive per kilogram is very low.

3. Unfair competition determined by imports insufficiently checked qualitatively, sanitary and fiscally.

The situation is serious and it applies particularly to imports from non-EU countries, as their compliance with quality and food safety and with customs import procedures is low, while verification of the accounting documents is highly questioned.

Very often, farmers say, these imports arrive right when the Romanian production is ready, the competition thus reducing prices, which in turn reduces farmers' motivation to use contracts.

Farmers argue that massive imports and the large chain stores' penchant for imported goods, especially at times when the Romanian producers can provide the necessary consumption needs, is affecting their access to retailers.

In addition, besides high standards regarding quantity, quality, delivery timeline, food safety measures and contractual penalties, all imposed by the modern distribution sector, it seems that one major obstacle to the access of indigenous production to large *retail* chains is represented by **costs**. The perception of farmers is that these can **be as high as 35 to 50% of the shelf value of the product**⁷.

The vegetables chain: connecting producers – retail chains - processors

Our evaluation of contract characteristics within the vegetables chain is based on several case studies and interviews with representatives of major vegetable producers, large retail chains and processors chains.

⁷ Producers of canned accuses hypermarkets of suffocating them with tax: it reaches 50% of prices, foreign manufacturers always prevail "Mediafax.ro, accessed 30 April 2013

Capitalizing on the vegetables production is rather difficult, because specific institutional guidelines are not followed through. Trade can either be made directly on the market or by using intermediaries [wholesale markets or straight from the farm]. Other part of the production is designated for big retail chains and for processing, usually if the farmer has managed to seal a contract.

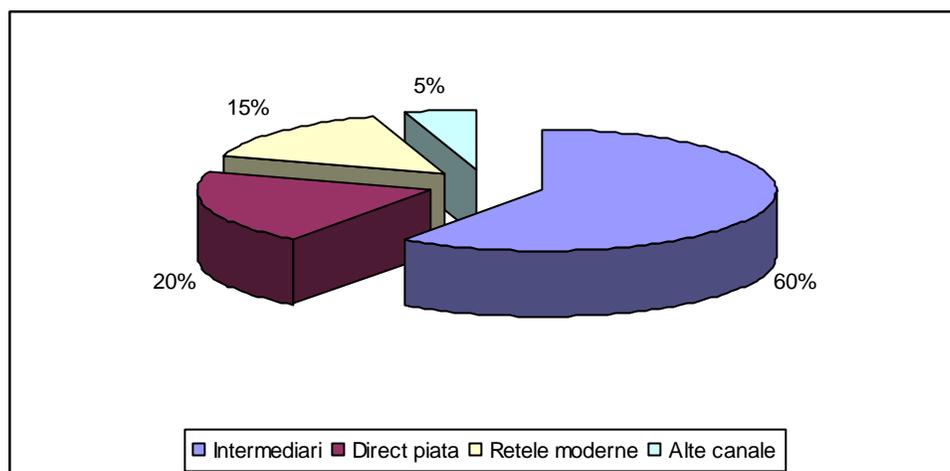
Regarding products sold through different channels, it is rather difficult to quantify the volumes that go through each one. Available information can only point to some estimates.

Following the research undertaken for this report, we estimate that more than half of the amount of vegetables sold is sold through a large number of intermediaries.

No formal written contracts are concluded with smaller size shops and supermarkets, discounter type, and few farmers can sell their products through hypermarkets. We estimate that less than 20% of the vegetables production is sold this way. In case the sale is made directly through this type of stores, then the connection to large retailers will be done via producer groups, associations or wholesalers. Modern retail formats require quality products in large quantities and well established frequency.

According to the field research conducted at a national level (more than 300 vegetable producers, both legal and natural persons, were interviewed, discussions took place with representatives of 25 of the 34 producer groups in the field, as well as with the representatives of four retail chains in Romania), vegetables are commercialized mainly through intermediaries (60%), directly to the market (20%), through modern distribution networks (approximately 15%), and other channels (5%).

Fig. 1: The main marketing channels on vegetables



Source: own estimates based on interviews with representatives of the vegetables agri-food chain

Trade in vegetable sector is highly fragmented. In general, producer groups consist mostly of individual producers and one or more farms with legal status. Case studies and interviews held with farmers representatives show that the trend is that the number of individual producers decreases, by increasing the share of farms with legal status. Producer groups appreciate they are not sufficiently supported, they say that they do not receive subsidies on time, but the main problem they face remains commercialization.

