BASIS BRIEF
Collaborative Research Support Program

Number 20 May 2004

Making Co-ownership Work:

Helping Land Reform Beneficiaries Access Land and Financial Resources through Equity Sharing in South Africa

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Is land reform working?

Land reform in South Africa has fallen far short of the goals set by the first democratically elected government in 1994. In KwaZulu-Natal, where farmland transactions have been monitored since 1997, only 0.5% of the commercial farmland owned by whites has transferred to historically disadvantaged owners each year despite an active land market and government grants to purchase land on a willing buyer-willing seller basis. The slow pace of land reform has been attributed to two fundamental problems. First, it is not always feasible to partition large commercial farms into smaller, more affordable units due to indivisible resources and the high cost of surveying, transferring and registering subdivisions. Second, prospective farmers lack capital and are unable to finance land with mortgage loans from commercial banks due to cash flow problems caused by high nominal interest rates and low cash returns to land.

Faced with these problems, most historically disadvantaged people who have acquired commercial farmland have done so by pooling their meager resources and purchasing farms collectively. During 1997-2001, disadvantaged owners acquired 121,484 hectares of commercial farmland in KwaZulu-Natal. Of this area, 13% was obtained through non-market transfers (mainly donations and bequests), 37% was purchased with settlement/land acquisition grants (SLAGs), and 50% was purchased privately. (SLAGs totaled R15,000, and later R16,000, and were grants to households wishing to purchase land or make capital improvements.) All the government-assisted transfers involved group ownership with title registered to a community land trust or communal property association (CPA). Corporate entities also accounted for a third of the farmland purchased privately by previously disadvantaged people. Hence, more than half of the farmland redistributed in KwaZulu-Natal is co-owned, a worrisome fact given the checkered history of cooperative farming models and concerns that several high profile group settlement schemes already have succumbed to weak institutions.

Farm worker equity share schemes (FWES)

FWES were initiated in South Africa by the private sector as a mechanism to redistribute equity from the original farm owner (usually white) to the farm's workers as shareholders. A successful FWES should redistribute wealth and future benefit streams, empower workers through skills transfer and participation in decision-making, retain quality management, attract private sector finance, improve worker productivity and labor relations, and provide for the transfer of ownership and control to workers in the long term. An assessment of the first scheme established in 1992 was positive, yet a more recent study argued that FWES are little more than a convenient way for commercial farmers to leverage cheap capital and eliminate strike action. By 1998, approximately 50 FWES had been initiated in South Africa, mostly in the Western Cape; the number has increased in recent years.

In November 2001, BASIS undertook a study of eight FWES to explore relationships between their organizational and institutional arrangements, management, empowerment and performance. Established enterprises producing deciduous fruit, wine, citrus and vegetables were selected in five regions of the Western Cape (see table next page for characteristics). The eight enterprises redistributed net farm assets totaling R6.8 million in constant 2001 prices, a

result that largely reflects the aggregate value of SLAGs awarded. At three projects, the size of SLAGs effectively limited the beneficiaries' equity share to 3.5-6.0% of total equity, underscoring a critical weakness of a "purely" market-driven land reform. Without substantial public grants to finance assets, people with limited savings and doubtful creditworthiness have little hope of acquiring meaningful equity in the short- to mid-term. While six of the FWES planned to transfer more equity to their worker-shareholders over time, the rate of accumulation remains very much in question.

Structural characteristics of FWES in South Africa

FWES, year registered	Turnover 2000/1 (000 Rands)	Main enterprises	# Worker-shareholders	% Female	% Workers' equity share
Project 1 1997	15,000	Olives, Table grapes	34	59%	3.5% Trust
Project 2 2000	1,500	Fruit, Proteas	66	52%	6% Company
Project 3 2000	850	Fruit, Citrus	70	54%	49%[1]
Project 4 1998	3,100	Wine grapes, Fruit	48	56%	5% Company
Project 5 1996	1,200	Wine grapes, Fruit	12	33%	17% Trust
Project 6 1997	3,500	Table & wine grapes, Citrus	36	39%	20% Trust
Project 7 2001	2,500	Wine grapes, Vegetables	27	33%	40% Company
Project 8 2001	0	Wine grapes	72	53%	50%[2]

[1] Workers have a 49% share in both landholding company and operating partnership.
[2] Land is rented from the municipality. Shares are held in operating partnership only.

In 1997, the Department of Land Affairs extended its SLAG program to finance worker interests in FWES, but growing doubts about the program saw a moratorium imposed on SLAG in 1999 and its replacement by the Land Redistribution for Agricultural Development (LRAD) program in 2001. While LRAD holds promise for redistributing wealth to emerging small-scale black farmers with means, the equity contribution required for even small grants is a stumbling block for the very poor. To qualify for an entry-level grant of R20,000, the applicant must contribute a minimum of R5,000 in cash, kind or labor towards the enterprise. A maximum grant of R100,000 is awarded if the beneficiary is able to contribute R400,000 in savings and loan finance.

