Do intermediaries sweeten the deal? An inquiry into the activities of intermediaries and their effect on small and medium producers within the Cocoa Value Chain in Ecuador.

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Daniel Arturo Zea Vallejo

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Members of the Examining Committee:
Georgina Goméz
Peter Knorringa

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This document represents part of the author's study programme while at the Institute of Social Studies. The views stated therein are those of the author and not necessarily those of the Institute.

Inquiries:

Postal address:

Institute of Social Studies
P.O. Box 29776
2502 LT The Hague
The Netherlands

Location:

Kortenaerkade 12
2518 AX The Hague
The Netherlands

Telephone: +31 70 426 0460
Fax: +31 70 426 0799

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List of Acronyms

CGCG	Center on Globalization, Governance & Competitiveness
FAO	Food and Agriculture Organization
GVC	Global Value Chain
ICCO	International Cocoa Organization
INEC	Ecuadorian National Institute of Statistics and Censuses
INIAP	National Institute of Agricultural Research
ISS	Institute of Social Studies
LPS	Local Production Systems
MAGAP	Ministry of Agriculture, Cattle raising, Aquaculture and Fishery
TCE	Transaction Cost Economics

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The fieldwork done opened my eyes to what really means to be a small cocoa producer while having limited resources and because of the characteristics of the market not being able to grow. Nevertheless, this just encourages me to find ways to reduce these differences and treatment in the market.

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This paper is dedicated to my parents, Daniel and Magali, and my sister Daniela since without their constant support and trust in me the outcome of this research paper would have been different. Thanks for supporting me from the very beginning, with your infinite love and patience.

Abstract

This research paper looks at the Global Value Chain of Cocoa in Ecuador and the relationships that exist between its actors. This study focuses on the role that intermediaries have within the Cocoa Value Chain in Ecuador and the effect that their actions have on the cocoa production of small and medium producers. The interest of this research is to identify how such actions enable or limit opportunities for the development of small and medium cocoa producers in Ecuador. The Transaction Cost Economics theory is the main analytical tool used for the analysis of the transactions that take place between intermediaries and cocoa producers. Since intermediaries are identified as the main buyers of cocoa in Ecuador, an analysis for this phenomenon is also performed during this project. Also taken into consideration is the power and information asymmetries that exist in the Cocoa Value Chain in Ecuador and the reasons for this situation. To this end, this research paper aims to better inform policy makers, as well as, to formulate academic knowledge on the rationale of middlemen and, small and medium cocoa producers regarding the relationships and transactions that exist between them.

Relevance to Development Studies

Middlemen have been a blind spot in academic research in Ecuador. This research offers an interesting opportunity to make visible the practical experience of understanding the relationships that exist between intermediaries and producers within an agricultural Value Chain. The study provides an analytical perspective to the transactions that occur between intermediaries and producers, and the effect these have on the producers' profit generation capacity and opportunities for development. Transaction Cost Economics theory proves again to be an efficient tool for the analysis of the different power and information asymmetries that exist within a Global Value Chain.

Keywords

Global value chains, intermediaries, middlemen, cocoa producers, development opportunities, long-term relationships, transaction cost economics, Ecuador

Introduction: Setting the scene

According to the Fairtrade Foundation (2011:2) "cocoa plantations cover 65 million hectares around the world within 57 countries where almost 90% of production comes from smallholdings of under 5 hectares and cultivation is generally extensive". This situation is also replicated in Ecuador where, according to the Ecuadorian National Institute of Statistics (INEC), by 2016 there were more than 100 000 cocoa growers, of which more than 88% owned less than 50 hectares (Ha). There are also more than 1000 "collection centers" that are mostly privately owned. These are mainly located in small cities where most of the cocoa production made by small and medium producers takes place. The owners of these centers are the main focus of this paper and will be referred to as the 'middlemen' or 'intermediary' henceforth. According to government officials interviewed, the regulation levels to these middlemen are very low, although cocoa is the fourth most important export product of Ecuador. Regardless of its importance to thousands of farmers and the country there is very little support from the national government towards small and medium producers.

