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**The Seminar**

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CHALLENGES OF TRANSITION AND  
INTEGRATION PROCESSES**

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# COOPERATION OF SMALL-SCALE HORTICULTURAL PRODUCERS IN UKRAINE

Volodymyr Ternovsky<sup>1</sup>, Olga Mirzoeva<sup>2</sup>

## *Summary*

*Cooperation of small horticultural producers and the effectiveness of this cooperation is a very important issue for the development of the agricultural sector in Ukraine.*

*Therefore, the goals of this study are analysis of existing models of cooperation, and identification of cooperation models which show promise for effective application among small agricultural producers, within the current legal framework, in Ukraine. Additionally this study aims to identify the factors which act as obstacles to the effective development of cooperation among rural citizens. In the process of conducting the study, the following methods were used: dialectical reasoning, abstract logical reasoning and systematic analysis, theoretical and methodological generalization of cooperation theory, definition of the essence of cooperation and its organizational forms. For identification of the main factors inhibiting cooperation, a survey methodology was used. Surveys were conducted among small-scale and large-scale horticultural producers.*

*This research is based on the fundamental provisions of economic theory, legal documents (e.g. laws, bylaws and regulations), academic publications of Ukrainian and international scholars in the area of cooperation, Ukrainian government statistics, and data from international development projects in Ukraine.*

*As a result of the study of the main models of cooperation, and in light of socio-economic conditions and legal environment, the agricultural service cooperative was identified as the most applicable model.*

*The main social, economic and legal road-blocks to the successful development of cooperation among agricultural producers were determined. Among the main economic barriers is poor access to financial resources for small producers, as available credit options have high interest rates.*

**Key words:** *cooperation, consolidation, horticulture, marketing, financial resources*

**JEL classification:** *Q13*

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## 1. Introduction

In the international arena, Ukraine is considered as a country with immense agricultural potential. The country is endowed with high quality soil, easily accessible water resources and a hardworking population. Of the 60 million hectares of land in the country, 42 million hectares are considered optimal for farming. All of the components to successfully develop the Ukrainian agricultural sector are present, yet this potential is largely undeveloped.

After the restructuring of large collective farms from 1999-2007 there was a division of state-owned land into plots, which were allocated to rural citizens for the purpose of farming. While many rural citizens received land after the division, a number of reasons contributed to the widespread renting of plots to large-scale agricultural producers who are mainly involved in grain production. To present date the rent received for these plots is generally minimal, especially when compared to the profits of the renter, and given socio-economic conditions in rural areas of Ukraine.

Nevertheless, approximately 70-90% of horticulture products, dairy, and meat in Ukraine come from small-scale producers and subsistence farming households. The long term development of these producers is hindered by a number of factors. One of these factors is ineffective implementation of cooperation strategies among small-scale producers.

Cooperation is one of the oldest forms of reciprocal agreement, enabling cooperating members to benefit from market opportunities that would be inaccessible to them as non-cooperating individuals to present date. It is widely considered that cooperation is one of the most important factors to the function of market-based economies. Without the effective organization of cooperative relationships, the links in the value chain are weakened, and as a result all constituents are less effective in their individual functions. The theoretical and methodological fundamentals of agricultural cooperation were established between the end of the nineteenth century and the beginning of the twentieth century by founders such as F. Bouche, U. King, R. Owen, F. Raiffaisen, M.I. Tougan-Baranovsky, and A.V. Chayanov.

In Ukraine, cooperation has yet to be recognized a major factor in supporting agricultural producers. The process of establishing of cooperatives in the sphere of market-related activities of agricultural producers has not become widespread. Functioning of existing cooperatives is not sufficiently stable and efficient. These findings contributed to the undertaking of this study (by Šapolov (2008)).

The main objectives of this study are analysis of existing models of cooperation, and identification of cooperation models which show promise for effective application among small agricultural producers, within the current legal

framework, in Ukraine. Additionally this study aims to identify the factors which act as obstacles to the effective development of cooperation among rural citizens.

## **2. Materials and methods**

In the process of conducting the study, the following methods were used: dialectical reasoning, abstract logical reasoning and systematic analysis, theoretical and methodological generalization of cooperation theory, definition of the essence of cooperation and its organizational forms. For identification of the main factors inhibiting cooperation, a survey methodology was used. Surveys were conducted among small-scale as well as large-scale horticultural producers.