Examples of best practices in contracting are quite fragile. **There is a very low level of strategic partnerships between farmers and processing factories, and they are almost inexistent between farmers and large retail chains.**

It is noteworthy that in 2012 the Metro retail chain launched a program entitled “De-ale noastre”, which involved 200 small vegetable producers from the agricultural area of Poiana Mare. Within this project, vegetable producers benefit from a collection centre, seeds, consultancy throughout the production process, and a guaranteed marketplace.

Still, in 2013, because the price was no longer fixed contractually, but on the basis of a weekly price index, part of the producers refused to sign the contracts. Furthermore, Metro showed a preference towards larger producers in the village. Part of those who dropped out also took into account the fact that they had to deliver only extra quality, while “intermediaries acquire other qualities, as well”.

Table 1: Frequency of formal contractual agreements

	<i>Farmer intermediary</i>	-	<i>Farmer processor</i>	-	<i>Farmer merchant</i>	-	<i>Processor merchant</i>	-
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"It would have been much easier to import them, than to make specifications with the manufacturer, to develop a product, to test it, to create its package, but we wanted to do this to have a contribution to the production of this country "

(Carrefour Romania Director)

Formal relationships [no of cases]	14/300	28/300	20/300	2/6
% of cases	4.6%	9.3%	6.6%	33%

Source: Field work 2011, 2012

After the field research, we conclude that **the frequency of written commercial relations is very low for all four stages of the chain**. The results show that the share of formal relations is very low for the farmer - intermediate and for the farmer-processor. A higher percentage of formal trade relationship is observed in the

All interviewed producer groups representatives indicated that the most important benefit in terms of contracting with large retailers or specialized intermediaries is that these partners use written contracts, while traditional intermediaries prefer verbal agreements.

processor – retailer relation. Formal relationships include formal written contracts and specific financial covenants such as price, quality, quantity, contractual penalties or other financial support. Large network of stores tend to choose more formal contractual relationships with processors than directly with farmers, which indicates coordination and organization more systematic and standardized in the downstream chain of vegetables.

The role of producer groups in facilitating access to large commercial chains

Thus far, the fruit and vegetables sector comprises only 34 producer groups and one producer organization (Hortifruct). Initially, back in 2008, there were 45 recognized producer groups in the fruit and vegetables sector. But some of the licenses have been withdrawn in 2011, leaving only 34 groups. It is expected that in 2013 four of the groups would upgrade to producer organization status.

According to interviews conducted with supermarket representatives, vegetable acquisition is generally done based on written contracts with local suppliers (mainly large vegetable farms, with legal status and part of producer groups).

Contracts are drafted by the large chain stores, sometimes with ambiguous contractual clauses on penalties like "under the law", without actually stating the law to which they refer.

Information obtained during interviews confirms that there is a lot of heterogeneity in the vegetable chain with quite contradictory effects. Generally, large retailers representatives indicated that they prefer to buy fruits and vegetables from large commercial farms, with legal status. However, where this is not possible, they buy from small producers through a specialized intermediary. Producer groups representatives have signaled a number of limitations with respect to small vegetable producers who supply big retailers. Firstly, the mechanism of acquiring vegetables varies from one store to another. Modern commercial networks usually pay off their fees three weeks or even a month after delivery, an important problem for producers who do not have enough liquidity to cover the period.

Secondly, in order for them to sell their products through retail chains, Romanian vegetable producers must pay an entrance fee worth up to 15%, called a "shelf tax", which is considered extremely high, considering their financial power. For instance, producer representatives have stated that "shelf tax" can vary between 10 and 15% of the price the farmer receives. This makes the price received by farmers to be smaller than the price obtained by selling products through traditional channels (intermediaries), the only advantage being the economy of scale, thus sales safety, in case of selling high volumes.

Industry organizations and trade unions recognize that it is very difficult for small producers to market their production through large retail chains because they **fail to provide sufficient quantities**. They consider that the "shelf tax" is too high, making it difficult for producer groups and particularly small producers to access retail networks.

Meanwhile, farmers and their representatives stressed that very high standards (various certificates required) and the low level of sorting and packaging infrastructure development are important limitations that prevent small producers from delivering goods to large chains.

We need to emphasize the important role of producer groups that connect farmers to markets, by providing assistance schemes such as consulting services, storage facilities, provision of agricultural inputs and the establishment of formal contracts between farmers and retailers.

Price volatility may cause small producers to violate their contract with the producer group. This attitude prevents the proper functioning of the producer group which no longer manages to sell 75% of its members' production, and the development plan initiated within the Operational Program cannot be accomplished.

Breach of contract and poor enforcement of contracts is one of the major problems that participants in the vegetable chain are facing.