Ecuador is a major exporter of premium cocoa with 54% of the market share in the world. According to the Ecuadorian Central Bank (2015) 90% of cocoa production is exported as beans. As will be observed in later chapters, from the information collected during this study, there are important deficiencies within the production of cocoa in Ecuador and the transactions this product goes under. The efficiency of the crops is low. The Ecuadorian small producer receives on average 4-6% of the final consumer price for chocolates while intermediaries receive 22-24% (CGGC, 2015:12). Therefore, this research paper attempts to identify and understand the reasons for producers not being able to receive a higher share from the final consumer price of chocolates. In order to do this; an examination of the main actors within the Cocoa Value Chain in Ecuador is presented. In parallel an evaluation will be made of the dynamics within this industry with special emphasis on the transactions that occur between middle-

men and, small and medium cocoa producers. An overview of the type of relationship that exists between the former two actors will be made, focusing on the characteristics that shape them.

There is a vast amount of literature reflecting how positive and beneficial the role of the 'intermediary' within a Global Value Chain (GVC) is, but when looking for information about the disadvantages of having an 'intermediary' or their behavior within the market structure the information is limited. For this reason, one of the main priorities of this inquiry is to analyze and to show academically in what ways intermediaries, being the main buyers of the cocoa production in Ecuador, affect the production of this commodity from small and medium growers. Because of this, academics would be able to refer to this project when talking about Global Value Chain and intermediaries. To ensure a high level of accuracy for this project fieldwork was conducted, which included meetings with cocoa growers, middlemen, cocoa exporting companies' representatives and government officials.

To enrich the analysis made during this research project, the theory of Global Value Chains presented by Raphael Kaplinsky (2001) will be utilized, as well as, the Transaction Cost Economics theory developed by Oliver Williamson (1989). Since there are many definitions of 'intermediaries', this paper will use the one made by Gary Biglaiser (1993:214) where he claims that "in many market there are agents who trade but do not originally own a good, do not physically alter the good, and receive no consumption value from possessing the good. These agents are middlemen, who make profits by buying a good from one individual and selling it to another at a higher price". This definition will be complemented by the roles and functions that intermediaries generally have outlined by Rose (1999). Similarly, in the case of arm's-length transactions it would follow the definition made by Wilkinson, J. (2013). All these concepts as well as others relevant to this report will be revised in the following chapter. To deepen the understanding of small and medium cocoa producers, an overview to the current shape of the worldwide cocoa industry will be made, as well as an analysis on

Ecuador and its cocoa industry incorporating the information given by government officials and academics during my fieldwork.

To reach an answer for the main question proposed in this paper an extensive analysis of the intermediaries and producers environment, and the challenges and opportunities within the Cocoa Value Chain in Ecuador will be made. This paper sets out to identify the reasons behind why small and medium cocoa producers mainly deal with intermediaries instead of directly with cocoa exporters. After identifying the characteristics of the relationships between intermediaries and, small and medium cocoa producers, the extent to which these affect the opportunities for the development of cocoa growers will be reviewed.

1.1 Research Objectives and Question

1.1.1 Objectives

- To better inform policy makers on the rationale of intermediaries and their role within the cocoa value chain in Ecuador.
- To understand the relationship between intermediaries and, small and medium cocoa producers.
- To formulate academic knowledge about the transactions that take place within the cocoa value chain in Ecuador and how it is structured.

1.1.2 Research Question

- In what ways do intermediaries affect the production of small and medium producers within the Cocoa Value Chain in Ecuador?

1.1.3 Research Sub-Questions

The following sub-questions assist in answering the main questions:

- Who are the actors within the Cocoa Value Chain in Ecuador?
- What types of transactions take place between middlemen, and small and medium cocoa producers?