Part of this policy debate is led by the urge to develop or maintain a commercially-oriented agriculture built upon the successes of individual landownership in the past. Part is motivated by the checkered history of group farming globally and of CPAs in South Africa. Even research on FWES is contradictory and not easily reconcilable with clear differences reported in the literature on whether FWES enhance beneficiary wealth, human capacity, empowerment, and wellbeing. Answers are inextricably linked with sampling bias (in FWES selection) and enterprise longevity at the time the studies were conducted. However, two substantive issues are central to the debate.

First, some practitioners assert that a FWES, while perhaps an investment option for increasing a financial stake in the enterprise, is not an appropriate mechanism for achieving genuine land reform. Unfortunately, in situations where individualization is infeasible, asset sharing (not physical land redistribution) may be the only pathway to agrarian reform. Second, even if some FWES work well, others do not, resulting in a mixed bag of performance and raising the issue of best institutional arrangements.

Institutions and economic performance

The figure (opposite page) presents a conceptual model linking institutional arrangements of a FWES to enterprise performance. The macroeconomic environment, influenced by domestic policy and trade, will have an important bearing on enterprise profitability regardless of its institutional makeup. A conducive macro-policy environment will aid the performance of a badly-designed enterprise, while a non-conducive environment (the deciduous fruit sector is a current example) will constrain the performance of a well-designed FWES. The macro-institutional framework influences the choices of economic agents, for example, with regards to organizational arrangements (partnership, trust, CPA, cooperative or company), security of property rights, and ease of transferability.

Even the best institutional arrangements will amount to little without investment in human capital that enables management and workers to take advantage of their new rights and asset ownership. This is particularly so in situations where land reform beneficiaries are participating in new organizational structures and require new skills to develop business plans, interpret financial statements, participate in decision-making, and access input and product markets. A favorable institutional environment combined with an enabled management and workforce should, all other factors being equal, improve operating efficiency, thereby increasing demand for fixed improvements and complementary inputs. In most commercial farming situations, performance also depends on access to loan finance from banks that evaluate applicants according to their institutional features, quality of management, net worth and debt-servicing capacity.

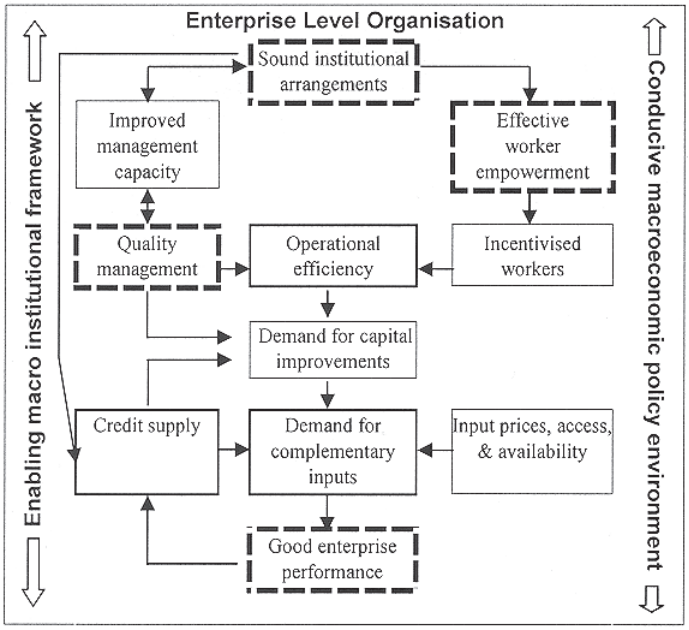
It is widely accepted that the decline of agricultural cooperatives is the outcome of flawed institutional arrangements stemming from the Rochdale principle that enterprises should be controlled by their members and not by capital. We find that inadequate property rights for equity sharing has several consequences. The *free-rider problem* discourages member investment because some portion of the gains accrue to individuals who do not contribute proportionally to the investment. Under the *horizon problem,* ownership claims fall short of the economic life of the asset, hence members tend to under-invest in long-term/intangible assets because they are prevented from retiring shares at their market value. A *portfolio problem* also arises when members cannot trade shares at market prices as they are unable to diversify/concentrate their asset holdings commensurate with their personal risk preferences. The *control problem* arises due to the costs members face in monitoring managers to ensure that they make prudent investment decisions and do not shirk or cheat. Together, these problems starve conventional cooperatives of equity and debt capital. The same problems characterize many of South Africa's new CPAs and trusts where members' voting and benefit rights are not proportional to their financial investment and cannot be traded at market value.

