

15. Collective arrangements in the agro-food supply chain: the case of the interbranch organization *Tabacco Italia*

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Abstract

The revision process of the tobacco Common Market Organization was characterized by the objective to reduce the production that caused an increasing uncertainty in supply. To confront such a dangerous situation, shareholders took advantage of Reg. (EU) 1308/2013 and founded the interbranch organization *Tabacco Italia*, which aims to foster a tight and effective coordination between tobacco producers and the tobacco industry. This organization was the result of an interbranch agreement that rules the primary aspects of deliveries, i.e. price, quality, etc. The aim of the present paper is to explore and describe this unique case study with respect to the transaction cost economics theory of hybrids.

Keywords: transaction cost theory, collective arrangement, Common Agricultural Policy, interbranch organization, tobacco

15.1 Introduction

The tobacco sector benefitted from a substantial number of incentives after the Common Agricultural Policy (CAP) of the European Union (EU) was enacted in the early 1960s. For decades, the EU's Common Market Organization (CMO) provided unlimited support for European tobacco production, making this crop the most highly subsidized in the CAP in relation to the area under cultivation. The organization of the common market with respect to raw tobacco was established in 1970, when its production was primarily centred in France and Italy. At that time, approximately 90% of community tobacco production received national financial aid that was intended to facilitate the distribution and/or disposal of the harvest to ensure a fair income for producers (Joossens and Raw, 1991). The goals of the tobacco policy were to establish a common policy throughout the community, expand tobacco production to disadvantaged farming areas, maintain a reasonable income for farmers and adapt production to match those tobacco varieties for which there is demand. As such, these goals implied an additional goal, namely, to reduce tobacco imports.

The key mechanisms of the tobacco policy were norm prices, premiums, export refunds, intervention prices, and maximum guaranteed quantities. Norm prices were prices that the EU wanted the processor to pay the farmer, albeit there was no obligation for the processor to do so. Premiums were those subsidies paid to the processors by the commission to persuade the processors to buy their leaf tobacco from community farmers, and as such, these premiums represented the cornerstone as well as the most expansive part of the entire system. Export refunds were those subsidies paid to processors who sold unwanted varieties of tobacco outside the EU to develop world markets. Intervention prices were the prices, set at 85% of the norm price, guaranteed to farmers or processors for the tobacco they were unable to sell on the open market. Thus, tobacco bought this way was stored by the member states in intervention stores. Finally, maximum guaranteed quantities were quotas for which the premium and the intervention prices were guaranteed. Accordingly, if these quotas were exceeded, both were reduced with the aim to make this variety less attractive economically thereafter.

During its lifetime, several gradual improvements have been implemented with the aim to create a better balance between production and demand (EP, 2009). According to Council Regulation (EC) No. 864/2004, the CAP reform adopted in 2003 was applied to the tobacco sector. The revision process of the tobacco CMO was characterized by the objective to reduce the production of a crop that engendered injury to human health as a response to society's demand. In Italy, 40% of tobacco aid (reference period 2000 to 2002 premium) was decoupled from production and integrated into the single payment scheme (SPS) during a transition period that extended from 2006 to 2009. Hence, in 2010, the tobacco CMO was terminated, and the tobacco market was fully liberalized. From 2010 forward, all subsidies were decoupled, with 50% being transferred to the SPS and 50% being shifted to the restructuring envelope.

Concurrently, the remaining subsidies were gradually reduced by 2013, and only a diminished area-based flat rate survived.

Consequently, in the short term, the cultivation of less profitable tobacco varieties in the EU ceased because the transfer of the tobacco premium into the SPS encouraged producers who were not covering their variable production costs to revert to some other land use. As a result, farmers introduced less profitable crops as substitutes for a higher value/higher labour-intensive crop, i.e. tobacco. Thus, this implied that highly intensive crops were replaced by less demanding and more mechanized crops, which cause a substantial increase in unemployment (Manos *et al.*, 2009). With respect to Italy, which, in 2009, was a leader in the European tobacco sector, with 28,564 hectares producing 97,798 tonnes of tobacco, the impact was significant, as five years later, the cultivated area of 18,248 hectares (-36.1%) produced only 53,924 tonnes (-44.8%). This enormous decrease completely reshaped the territorial redistribution of the cultivation of tobacco, as farmers continued cultivating tobacco in only four regions, namely, Umbria, Toscana, Veneto, and Campania. Moreover, the effects of these policies, which were immediately felt in the agricultural production phase, were reflected in the subsequent processing phase, causing a reduction in those sectors with industries active throughout the tobacco processing chain (Arfini *et al.*, 2005). Thus, these changes resulted in a serious issue for the tobacco supply chain as a whole. Therefore, to ensure stable and sufficient deliveries of raw tobacco for the industry during the period 2010 to 2014, a coupled payment (article 68 of Regulation EC 73/2009) was introduced in Italy that allowed farmers, via producer's organizations, to receive direct aid only after signing a cultivation contract with the industry.