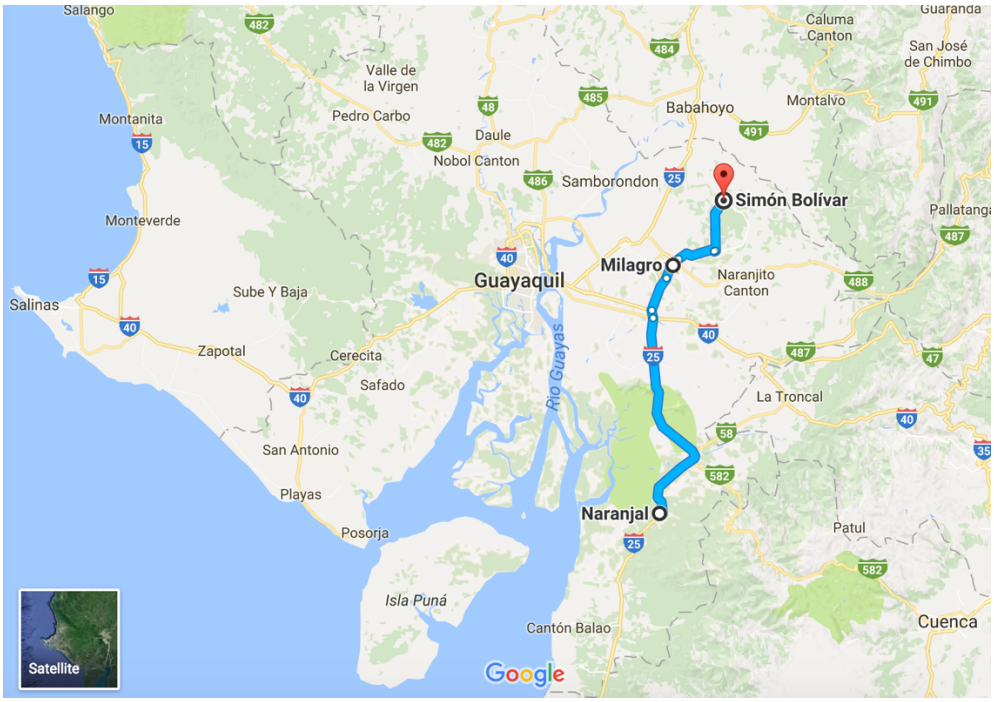
- Why do producers sell mainly to intermediaries in the Guayas Province in Ecuador?

1.2 Research Methodology

As a result of the nature of this research paper a mixed methodology was used in order to gather primary and secondary data. Primary data was collected through 'semi-structured interviews' together with the use of the 'observation method'. Secondary data consisted of databases and academic papers collected during this fieldwork. 'Semi-structured interviews' were used as the main tool to gather data, as O'leary (2004:121) claims, "that cultural barriers should be taken into account". Heeding this advice, semi-structured interviews were more appropriate as a survey or a strict script with an intermediary would not allow the individual to share the information needed for the research, since some of them could be participating in illegal practices and having them on record could be threatening for them. Additionally, semi-structured interviews allow for a more natural reaction from interviewees allowing them to speak their mind freely, which allows for the introduction of the voices of the different actors in this paper.

48 individuals were interviewed, 30 of which were small and medium cocoa producers, ten were intermediaries, five were government officials and three were exporter companies' representatives. This fieldwork took place during six weeks between the middle of July and the end of August 2017. The average amount of time that the interviews with intermediaries, and small and medium producers, took was 30 minutes. All the interviewees were asked if pictures could be taken and were assured that their names will remain in confidentiality and were not going to be displayed in this paper. The area where the interviews of intermediaries and cocoa producers took place was within the Guayas province, where 40% of the total cocoa production takes place. The interviews were conducted in the cities of Milagro, Naranjal and Simon Bolivar (Map 1).