The payment mechanisms offered by stores (20-30 days from delivery date) is less attractive than the traditional oral agreements on the spot market (payment on the spot, at the time of transaction). At the same time, for instance, when the price or a variation margin is written in the contract, a rise in vegetable prices on the market will increase the manufacturers' benefit if he sells on the market (out of contract), and vice versa.

The opportunistic behavior of some farmers to sell outside the contract and the producer group is accentuated by price volatility, high VAT tax, "shelf tax" and other costs imposed by group formalization. In the absence of special tax breaks producer groups will continue to be undermined by their own members who seek easy ways to immediate gain.

Conclusions and recommendations

Participation in producer groups is not sufficient for the facilitation of their participation in the distribution networks of retail chains, on the one hand due to the producers' opportunistic behavior, and on the other hand because of the large entry costs imposed by modern formats. At the same time, participation of producer groups is an imperative condition. In the EU, the common market supports the formation of producer groups and other associative forms. While in the Netherlands the organization degree is 104% and the EU average is 34%, **in Romania the degree of producer organization is extremely low, under 1%**. Hence, we reiterate the main conclusions and recommendations of a preceding report ⁸:

Small and medium size agricultural producers in Romania need support in forming associative structures, especially in order for them to be sustainable in the longer run.
The new Rural Development Program should include a measure dedicated to the development of associative structures in agriculture through integrated programs, which can withstand the costs of "incubating" such associations, from set-up consultancy, organizational development, business planning, market place outlets, to obtaining financing.

⁸ CRPE Policy Memo no. 27 "Union make the power. Models and best practices for sustainable agriculture association ", November 2012

- It is necessary to **formulate clearer, less bureaucratic requirements in the Applicant Guide for measure 142 – Formation of Producer Groups in the NRDP**, as many of those interviewed for this report have identified it as a difficulty.
- An intervention priority with a view to stimulating associative forms in agriculture is fiscal policy. Granting fiscal facilities for farmers organized in producer groups would be highly beneficial: a **lower VAT level for selling production through an association or for the bulk acquisition of agricultural inputs**. This measure would lead both to reducing opportunism in contractual relationships, and also to improving the functioning of producer groups.
- It is also necessary to introduce fiscal measures such as a **VAT reduction for all agricultural/foodstuff produce**, and a **lower VAT for farmers, regardless of the legal type of organization** they have chosen. A larger tax base would mean not only increasing the number of tax payers, but also the regulation of commercial behavior of all the actors in the distribution network. Producer groups could also be stimulated through **tax breaks on reinvested profits**.
- It would be beneficial to **finance short commercialization chains, and models such as “vegetable basket”, “driver farmer” and community-supported agriculture⁹ in the next Rural Development Program (2014-2020), through a dedicated measure**. Promotion of short distribution chains would practically counterbalance the commercial power of large retail chains and would contribute to restoring market balance.
- Also, **the new RDP should support the formation of inter-professional organizations for a product or a group of agricultural products (IAPOs)**, which have an important role in managing supply and demand in product channels, being consulted by the Ministry of Agriculture with respect to regulating chain policies. IAPOs could also play a very important role in the consolidation of contracting practices, and could represent an instrument of ensuring the enforcement of general contracts between producers and large retail chains.

Other pragmatic recommendations for supporting producer groups' access to large distribution networks:

- Evaluating the potential of agricultural areas (vegetable and fruit production) and investing in greenhouses, deposits, collection centers, where local production could be stored, rather than imported products;
- Supporting partnership between large retailers and producer groups, associations or co-operatives;

⁹ *Idem*

- Renegotiating a new code of best practices and a general contract framework for the regulation of the most important aspects in the producer-retailer relationship (commercial negotiations, payments, promotions, compensations, litigations);
- Professional training for the beneficiaries of measures related to the formation of producer groups, as well as other target groups that benefit from other RDP measures, which could include courses on the establishment and functioning of various associative forms: IAPOs, producer groups, with the goal of informing and supporting the constitution of various bottom-up associations, which, once formed, are capable of understanding and initiating market intervention measures.

This report is published under the **"Rural Development through Entrepreneurship and Association" program** - initiated and funded by RAF and implemented in partnership with PACT, CIVITAS, CSDF, CMSC, CRPE and CEED.

The contents of this report do not necessarily represent the official position of the RAF and the consortium members. The opinions expressed do not automatically involve position of all CRPE affiliated experts or other institutions and partner organizations.

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Romanian Center of European Policy
Știrbei Vodă nr. 29, Etaj 2
Bucharest
office@crpe.ro
Tel. +4 0371.083.577

Fax. +4 0372.875.089

For further details about CRPE please visit www.crpe.ro