More recently, Article 52 of Reg. (EU) 1307/2013 stated that tobacco could not benefit any longer from coupled payments, and as a consequence, it removed all of the justifications for fostering the adoption of contracts between producers and the industry to regulate provisions regarding tobacco (Ciliberti and Frascarelli, 2014). Thus, it follows that the absence of a specific incentive may generate two main issues for the tobacco supply chain in Italy: a further decrease in tobacco production, especially in less suitable and less developed areas, and a greater uncertainty of deliveries towards first processors and manufacturers. This condition could threaten the functioning of the entire tobacco industry in Italy because, without a competitive supply stage that guarantees stable deliveries, all stages thereafter, i.e. processors and manufacturers, could not function effectively. Therefore, to confront such a dangerous situation, shareholders have exploited the new rules of the CAP 2014 to 2020 reform and, more specifically, Reg. (EU) 1308/2013 (CMO). This has resulted in the founding of the interbranch organization *Tabacco Italia* (OIT), which aims to reorganize the entire supply chain by fostering a tight and effective coordination between farmers and the industry due to an interbranch agreement (IA) that oversees the main aspects of deliveries, namely, price, quality, etc. The main purpose of the present paper is to explore and describe, with respect to transaction cost economics (TCE) theory on hybrids, the functioning of the aforementioned interbranch organization (IO) that

represents a unique case study for the tobacco sector in Europe and thereby provide useful insights for policymakers, scholars and stakeholders.

15.2 Theoretical framework

Transaction costs theory focuses on the conceptual development of hybrids, particularly the work of Menard (2004). The family of hybrids is located between markets and hierarchies and ranges from contract-based approaches, which are closer to the market, to more integrated structures, which are closer to the hierarchy. Williamson (1991) argues that hybrids generally mix the two types of adaptation found in polar modes of organization, namely, autonomous adaptation, as in markets, and cooperative adaptation, as in hierarchies. Three main characteristics play a key role in hybrids. First, parties pool part of their resources, while keeping their property rights and their associated decision rights distinct, which makes the selection of partners a critical factor. Second, the main mechanism implemented for coordinating parties who maintain separate decision-making rights is contractual. Third, competition persists among partners in hybrid arrangements (Menard and Valceschini, 2005). Thus, it follows that in such arrangements, contracts provide a framework for facilitating the organization of transactions and thereby promote confidence among the parties that because the relationship is valuable to all, it deserves the requisite efforts and investments. Moreover, contracts play a crucial role among coordinating partners, as they specify the number of parties to be included in the arrangement, the duration of the relationship, the requirements concerning quantities and quality standards, and the adaptation clauses and complementary safeguards.

Hybrids tend to develop in highly competitive markets where pooling resources is perceived as a way to manage significant uncertainties as well as a way to survive. This introduces one of the main characteristics of hybrid arrangements, specifically, the degree of uncertainty surrounding the transactions they intend to organize. The literature on hybrids is quite unanimous with respect to the role played by uncertainty in decisions regarding the level at which partners pool resources. In the case of the tobacco sector, for instance, such uncertainty can grow out of a hybrid because of the inputs required, the outputs expected or the transformation process itself. Assuming competitive markets, problems with inputs are often connected to issues of quality, quality control and the risk of free-riding. However, uncertainty may also result from factors exogenous to the arrangement, such as the institutional environment (e.g. the new CAP reform) that influences the preference for a hybrid mode of organization rather than market or integration, as well as from the choice of a specific form of hybrid (Menard, 2004). However, among the determinants of hybrid arrangements, uncertainty is secondary to the existence of specific investments. Indeed, without a minimal degree of mutual dependence in assets, there would be no hybrid arrangement. It follows that the more specific mutual investments are for both parties, as in a highly labour-intensive and highly technological crop such as tobacco, the higher the risks of opportunistic behaviour and the tighter the forms of control implemented. In fact,

hybrid organizations develop because of the advantages partners find in linking some of their investments, and by so doing, they establish and accept mutual dependence. In practice, it is the combination of opportunism, which is due to asset specificity, and miscoordination, which is due to consequential uncertainty, that determines the governance characterizing hybrid organizations while taking into account that parties have a strong incentive to choose the arrangement that minimizes their costs of governance. Hence, in the tobacco sector, these types of organizational arrangements are expected to be implemented in a way consistent with strategies oriented towards minimizing transaction costs, particularly those costs depending on uncertainty (due to the new institutional environment) and on the degree of specificity of investments among parties, i.e. farmers, first processors and manufacturers.

Indeed, problems of coordination across the different stages of the supply chain, with high transaction costs as a consequence, always arise with respect to agricultural products. Since this issue is particularly relevant in the agro-food industry, alternative arrangements, grouped under the concept of hybrids, have played an important role (Martino and Pampanini, 2006). Over the last twenty years, there have been changes in society's expectations of the appropriate role of public intervention in agriculture as well as an increasing desire to reduce the levels of financial expenditures. Competition, therefore, is expected to increase among producers and areas, and production is expected to concentrate in areas with comparative advantages for price competition. However, the latter can be avoided through integration, which not only consists of the merging of productive units, but it can also assume collective forms, such as contract setting within value chains, marketing cooperatives that are common in the primary stage of agricultural markets and all forms of hybrid governance structures. The integration strategy engages both collective and public resources, and moreover, it requires market facilities and coordination instruments that correspond to public instruments and collective structures such as IOs (Dervillé and Allaire, 2014). Towards this purpose, European public institutions have provided a new regulatory framework to improve coordination across supply chains by means of legitimizing IOs. These IOs are important examples of collective organizations of the hybrid type. Generally, an IO is defined as a private organization recognized by the State that gathers all segments of an agro-food chain with the objectives to elaborate contractual policies, guarantee equity among partners and allow the enhancement of chain performance. Once decisions have been approved by the IO, all producers and industrial entities must comply with them. These arrangements could reduce opportunistic behaviour, enforce contractual arrangements and improve coordination to better adapt supply to demand in the long term. In addition, whereas the governance mechanisms, on the one hand, can mitigate transaction costs that would otherwise be carried by the central governments, on the other hand, they can also mitigate risks associated with contractual agreements. Royer *et al.* (2016) recognized that collective organizations, such as IOs, aim to: (1) reduce the variability of deliverables; (2) reduce the variability in price; (3) foster innovative investments; (4) reduce the risk of opportunism from downstream partners through contract enforcement; and (5) face various intensities of uncertainty that affect transactions.