Map 1.1: Map of the cities visited (Milagro, Simon Bolivar and Naranjal)



Source: Google maps (2017)

My granddad has been a small cocoa producer for fifteen years and owns four hectares (ha) of cocoa CCN51. At various times I had the opportunity to accompany him to sell his cocoa production since I was 15 years old. Because of this he has access to a small network of producers and motivated me to take up this research. This was my starting point. I interviewed 4 of his friends. Then using the 'snowballing' technique I asked them to refer me to other small or medium cocoa producers who they may know and might accept to be interviewed. This was a very effective technique which as explained earlier allowed me to visit three different cities which are hubs for cocoa production and trade in Ecuador.

Because I wanted to get accurate answers from the intermediaries and producers, it was recommended by colleagues that have done research before in Ecuador, that I try to look for producers and intermediaries at times when they are free. For this reason, most of the interviews took place during weekends. When I asked interviewees when was the best time for me to visit them and their

peers, they all agreed that weekends were the best since they are less busy and more relaxed. I was also limited by transportation since I was based in Guayaquil and to reach the cocoa crops of the producers I needed private transportation since there are no means of accessing these plots by public transportation. These farms as well as the collection centers managed by intermediaries are a two-hour drive away on average.

The 'snowballing technique' was also used regarding intermediaries. Nevertheless, I was just referred to four intermediaries whom I interviewed. The rest I approached directly, at random, and showed my credentials as a master's student doing a research project about the cocoa industry in Ecuador. Whilst three rejected me, six replied positively. It was easy to approach them since they were mostly based alongside the main road of these small cities. The interviews with the exporter companies' representatives and government officials were made in their offices. Each was contacted through email and later meetings were arranged with them. The government officials I interviewed were working at that time in the Ministry of Agriculture (MAG) and in the Ecuadorian National Institute of Statistics (INEC). The information, as well as, databases given by these 8 individuals were used to enrich Chapter 3, which talks about the worldwide market of cocoa and the state of the cocoa industry in Ecuador.

With regards to the limitations of this research paper, the size of the sample is of concern. This limitation is acknowledged but due to time constraints (six-week fieldwork) and logistics regarding transportation, could not be mitigated. Nevertheless, the level of representativeness and generalizability of this sample is high. With regards to the intermediaries interviewed, 15% of the ones that are alongside the road between these three cities answered the questions in a similar manner. It is also worth mentioning that in the case of the intermediaries they were approached at random since I wanted the sample to be varied.

After performing fieldwork, involving more than 48 individuals including cocoa growers, middlemen, cocoa exporting companies' representatives and government officials, important information was collected regarding the current state of the cocoa industry in Ecuador. This included the conditions under which

cocoa is grown in the country, its different varieties, and relevance for the international market. The information gathered is used to make an accurate assessment in order to answer the research question set in this paper.

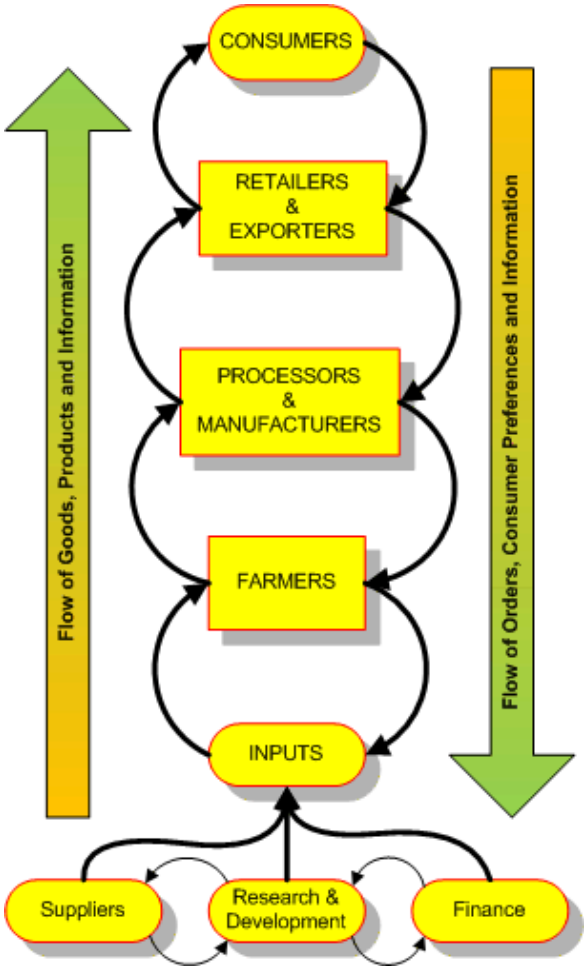
Chapter 2 Theorizing the production network of cocoa in Ecuador