This research is based on the fundamental provisions of economic theory, legal documents (e.g. laws, bylaws and regulations), academic publications of Ukrainian and international scholars in the area of cooperation, Ukrainian government statistics, and data from international development projects in Ukraine.

## **3. Results and discussion**

As was indicated in the introduction, the agricultural sector of Ukraine is largely comprised of small producers with 70-90% of them engaged in dairy and vegetable production. Considering their activities not as merely production, but in broader market context, we can see the following economic problems, which can arise for every agricultural producer. They are as follows:

- Searching for markets;
- Sales of produce;
- Acquiring production inputs (e.g. seeds, fertilizers, equipment);
- Inefficient use of technology, or lack thereof;
- Insufficient storage capacity, or lack thereof;
- Specialist support services (e.g. that of a veterinarian, agronomist)
- Produce processing

These problems cannot be resolved by small producers on their own. As such, the most progressive of them are motivated to use one or another form of cooperation.

Functioning as a link between agricultural units, a cooperative does not pursue interests other than that of its members. A cooperative is controlled by its members and enables them to reap advantages from the organization.

The functioning of cooperative establishments is regulated by principles of cooperation – a system of historically formed socio-economic norms and requirements. Alignment to those principals identifies a cooperative.

From the perspective of the state, cooperation is currently considered as a promising avenue for enabling small farmers and owners of household plots to be competitive in the marketplace. Previous experiences showed, that with a weak material and technical base, insufficient funds and monopoly action by some market actors (e.g. agricultural service providers, input suppliers, and processing enterprises), achieving stable and profitable production is not possible without cooperation in the industry. In the present conditions of economic reform, there is an objective need to connect farms in the cooperative structure in order to improve the efficiency of individual operations (by Gorelova (2011)).

According to the objectives of the study, discussed are cooperatives which provide services to small agricultural producers such as processing, procurement, storage, sales, and transportation. The study analyzes the organizational and economic aspects of the activities of cooperatives providing such services. Summarizing the above, we can conclude that cooperation is a multifunctional phenomenon, which enables its participants to deepen their specialization, improve the overall quality of services, overcome the barriers to market entry, save time, and accelerate the achievement of specific goals (by Šaplov (2008)).

In general, cooperatives can be grouped together for a number of attributes: purpose of creation, source of origin, size of mutual funds, etc. In agriculture, however, we can distinguish two main categories of cooperatives: production and service (by Šaplov (2008)).

In order to determine the more appropriate model of cooperation for small producers, a study was conducted, looking at fundamental differences between the two models of production and service cooperatives for study was used results of conducted researches by Bondarchuk et al. (2011) and Cimbal (2010).

After analyzing the differences and advantages of each type of co-op, we can conclude that the service cooperative is most suitable for small producer cooperatives because its legal status and operational principles permit the following:

- Unification of small producers as both natural persons and legal entities;
- Members of the cooperative will focus on the production of produce. Other activities such as procurement of supplies and sales and marketing of produce are taken on by the co-op and its hired workers;
- Establishment of more democratic principles, where one member of a cooperative has one vote. The influence of one's vote in a production cooperative is often dependent on ownership stake;
- Minimization of the tax burden while conducting legitimate business with formal financial statements, due to non-profit status.

**Table 1:** Main differences between production and service cooperatives

Differentiating factor	Type of cooperative	
	Production	Service
Ownership	Cooperative owns the land and the production assets, the owner of end products	Cooperative owns production assets; end product of the members remains their individual property
Participation right	Only individuals that are founders and owners. Number of members limited.	Natural or legal persons are the owner-clients that delegate their activities to the cooperative
Purpose	Profiting from agricultural production	The provision of services necessary for the activities of its members farmers
Labour	Activities of the cooperative carried out mainly by members of the co-op	Not applicable/hired workers
Status	Commercial entity	Non-profit organisation
Income distribution	Dividends are distributed among members according to their labour participation and property contribution (share)	Earnings is allocated in proportion to the volume of services provided by the cooperative to its members
Limitation on profits	None	Not-profit orientation
State regulation	As a rule, in the form of an enabling legislative environment	Tax relief and subsidised credits
Investments	Multiple sources of investments	Investments mainly from clients
Taxation	Profit and dividends are taxable	Non-profit status
Clients	As a rule, persons who are not the owners of the cooperative	As a rule, persons who are owners of the cooperative

Source: Bondarchuk et al. (2011) and Cimbal (2010).