Another important feature of IOs is that they are embedded in a legal framework that institutes a centralized and compulsory negotiation between partners by imposing various conditions regarding product distribution and supply management (Martino *et al.*, 2012). This institutional embeddedness provides IOs the legitimacy needed to adopt and implement measures (Royer *et al.*, 2012). Therefore, on the one hand, IOs are organizational hybrids with partners who have different property and decision rights to construct an agreement by which they pool some of these rights and abandon part of their autonomy. On the other hand, these arrangements are also institutional hybrids in that they mix public and private interests in a specific way as they combine self-regulation mechanisms operated by private partners and a legal framework that supervises and enforces these mechanisms. Consequently, IOs can be considered as hybrid arrangements that combine a self-regulation mechanism operated by private partners along the supply chain with a legal framework that determines the conditions by which these mechanisms operate. Ideally, an adequate legal framework brings to the parties a downward shift in the costs of governance, making the choice of a hybrid arrangement more advantageous and institutionally legitimate.

15.3 Objectives and methods

15.3.1 Objectives

Against the theoretical framework, the aims of the present paper are threefold. First, it accurately describes the main features of the OIT and analyses the effects of the extension of the rules (*erga omnes*), which were applied for the first time in the European tobacco sectors. Second, the work represents a first attempt to shed light on the hybrid's nature of the OIT. Third, it aims to evaluate the interaction between the evolution of the CAP regulatory framework (2014-2020) and the adoption of a new (or revisited) form of governance in the Italian primary sector.

Thus, it follows that this is a (preliminary) exploratory study that investigates the impacts of the new CMO regulation on the governance of the tobacco supply chain and describes the functioning and main features of the new collective arrangement represented by the OIT.

15.3.2 Materials and methods

The most suitable method to pursue the aims of this paper is the case study. This technique is particularly suited to the comprehension of real phenomena, even though it cannot provide any quantitative indication on the phenomena analysed nor can it yield any statistical generalizations. Therefore, the study should not be considered as an interview conducted in a classical survey, and the dimensioning of the sample should be considered irrelevant (Yin, 2009). The research protocol involves elaborating on the following research questions with respect to the policy and theoretical framework:

- How has the new institutional environment influenced the governance of the Italian tobacco supply chain after 2013?
- What are the effects of the new form of governance of the Italian tobacco supply chain after 2013?

Both questions reveal the exploratory and descriptive natures of the present paper and clarify the purposes of the case study approach.

After the specification of the research questions, the appropriate unit of analysis must be selected. To this purpose, the interbranch OIT is identified as the unit of analysis, since it is broadly functional to effectively carry out a case study research. It is particularly suitable to this aim, as it is strongly involved in the changes introduced by the new European regulatory framework in the tobacco sector.

Accordingly, a specific design for the case study depends on the number of case studies that are analysed (e.g. single versus multiple case) as well as the number of units of analysis, i.e. a unitary – holistic case study or a multiple – embedded case study (Figure 15.1).

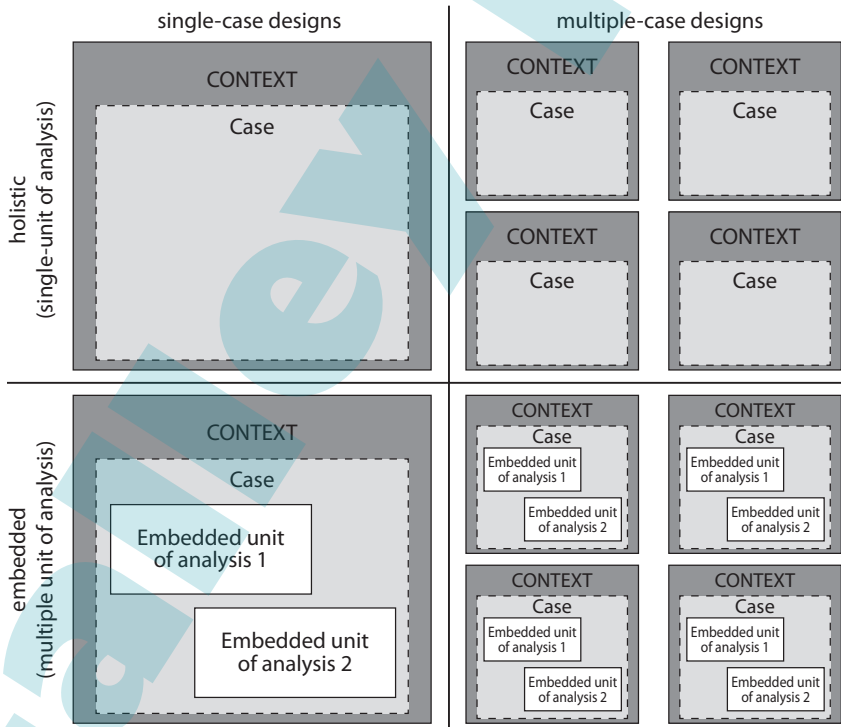


Figure 15.1. Basic types of designs for case studies (Yin, 2009).