This section will construct the analytical framework to underline the role of intermediaries in the production network of cocoa in Ecuador. Special attention is given to how this role affects the production from small and medium producers of cocoa. The theories that have been chosen are outlined followed by an explanation of their characteristics and their relevance to this paper. These concepts and theories are crucial for the understanding of the Cocoa Value Chain in Ecuador, its main participants (exporters, intermediaries and producers) and the transactions that happen between them, especially the ones between small and medium producers and intermediaries.

Global Value Chain theory

While reviewing the varied literature on GVCs, academics such as Knorringa (2017), Kaplinsky and Morris (2013:8) and Hakemulder et al (2016:2) develop similar definitions about this term, where they define it as "the full range of activities which are required to bring a product or service from conception, through the different phases of production (involving a combination of physical transformation and the input of various producer services), delivery to final consumers, and final disposal after use." The graph formed by Knorringa (2017) in figure 2.1 specifies the different actors and segments within a GVC. Small and medium producers and intermediaries are important participants within a GVC, which in parallel is the main subject of study in this research. Humphrey and Schmitz (2004:97) specify that "the value chain literature focuses on export oriented (agro-) industries, which are usually privately owned and managed and may have a governance structure enforcing compliance with international standards." To fulfill one the objectives of this paper a review of the structure of the Cocoa Value Chain in Ecuador and its participants is made in Chapter 3.

Figure 2.1: Model of a standard Value Chain



Source: 'Value Chain, Clusters and Enterprise Development' Lecture. (Knorringa, P. 2017)

Gereffi and Kaplinski (2001:6) explain that the "level of analysis of value chains can be global, macro, meso or micro level…where Meso usually refers to regional or city level activities". Considering the main actors of this research and the extent of their actions this project has a meso-level analysis. Van Dijk, M and Trienekens, J. (2012:46) state that "concepts such as power relationships and information asymmetry are key for Value Chain analysis". Based on the statements made above, the GVC concept will allow us to decipher whether the Cocoa Value Chain in Ecuador is private, owned by public parties or a combination of these. Relatedly, the bargaining position of small and medium producers in front of intermediaries and exporters, and whether there are opportunities for them to increase value addition in the cocoa production process, will also be

analyzed. Equally, GVC analysis serves as a tool to briefly identify the business models of small and medium producers and intermediaries, thereby allowing us to understand the reasons behind their behavior at the time of a sale. This analysis is presented in Chapter 5.

"The big advantage of the GVC concept is that the development of economic activities is put in context of resources and markets, of individual entrepreneurs and clusters of producers competing in local, regional or international markets" (Bair and Gerefi, 2001:1890). The GVC theory is recognized for being able to identify features such as which segment of the value chains are particularly profitable, the factors influencing their functioning and whether integration is or is not taking place. Another feature of the GVC concept is that it allows us to identify the quality of relationships between different stakeholders since it is a key factor that directly affects the functioning of the cocoa value chain in Ecuador. According to the literature, "Value chain opportunities and constraints generally required coordinated response by multiple firms in the chain- which necessitates trust and willingness to collaborate" (Trienekens, 2011:52). One of the aims of this paper is to analyze how the quality and level of the relationship between middlemen and, small and medium producers affect cocoa production in Ecuador.