Our judgements are confirmed by ML Zach, who posited that small-farmer (peasant) cooperatives do not destroy the individual peasant, and vice versa: "Thanks to cooperation, a new type of peasant farming has emerged, where for the individual producer only the core work of agricultural production remains, while other business transactions of purchase, sale, financing and processing are performed through the collective strength of an organized unit" (Zak (1919)).

Ukrainian legislation defines an Agricultural Service Cooperative as: a cooperative, created primarily to provide services to members of the cooperative and to other



non-members to carry out their agricultural activities. Agricultural service cooperatives cannot dedicate more than 20% of their activity to servicing non-members.

The agricultural service cooperative is created on the basis of mutual benefit and economic cooperation. The Law of Ukraine "On Agricultural Cooperation" categorizes service cooperatives depending on which activities they engage in (processing, harvesting, marketing, supply-chain logistics, or multi-service). A more detailed list of services that a service cooperative could provide, may appear as such:

- Storage and sales of produce;
- Processing of agricultural produce and lumber;
- Supply chain logistics management;
- Production of certain agricultural products (seedlings, young poultry, swine and cattle breeding, etc.);
- Repair of agricultural machinery and its maintenance;
- Transport services;
- Gas supply, telephone, "computerization" of agriculture;
- Execution of certain types of agricultural work (plowing, harvesting, pest and disease management of agricultural crops, artificial insemination of livestock, veterinary services);
- Implementation of construction work orders and project documentation;
- Production of certain types of fertilizer, machinery and equipment;
- Consulting services (e.g. accounting, finance, audit, agronomic, zootechnical, economic, etc.)

One of the most important prerequisites for the formation and success of the service cooperatives is not only in the spatial concentration of agricultural producers, but also the concentration of producers of similar products. Also of importance is the support of government and agricultural associations in cooperative formation. A strong leader is also critical to driving the process of cooperative establishment and management.

In the absence of appropriate organizational and economic conditions, cooperatives face serious challenges due to the lack of initial capital for the formation of the material and technical base, the selection of specialists with a cooperative mindset, sales, production, accounting and reporting, taxation, credit, etc. For the determination of negative influence on agricultural service cooperative development was used researches of Pantelejmonenko (2008) and Rižik (2011). At the same time it was conducted among small-scale agricultural producers. The results are introduced in Table 2.

**Table 2:** Negative factors influencing the development of agricultural service cooperatives

<b>Groups of factors</b>	<b>Influence</b>
Public-legal	<ul style="list-style-type: none"> <li>- Inadequate legislative support in terms of recognizing the non-profit nature of agricultural service cooperatives;</li> <li>- Ambiguous status of cooperative taxation;</li> <li>- Lack of support from local government authorities;</li> <li>- Lack of informational support;</li> <li>- Lack of adequate public funding</li> </ul>
Economic	<ul style="list-style-type: none"> <li>- Limited access to credit;</li> <li>- Lack of resources to support learning from international experience in cooperation</li> <li>- Limited amount of working capital, fragmented structure of the agricultural market;</li> <li>- Negative impact of intermediaries, namely their monopoly in the market for support services;</li> <li>- Aggressive competitive environment</li> </ul>
Organizational	<ul style="list-style-type: none"> <li>- Lack of structured vertical cooperation, cooperative distribution centers, etc.;</li> <li>- Low level of knowledge or misinformation about the benefits of cooperation;</li> <li>- Lack of experience in the management of shared resources;</li> <li>- Lack of management capacity among cooperative members;</li> <li>- Absence of a specific strategic plan for the development of cooperatives and markets in rural areas;</li> <li>- Lack of qualified personnel;</li> <li>- Failure of elected Board members to fill their functions</li> </ul>
Socio-psychological	<ul style="list-style-type: none"> <li>- Absence of universally recognized methodological understanding of the agricultural service cooperative;</li> <li>- Heightened sense of risk associated with mutual funds;</li> <li>- Distrust between members of the cooperative;</li> <li>- Comparison of cooperatives to collective farms in the Soviet Union;</li> <li>- Low level of initiative among members of the cooperative;</li> <li>- Temptation to move from the cooperative form of a commercial business;</li> <li>- The spread of "pseudo-cooperatives."</li> </ul>