Taking into account that the OIT, as a unit of analysis, represents a unique case (Yin, 2009), as it was the first IO in the tobacco sector to benefit from the extension of rules in Europe since the new CMO regulation was enforced, it follows that the holistic single case is the most valid and reliable case study design to address the research questions. Furthermore, because the case study examines only the global nature of an organization (i.e. the OIT), a holistic design is advantageous, considering that no logical subunits can be identified.

With respect to materials, the reliability of the case study research approach stems from the ability to obtain empirical evidence from multiple sources of data. As no single source has a complete advantage over all others, a case study should use as many sources as are relevant to the study (Yin, 2009). If data converge in the same direction, the triangulation of evidence is achieved, and as a consequence, the data gathered are corroborated, and the reliability of the case study is substantiated. The triangulation occurs when various types of evidence support the event or fact constituting the case studies. Indeed, multiple measurements of the same phenomenon lead to a high quality final result.

The information gathering was conducted from June 2015 to February 2016 using three main sources of evidence: documents, multiple (direct and participant) observations and open-ended interviews. Documents include private documents, such as statutes, memoranda, regulations, decrees, and study reports, whose validity and reliability have been carefully verified. Observations consist of site visits of formal activities, such as job meetings, briefings, assemblies, and active participation in the events being studied, such as scientific collaborations between the university and the OIT and consultancy activities. Finally, during the aforementioned meetings, members were interviewed and asked their opinions regarding specific events or facts related to the case study.

15.4 Results: the case study of the interbranch organization *Tabacco Italia*

A short description of the regulatory framework that allows the recognition of IOs in the tobacco sector and explains the extension of rules is provided. The governance, the aims and the allocation of the decisional rights of the OIT are then analysed, and the enforcement of rules and contractual arrangements established by the IA, which in turn has been extended *erga omnes* for the period 2015 to 2017, is discussed.

15.4.1 The regulatory framework

The new Common Market Organization

In a phase where the reinforcement of both vertical and horizontal integration represents the main strategy to confront competition across the world markets, decrease transaction costs and strengthen relationships with suppliers and clients,

the stakeholders of the Italian tobacco sector took advantage of the new regulatory framework introduced by the CMO 2014 to 2020 (Table 15.1). Article 157 of the regulation states that member states may recognize IOs that: (1) are composed of representatives of economic activities linked to production and to at least one of the stages of the supply chain; (2) are formed according to the initiative of all or some of the organizations or associations that they constitute; and (3) are in pursuit of a specific aim and take into account the interests of their members and of the consumers, which may include specific objectives as listed in the Regulation¹. In addition, the new CMO, i.e. Article 164, states that in the tobacco sector, an organization/association could request the extension of rules where it is deemed representative in the economic area or in areas involving a member state, that is, when it accounts for at least two-thirds of the volume of the production of, the trade in, or the processing of the product or products concerned.

Accordingly, the OIT was officially recognized by the national government on the basis of Reg. (EU) 1308/2013, and the Ministry of Agricultural, Food and Forestry Policies (MAFFP) extended its rules *erga omnes* by means of Departmental Decree n.2988 dated 7 August 2015, as the OIT gathered both representatives of producers and first processors, representing 84.8 and 80.3%, respectively, of the tobacco contracted in Italy in 2014 (i.e. 69,166 tonnes). Finally, the OIT also obtained the extension of financial contributions paid by its members as a result of Article 165, which states that:

individual economic operators or groups which are not members of the organisation but which benefit from those activities shall pay the organisation all or part of the financial contributions paid by its members [...].

¹ Article 162 states that for tobacco sectors, the specific aims may also include at least one of the following objectives: (a) concentrate and coordinate the supply and marketing of the produce of the members; (b) adapt the production and processing jointly to the requirements of the market to improve the product; (c) promote the rationalisation and improvement of production and processing.

Table 15.1. EU regulatory framework for interbranch organizations and extension of rules.

Article	Title
157	Interbranch organizations
158	Recognition of interbranch organizations
162	Interbranch organizations in the olive oil, table olives and tobacco sectors
164	Extension of rules
165	Financial contributions of non-members
168	Contractual relations

15.4.2 Governance and aims

15.4.2.1 Representative bodies and allocation of decisional rights

Members of the OIT are both representatives of producers (*Unione Nazionale Tabacco* – UNITAB and *Organizzazione Nazionale Tabacco Italia* – ONT) and of first processors (*Associazione Professionale Trasformatori Tabacchi Italiani* – APTI) (Figure 15.2). The UNITAB is an association of Italian producers that are also members of the European Association of Tobacco Growers. The ONT, which was founded in 2002 and legally recognized by the MAFFP in 2010, gathers tobacco producer organizations (POs) from Campania, Umbria, and Toscana and represents more than 60% of the Italian production in volume. The APTI represents both Italian first processors and exporters. Its members are the biggest firms in this sector, e.g. multinational enterprises and cooperatives, and it processes approximately 75,000 tonnes of tobacco every year, i.e. 60% of the national volume processed.