Clusters and Local Production Systems

The GVC theory offers the tools to make a general overview of the functioning of the cocoa value chain at a macro level. However, as explained above the analysis that is conveyed in this research paper is at a meso-level. For this reason, the concepts of Clusters and Local Productions Systems (LPS) are incorporated into the analysis. There is a lively debate about what constitutes a cluster and its typologies. As Mohring (2005:21) states "various cluster types exist depending on their firm compositions, industry sector, cluster raison-d'être and organization." This was earlier claimed by Helmsing (2001:282) where he explains that "there seems to be a growing consensus that there are many types of clusters, not only in advanced countries but in developing countries". For the best interest of this paper the definition made by Mohring J. (OECD, 2005:29)

will be adopted which describes the term Cluster as "an agglomeration of vertically and/or horizontally linked firms operating in the same line of business in conjunction with supporting institutions". Ketels et al (2006:9) reinforce and complete the cluster concept by saying that it is "a group of companies and other institutions in related industries that are co-located in a specific geographic region". The former definition offers a justification for their use in this project since together they describe the environment where fieldwork took place, since the interviewees were geographically located in the same city/area operating in the same line of business (production and trade of cocoa). Whether they were vertically and/or horizontally linked and their level of support to each other will be analyzed in Chapter 5.

In parallel to the concept of clusters, the Local Production Systems approach offers a similar view on this topic. Gomez (2011:190) defines LPS as "the territorial agglomeration of economic, political and social agents dedicated to a specific production sector, no matter how strong or weak the connections among them may appear". In other words, the LPS concept attempts to encompass and analyze all the relevant stakeholders that are involved directly and indirectly in the production and delivery system in both horizontal and vertical relationships. This occurs at a sub-national, regional level considering the transactions and operations that a product or service needs to go through before being distributed and consumed.

These characteristics of the LPS concept work as another tool that helps us to understand more accurately the shape of the relationships between producers and intermediaries, as well as the ones between middlemen and exporters, and the possible power asymmetries that exist between them. The LPS and cluster concepts facilitate the understanding of the differentiated positionality of intermediaries, and small and medium producers, and their potential impacts on local development on the value chain as well as in the cultural, social and political environment in which they exist. These approaches are another tool that allows us to disentangle and comprehend the reasons behind the behavior of the various actors in the Cocoa Value Chain in Ecuador.

Transaction Cost Economics theory

The GVC theory together with the concept of cluster and LPS helps us to identify how the relationships between middlemen, and small and medium producers are structured. Meanwhile, the Transaction Cost Economics (TCE) theory developed by Williamson (1989) allows us to deepen our understanding of these structures by working as a tool that explains the dynamics and transactions that exist between producers and intermediaries as well as between intermediaries and exporters.

Williamson (1989:139) explains that "transaction cost economics pairs the assumption bounded rationality with a self-interest seeking assumption that makes allowance for guile. Specifically, economic agents are permitted to disclose information in a selective and distorted manner. Calculated efforts to mislead, disguise, obfuscate are thus admitted." Thus, this analysis departs from the assumption that this theory can help us to understand the different 'informal' transactions a producer needs to incur in order to sell their cocoa production. This also allows us to identify the level of bargaining power that cocoa producers have. In parallel the position of power that intermediaries have is also analyzed. As Gulbrandsen et al (2015:193) state "Transaction Cost Economics is the paradigm that scholars rely on most often to examine and make sense of the drivers of firm boundaries (make-or-buy) with respect to the acquisition of requisite capabilities".

While reviewing Williamson's theory (1989) there are two characteristics that actors within a transaction have 'bounded rationality' and 'opportunism'. The former is defined as our limited capacity to understand business situations, which limits the factors we consider in the decision. While the latter is defined as actions taken in an individual's best interests, which can create uncertainty in dealings and mistrust between parties. These two features of the theory allow us to reinforce the analysis on the main actors within the Cocoa Value Chain in Ecuador.