Best institutional practices

The theoretical model postulated in the figure was collapsed into a tractable empirical model to focus on constructs that are uniquely observable (dashed boxes). The empirical model argues that "sound" institutional arrangements within a FWES have both direct and indirect effects on enterprise performance through worker empowerment and quality management. In turn, institutional arrangements are influenced by the quality of management, as good managers are expected to be more proactive in choosing institutions that enhance FWES performance and transferring skills that empower worker-shareholders.

To test the model, observations on 35 variables representing these theoretical constructs were taken from the case studies and subjected to hierarchical cluster analysis to find "natural groupings" (in effect positive relationships), if any, among case study variables. Following the logic of the model, it was expected that natural groupings should contain a healthy mix of variables drawn from each theoretical construct. The analysis revealed four distinct natural groupings, each highlighting a particular set of positive relationships among sound institutions, quality management, effective empowerment and good performance—where measures of performance signalled both financial health of the FWES and benefits passed on to its workers. (Due to the "newness" of FWES, it was not possible to collect comprehensive data on conventional measures of financial health; e.g., profit or rate of return on assets. Instead, performance was based on whether dividends had been declared, capital gains were realized, wage level of skilled workers was superior, external equity was invested, project assets were accepted as collateral, and on whether workers had influence on decision-making, received improved housing or more secure residential rights, established their own businesses on the FWES, and felt empowered.)

Conceptual framework



Enterprises were then ranked from best to worst based on the cumulative tally of performance attributes held (maximum eight) plus three additional attributes for social and human capital empowerment. The following best institutional practices are based on the natural groupings among performance indicators and other variables in the analysis, and on their association with the best and worst ranked FWES.

1. A successful FWES should be operated as, or like, a company with voting and benefit rights tradable and proportional to individual investment.
2. Workers' interests should not be diluted by a transfer of shares to non-workers as a result of bequests or sales to outsiders. More successful FWES often created a unitized trust to warehouse and buy shares from workers who leave the scheme, disbursing the proceeds to the worker or, in the event of death, his or her estate. Only new and existing employees can acquire these shares.

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Briefs

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Publication made possible by support in part from the US Agency for International Development (USAID) Grant No. LAG-A-00-96-90016-00 through BASIS CRSP.

Edited and layout by
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3. While striving for the ideal of fully transferable shares, a temporary moratorium on the sale of shares—particularly by the previous owner—helps preserve the creditworthiness of the enterprise by preventing sudden outflows of equity capital and managerial expertise. The more successful FWES also committed to a gradual, and therefore predictable, reduction in the proportion of equity held by the previous (white) owner.
4. Workers should participate in the design of the FWES and its operating rules. This participation is facilitated by training programs that transfer basic literacy, life and technical skills. Worker representatives should also receive ongoing mentoring in financial, administrative and managerial skills to help them participate meaningfully in policy decisions and perform their duties as office bearers.
5. Good performance requires accountable management. For directors and trustees, accountability is facilitated by transparency but is ultimately ensured by mobility of capital and a sound electoral process.
6. Successful FWES usually offer salary incentive schemes to managers and employees, observe a long-term business plan, entrench formal procedures to resolve disputes, and, without exception, have a history of good labor relations.

While the constitutions of most CPAs and trusts provide for transparency and accountability, they do not embrace the fundamental institutions that eliminate free-riding. This is particularly true of early land reform projects in KwaZulu-Natal where members of large beneficiary groups were given rights to use co-owned land rather than (benefit) rights allowing them to share in profits of joint enterprises managed by elected and hired experts. As a result, members who own few or no livestock (women) derive very little benefit from shared grazing land despite having contributed equal amounts of grant money to its purchase.

Conclusion

It is understandable why development practitioners often are skeptical about the feasibility or viability of group farming models, including FWES, considering the frequently cited dismal performance of agricultural production cooperatives and collectives. While it is important to carefully consider arguments of efficiency and performance, there are many instances where co-ownership endures despite persistent failures because individualization does not represent a viable, efficiency-enhancing alternative. Under conventional cooperatives, returns and voting rights are not proportional to individual investment, and shares cannot be traded at market value. Consequently, inadequate property rights create four stereotypical weaknesses characterized by the free-rider, horizon, portfolio, and control problems.

The New Institutional Economics analysis of traditional versus new generation cooperatives sheds much needed light on the type of institutions and organizational features that promote efficient use of co-owned resources. While recognizing the advantages of sole proprietorship, our research focused on co-ownership because, despite its flaws, it is an unavoidable and significant pathway for poor beneficiaries to secure land, wealth and financial resources, and its benefits can be augmented through sound institutions, human capital development and grant support.

Suggested reading

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