The decision-making body of the OIT includes the board of directors (BOD), the president, the members' assembly (MA) and the audit committee. The BOD is equally composed of representatives of both producers and processors, and its members administrate the OIT for a period of three years. The President is alternately a

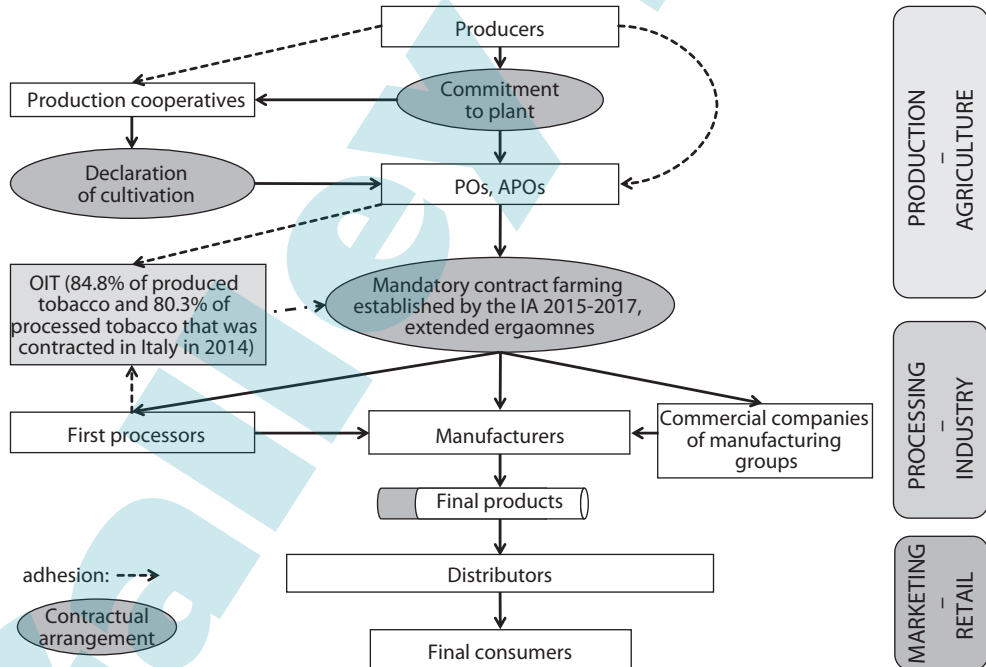


Figure 15.2. The Italian tobacco supply chain and the role of the organization Tabacco Italia.

representative of the farmers or the industry. He promotes the constitution of specific product committees (PCs) and makes decisions about the participation of the OIT in other national, European or international organizations. The MA is composed of two groups that represent, on the one hand, tobacco producers and, on the other hand, processors and traders. PCs participate in the MA but cannot vote. The MA gives directives to the OIT, adopts rules of functioning for the CPs and the OIT, approves the budget and elects the BOD members. Furthermore, according to Article 164 of Reg. (EU) 1308/2013, some decisions adopted by the MA can be extended *erga omnes* to other operators or groups that are not members of the organization.


15.4.2.2 Organization Tabacco Italia aims

According to Article 157 of Reg. (EU) 1308/2013, the OIT pursues specific aims while taking into account the interests of their members. To allow for the proper analysis of OIT functioning, the aims are attributed to the following activity areas:

- organization of supply and market control;
- coordination of supply chain relationships;
- quality of production and competition policy;
- research and development;
- environmental compliance and sustainable production.

Table 15.2 reports the classification of the OIT objectives for the five activity areas previously identified.

15.4.3 The interbranch agreement: enforcement of rules and contractual arrangements

According to the statutory aims, the OIT elaborated an IA for the period 2015 to 2017 that was approved by the MAFFP. The IA  focuses on the production and trade conditions that compel the Italian tobacco industry to comply with market requests. The IA consists of specific rules for tobacco producers, their POs or their associations (APOs) and the industrial companies (first processors, manufacturers), and it introduces several possibilities for: (1) marketing coordination; (2) contract framing; (3) qualitative features of tobacco; (4) harvest insurance; (5) production methods; and (6) financial contribution. Table 15.3 describes the primary elements of the IA.

15.4.3.1 Contractual relationships, extension of rules and enforcement


The IA is a collective arrangement that disciplines many aspects to foster the coordination and marketing of raw tobacco in Italy. Accordingly, it defines the main elements of contract farming between producers and processors/manufacturers (Article 2) as well as qualitative requirements for raw tobacco (Article 3). The IA presents a model of the contract valid for the period 2015 to 2017. The contract involves PO and/or APO .

Table 15.2. Organization Tabacco Italia: objectives and aims for activity areas.

Organization of supply and market control	Concentrate and coordinate supply and marketing Coordinate and improve way products are placed on the market Draw up standard contracts for sale of agricultural products Collaborate with public administrations
Coordination of supply chain relationships	Forecast production potential and record public market prices Explore potential export markets Promote rationalization and improvement of production and processing
Quality of production and competition policy	Develop methods and instruments to improve product quality Establish stricter production and marketing rules Fully exploit product potential
Research and development	Adapt production and processing to requirements of the market Foster R&D activities by means of research and market studies Improve knowledge and transparency of production and the market Develop methods and tools that will increase economic efficiency
Environmental compliance and sustainable production	Seek ways to restrict the use of animal-health or plant-protection products and ensure soil and water conservation Promote and conduct research into integrated production Contribute to the management of by-products and the reduction and management of waste

Table 15.3. Interbranch agreement: main elements.