*Source: the results of research and survey.*

Most of the points of negative impact on cooperative development are indicated by many authors in their scientific work. At the same time they offer solutions to these problems, which are based on the theoretical and practical experience of the formation and functioning of cooperatives.

We propose to draw on the experience of international development projects that operate on the territory of Ukraine. The work of these projects, to varying degrees, is aimed at developing small producer cooperatives.

In our opinion, the most successful case of practical application of cooperation principles among small producers is by the Ukraine Horticultural Development Project (UHDP). The Project (2008-2013) was implemented by Mennonite Economic Development Associates (MEDA) in the network of international technical aid in accordance with Memorandum of Cooperation between Canadian and Ukrainian government represented by Canadian International Development Agency (CIDA) (<http://en.uhdp.org.ua/>)

For a partial levelling of the negative impact of the factors described in Table 2, the Project staff took the following approach:

- The initial stages of cooperation of small producers employed the "lead-farmer" model. Lead farmers served as informal leaders of producer groups.
- Project staff, in communications with producers, avoided using the word "cooperative", in light of with its negative perception and association with the old Soviet Kolхозes (collective farms). Instead, the following language was used in describing the cooperation: consolidation cluster, group of farmers, informal cooperation
- Educational programs and trainings for managers of cooperatives were developed and implemented in order to transfer knowledge about the basics of cooperative management.
- Audit firms assisted in the development of record keeping systems and provided accounting support services for the first few months of operation of the cooperative. This has greatly helped in the organization of documents and in reducing the tax burden on cooperatives.
- A financial institution (Agro Capital Management LLC.) was created to finance the development of members of cooperatives (small farmers and owners of household plots) as well as cooperatives themselves, by providing discounted leasing of agricultural equipment.

The steps described above, among other actions, led to the effective operation of the cooperatives created during the period of activity of the Project.

We see that the organization of service cooperatives in Ukraine requires a series of steps to create effective conditions for the development of agricultural service cooperatives as an integral component of the agro-industrial complex of Ukraine. It follows that it is necessary to produce educational material on generating the conditions required to enable the development of agricultural service cooperatives, as an essential component of the agricultural service industry in Ukraine. In the

development of agricultural service cooperatives, we propose the following main directions:

- Comprehensive informational support, from government, of the agricultural cooperative movement;
- Promotion and governmental support of Ukrainian integration processes with regards to the formation of local institutions in the sphere of agricultural cooperation;
- Application of the experience of international development projects for improvement of legislation around cooperatives;
- Promotion of the development of agricultural service cooperatives by easing the tax burden;
- Strengthening of partnerships between agricultural cooperatives and institutions of higher education
- Acquisition of experience in international collaboration among producers, specifically in the area of agricultural cooperation;
- Strengthening competitiveness of domestic service cooperatives by improving product quality;
- Attracting a wide range of socially active groups and individuals to the development of agricultural cooperatives through direct economic participation or promotion of the cooperative self-help ideology

#### **4. Conclusion**

As a result of the study of the main models of cooperation, and in light of socio-economic conditions and legal environment, the agricultural service cooperative was identified as the most applicable model for advancing the agricultural sector in Ukraine. It is of our opinion that this model of cooperation is the most effective in remedying the existing negative attitude in Ukraine toward cooperation. Additionally, the agricultural service cooperative provides benefits to small producers in servicing both the production and sales of their produce.

The main social, economic and legal road-blocks to the successful development of cooperation among agricultural producers were determined. Government must work more intensively on the development of a strategy for cooperation among agricultural producers and provide incentives to stimulate the creation of cooperative units. Among the main economic barriers is poor access to financial resources for small producers, as available credit options have high interest rates.

The authors of the study recommend conducting informational sessions/trainings with rural populations, applying the experience of international development projects.

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