Marketing coordination	AGEA (Agenzia per le erogazioni in agricoltura, i.e. Italian Agricultural Payments Agency) communicates to the Organization Tabacco Italia (OIT) information concerning cultivated areas and expected production with respect to cultivation contracts
Contract farming	Producers, first processors and manufacturers sign and fulfil contractual conditions established by the interbranch agreement (IA)
Qualitative features of tobacco	Tobacco must fulfil minimum qualitative requirements established by the IA
Harvest insurance	Promotion of the drafting of insurance contracts against weather damage.
Production methods	Producers must comply with guidelines concerning good agricultural practices and products specifications
Financial contribution	Members must make Interbranch fixed financial contribution (established every year by the OIT) to the organization to cover costs directly incurred during production, marketing and R&D activities

as well as first processors or manufacturers. Furthermore, it specifies duties for both parties as well as additional information, as reported in Table 15.4.

Furthermore, according to Article 168 of Reg. (EU) 1308/2013 and Article 62 of the law decree 24 January 2012 (Cresci Italia Decree), the OIT establishes that every

Table 15.4. Interbranch agreement: main elements of contracts for 2015-2017 (own elaboration on Agea Circular n.2015.394).

Item	Decision
Recognition of sellers/purchasers	To sign contracts, parties must be recognized by national authorities
Purchaser's responsibility	Purchasers must communicate the certificate of recognition by 31 March Purchasers must transmit the list of associated firms by 25 September
General rules for contracting	The same purchaser may sign more than one farming contract with the same producer organization (PO)/association of producer organizations (APO), but with different farmers
Time	Contracts must be signed by 15 May and PO/APO must send them to AGEA by 20 June
Typology of contracts	1. Contract farming stipulated between the PO/ member by name of a specific number of members with first processors or a manufacturer 2. Commitment to plant stipulated between the PO/APO member and the PO/APO or between a cooperative member and the cooperative of production 3. Declaration of cultivation stipulated: (1) between the APO and the PO, when the former signs a 'farming contract' with purchasers, refers to the totality of the commitment to plant; (2) between a cooperative of production (associated with a PO or with a consortium of a cooperative of production) and the PO/consortium, refers to the totality of the commitment to plant
Change of ownership	Not allowed unless the purchaser cannot fulfil the contractual obligations.
Breach of contract	Causes definitive revocation of the recognition that forbids new contract negotiations
Delivery	From 9 January to 15 March for all varietal groups (except for Kentucky and Nostrano del Brenta – 9 January to 31 March)
Payment	Purchasers must pay within 30 days of delivery Within 10 work days after payment, APO transfers money to PO Within 10 work days of previous money transfer, PO remits money to producers
Administrative controls	Regarding purchasers: controls are concerned with compliance with the time of payment (30 days) Regarding PO/APO: controls are concerned with the transfer of money to members
Technical controls	Performed on a sample of 5% of producers involved in contract farming Conducted both at the producers' barns/warehouses and at first processors' storage centres

delivery of raw tobacco in Italy by a producer to a processor must be covered by a contract among all parties and that the first purchasers (processors/manufacturers) must make an offer for a contract (Ciliberti and Frascarelli, 2013). Furthermore, any contract or offer for a contract shall be made in writing and shall be made in advance of the delivery. Contracts must include the following elements: (1) price; (2) quantity and quality of the products and the timing of deliveries; (3) duration of the contract; (4) details regarding the payment period; and (5) arrangements for collecting or delivering products. However, it is further noted that all elements of the contracts for the delivery of agricultural products concluded by producers, collectors, processors or distributors shall be freely negotiated among the parties.

Article 9 of the IA requests an extension of the rules and of financial contributions according to Articles 164 and 165 of Reg. (EU) 1308/2013 to all Italian producers, POs, APOs, processors and manufacturers who are not members of the OIT. As previously noted, the MAFFP allowed for the extension of rules *erga omnes* in August 2015, since it regroups more than two-thirds of the production volume. Table 15.5 presents the rules that have been extended to all actors of the tobacco supply chain in Italy for at least three years, i.e. 2015 to 2017.

Finally, the enforcement of the *erga omnes* is ensured by the Central Inspectorate for Agro-food Products Quality Protection and Fraud Repression of the MAFFP. In the event of non-compliance with the IA, the agents lose, temporarily or definitively, the ability to sign contracts and are assessed an administrative fine not to exceed 10% of the contract value. This penalty system is aimed to dissuade free-riders and hinder the violation of rules. Moreover, in the case where the IA establishes a specific arbitration commission, which is composed of five members (two chosen by producers, two by purchasers and a president chosen by the MA), the aim of the commission is to resolve any controversies between parties and guarantee the enforcement of the agreement.

Table 15.5. Extension of rules for activity areas.

Activity area	Extended rule (item)
Organization supply and market control	Production and market reporting Measures to promote and exploit the potential of products
Coordination of supply chain relationships	Development of standard contracts that are compatible with EU rules Organization Tabacco Italia (OIT) financial contributions
Quality of production and competition policy	Measures to protect organic farming as well as designations of origin, quality labels and geographical indications Stricter production rules than those laid down in the EU or national rules Definitions of minimum qualities and minimum standards of packing and presentation Use of certified seed and monitoring of product quality
Research and development	Studies to improve quality of products Research of methods of cultivation permitting reduced use of plant protection or animal health products and guaranteeing conservation of the soil and conservation or improvement of the environment Management of by-products
Environmental compliance and sustainable production	Protection of the environment Research to add value to the products through new uses that do not pose a threat to public health Plant health or food safety

15.5 Discussion

The present paper highlights the main reasons for the foundation of the OIT and the extension of rules in the tobacco supply chain. Since 2009, the CAP reforms have caused a complete reorganization of the supply chain, but despite the European institutions strongly reducing public aid for tobacco, the production has maintained a central role in the Italian agriculture sector both in terms of value added and employment. Moreover, the rapid decline in the number of inefficient producers, middlemen and first processors from 2009 to 2014 has laid the groundwork for the strengthening of both vertical and horizontal collaborations. Indeed, the liberalization of the tobacco market in the EU has forced farms and industries to establish organizational arrangements that will enhance the competitiveness of the Italian supply chain, improve the quality of raw materials, and deliver a stable supply of products.

These elements note the strong connection between the regulatory framework and the economic results of the production dynamics regarding one of the most funded crops of the European agriculture that has led Italy to create the OIT and resulted in the collaboration of POs, first processors and manufacturers. As previously stated, what makes the OIT an interesting and unique case study is that, since it is highly representative of the Italian tobacco sector, it was allowed to extend *erga omnes* the rules established by the IA, which regulates the main aspects of the deliveries, such as price, quality, etc., as well as contractual arrangements between producers and industrial companies of the Italian tobacco industry.

In this regard, Table 15.6 depicts the influence of the regulatory framework on the determinants of hybrid arrangements with respect to the case study under investigation. Specifically, it highlights: (1) whether and how CMO rules and IA measures interacted with the traditional determinants of transaction costs in the agricultural sector, i.e. asset specificity and uncertainty, according to scholars (Menard and Valceschini, 2005; Royer *et al.*, 2012, 2016); and (2) whether and how the collective arrangements of the IA stimulated resource pooling, which typically characterizes the hybrid form of governance.

Moreover, the contractual arrangement established by the IA represents an organizational solution that fosters resource pooling between farmers and raw tobacco buyers to weaken free-riding activities and manage significant uncertainty in the tobacco world market. Written contracts offer legal protection that acts as an incentive for the extremely high investments characterized by the tobacco supply chain, both from the perspective of supply, i.e. farmers, and demand, i.e. first processors and manufacturing companies.

Moreover, the contractual arrangement entails many conditions that influence the governance of the tobacco supply chain. The commitment to comply with conditions concerning good agricultural practices reduces uncertainty often connected to issues of the quality and the quality control of raw materials while simultaneously requiring

Table 15.6. The influence of the regulatory framework on the determinants of hybrid arrangements: evidence from the Organization Tabacco Italia (OIT) case study.

Common Market Organization (CMO) rules and main interbranch agreement elements / arrangements	Specificity of investments	Contrast to free-riding activities (uncertainty)	Resource pooling
Producers, first processors and manufacturers sign and fulfil contractual conditions (according to Art. 168 CMO) by means of 3 types of written contracts (contract farming, commitment to plant and declaration of cultivation) that include elements such as price, quality, duration, payment period, and delivery	X	X	X
Producers committed to comply with guidelines concerning good agricultural practices and product specifications	X	X	
The same purchaser may sign more than one contract farming with the same producer organization (PO)/association of producer organizations (APO), but with different farmers			X
Change of ownership not allowed unless the purchaser cannot fulfil contractual obligations		X	
Breach of contract causes definitive revocation of the recognition that forbids new contract negotiations		X	X
To sign contracts, both parties must be recognized by national authorities		X	
Extension of rules and financial contributions of non-members (according to Art. 164 and 165 CMO)		X	X
OIT members pay a fixed financial contribution to cover costs directly incurred during production, marketing and R&D activities		X	
Promotion of the drafting of insurance contracts against weather damages	X		
Administrative controls concerning compliance with time of payment and transfer of money to OP/AOP members		X	

specific investments that increase the mutual dependence among assets. Additionally, the official recognition of contractors by national authorities aims to further reduce the risks of opportunistic behaviours, whereas the revocation of such recognition in the event of a contractual breach stimulates resource pooling.


With respect to the extension of rules and financial contributions to non-members, these factors represent an innovative organizational solution, which is embedded in the legal framework of the CMO reform, that enables the improving of coordination and the pooling of resources to more effectively face uncertainties that affect transactions along the tobacco supply chain. With regard to the promotion of insurance against weather damage, such insurance increases the degree of mutual dependence among assets consistent with tighter forms of coordination and governance, such as that established by the IA. Lastly, the administrative controls concerning compliance

with on-time payments and transfers of money to the OP/AOP members represent an attempt to enforce contractual clearances to reduce free-riding activities and uncertainty.

The preliminary attempt to analyse the OIT under the lens of the TCE reveals that, even in the absence of specific financial contributions, the OIT may generate efficiency gains and reduce transaction costs by gathering thousands of transactions and eliminating many intermediaries, according to Menard and Klein (2004). At the same time, such a hybrid arrangement maintains the autonomy of producers and industrial companies, thus benefiting more from incentives than what vertical integration would allow while reducing agency problems for processors and distributors. As a consequence, uncertainties over quantity, quality, and price that plague so many agricultural activities, such as tobacco, are reduced, which potentially stimulates investments and lowers transaction costs even more. Accordingly, these arrangements are not automatically detrimental to the final consumers, as is often argued by opponents of these arrangements.

Furthermore, the case study approach applied to the OIT sheds provides information on the institutional embeddedness of the tobacco sector and on the consequences derived from the relationship between the regulatory environment and private initiatives. More specifically, as noted in the extant literature, hybrids, such as the OIT, are characterized by the fact that the two dimensions, namely, private organizational arrangement and institutional embeddedness, are tightly interwoven, which may explain their stability and even their success over time. According to Menard and Valceschini (2005), it follows that both of these dimensions must be considered: the institutional environment, i.e. rules, laws, and policies, and the organizational arrangements embedded in this environment and implemented by agents, i.e. IO members.

In Europe, the agricultural policy established by the EU has long encouraged the formation of networks, some of which were officially promoted and supported. Currently, despite the 'old' tools of the CMO, e.g. quotas, import duties, and export refunds that have been dismantled and/or deactivated, policymakers strive to maintain market stability and improve agricultural competitiveness by means of promoting more vertical and horizontal integration and coordination (Ciliberti and Frascarelli, 2014, 2015). Jolink and Niesten (2012) reported that several studies demonstrate that rules and regulations of the institutional environment influence the formation of hybrids. Such rules mostly concern European or national efforts to introduce various industries to competition that conversely causes an increase in hybrid organizations. Therefore, the general trend is that the liberalization process leads to the creation of quasi-markets, in which efforts to mimic private markets are combined with the provisions of public services.

The OIT case study indicates that the institutional environment influences the choice of a specific mode of hybrid and its characteristics  result of the rapid

and unpredictable changes over the last several decades in the environment of organizations and that these changes have led to a substantial increase in the number of hybrid collaborations among organizations. Conversely, hybrid formation is surely affected by the consequences of large environmental uncertainties. Indeed, while a strong inducement to form hybrids results from the rapid and unpredictable changes in a firm's environment, a larger environmental uncertainty increases the complexities involved in agreeing on price, quality and volume in alliance contracts. In conclusion, what emerges is that the OIT is a private organization with institutionally embedded functions and that it aims to improve communication activities along the tobacco supply chain, reduce information asymmetries, increase trust levels in the relationships between producers and the tobacco industry and elaborate common growth strategies. It follows that the formation of hybrids, such as the OIT, has been affected by, on the one hand, rules and regulations in the (European) institutional environment that have imposed competition in industries and, on the other hand, by the large (and growing) uncertainty due to the gaps left in the same institutional environment as a result of the dismantling of the protectionist and distortive CAP aids in effect until 2009.

15.6 Concluding remarks

Whereas the CAP reform 2014-2020 abolished all forms of coupled support to the tobacco sector beginning 1 January 2015, during the period 2010 to 2014, farmers received Article 68 payments (Reg. EU 73/2009) if they signed a contractual arrangement with the first processors. Without such a financial incentive, the risk was that contractual relationships would be abandoned and more uncertainty would be introduced. To address the issue of a dangerous deregulation in the Italian tobacco sector that could increase transaction costs along the tobacco supply chain, stakeholders, e.g. representatives of both the agricultural and the industrial world, seized the opportunity offered by the new CMO and undertook an innovative path towards the diffusion of collective arrangements in the Italian agricultural sector due to Regulation (EU) 1308/2013, i.e. CMO 2014-2020.

The present paper reveals that OIT represents, as of now, an interesting and unique case study of how, in the absence of any form of financial contributions, the interaction between the regulatory framework and the institutional environment affects the organizational arrangements in the Italian agro-food sector to increase the efficiency and profitability of the tobacco sector. Indeed, as a reaction to the elimination of a financial incentive that aimed to promote contracts along the tobacco supply chain, this chain initially faced a period of strong and rapid decline in Italy in terms of both production and employment. However, soon afterwards, it promptly reacted to the increasing uncertainty due to the liberalization of the European market by taking advantage of the three policy tools established by the new CMO to promote coordination among farmers and first processors/manufacturers.

The case study approach was used in this preliminary explorative study to analyse the features of the OIT with respect to the TCE theory of hybrids. In this regard, the main characteristics, such as governance, aims, and allocation of decision rights, the enforcements of rules and the contractual arrangements along the supply chain IA, were investigated. This study revealed that the organizational arrangements may reduce transaction costs by means of limiting uncertainty caused by opportunistic behaviour and influenced by the changing regulatory framework and that they may foster specific investments in the tobacco sector.

Finally, special attention was devoted to the close relationship between the private and public dimensions, i.e. the form of the organization and institutional environment, as enabling such a collective arrangement could ensure the stable supply of raw materials for the industrial companies, i.e. first processors and manufacturers, and guarantee a better quality tobacco, which would then stabilize markets and increase the competitiveness and profitability of the entire supply chain.

15.6.1 Limitations and future developments

The present paper has certain limitations to be considered. First, because it addresses a recent topic, it is not feasible to allow any generalization of the results by means of quantitative methods. Thus, the case study approach is the most suitable in that it allows for a preliminary exploration of the OIT case with respect to the theory on hybrids. Notwithstanding, as the holistic single case is often considered less compelling than the multiple cases, the study is considered less robust; however, it must be considered that, by definition, an unusual case, such as the one described in the present paper, is likely to involve only a single case by definition, since the rationale for multiple case designs cannot be satisfied. It follows that the contribution of this study should be considered as preliminary, and therefore, it is recommended that a quantitative research or multiple case study approach with the OIT members as the unit of analysis be conducted after the IA enforced by the OIT produces tangible effects on the Italian tobacco supply chain. Such a study would be extremely useful because it would provide insights regarding the role of this hybrid promoted by the EU institutions and with respect to its effectiveness to achieve a more competitive European agro-food sector.

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