While describing TCE theory Williamson (1989:142) outlines the "three principal dimensions on which TCE relies for purposes of describing transactions [which] are (1) the frequency with which they recur, (2) the degree and type of uncertainty to which they are subject, and (3) the condition of asset specificity." Maltsoglou and Tanyeri-Abur (2015:4) states that "these dimensions are vital for the analysis of the assessment impacts of globalization on the smallholder in the field of agriculture."

TCE entails an examination of the comparative cost of planning, adapting and monitoring task completion. TCE is more self-conscious about its behavioral assumptions and regards the business firm as a governance structure rather than a production function. Based on the dimensions described earlier and for the purpose of this study the analysis of the Cocoa Value Chain under the concept of TCE is subdivided into two categories, namely 'information costs' and 'negotiations costs'. Due to the characteristics outlined above, the TCE theory is used to explain why small and medium cocoa producers continue to sell their production to intermediaries when there are other buyers, such as exporters, who could offer a fairer price. Equally the reasons behind why exporters do not buy cocoa beans directly from cocoa producers are addressed.

Information asymmetry and Signaling theory

For this research it is essential to understand the behavior of intermediaries, and small and medium producers. The TCE theory allows us to analyze the reasons behind certain behaviors during transactions and their effects. The 'information asymmetry' and 'signaling' concepts help us to look at the small details within these transactions and behaviors, providing insight into why producers keep selling their cocoa production to intermediaries**.**

Certo et al (2011:41) explain that **"**individuals make decisions based on public information, which is freely available, and private information, which is available to only a subset of the public". The concept of 'information asymmetry' was chosen since information affects decision-making processes used by

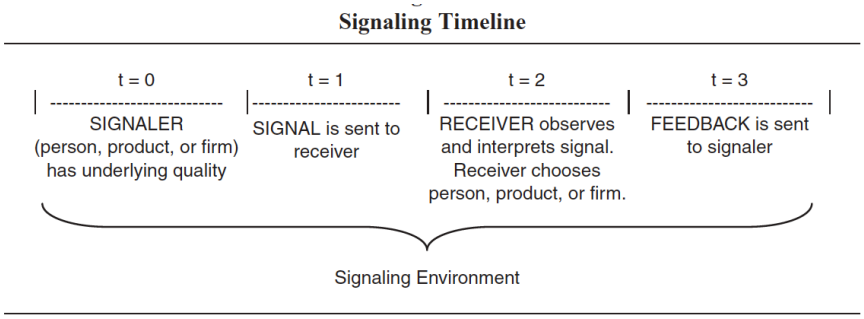
individuals in households, businesses, and governments. Stiglitz (2002:469) explains that information asymmetries happen when "different people know different things. By nature, information is owned by an individual, meaning that it is private. Information asymmetries arise between those who hold that information and those who could potentially make better decisions if they had it." If an intermediary holds information such as the real price, he/she would have the advantage in a negotiation with a producer. If the producer would have access to this real price he/she would not be in a disadvantageous position. The route of the price of cocoa and why producers mainly sell to intermediaries is reviewed in Chapter 5. While the effects on this price management from intermediaries is analyzed in Chapter 6.

Together with the concept of 'information asymmetry', 'signaling' theory is also used with the purpose of analyzing the behavior of an intermediary when buying cocoa from small and medium producers. As Certo et al (2011:41) explains "Signaling theory is useful for describing behavior when two parties (individuals or organizations) have access to different information". The literature reviewed about this theory reveals that there are two principal actors, the signaler and the receiver, together with the signal itself. Signalers are defined as insiders who obtain information about an individual, product, or organization that is not available to outsiders. Receivers are outsiders who lack information about the organization in question but would like to receive this information.

Certo et al (2011:45) explains that there are two main characteristics of efficacious signals, observability and signal cost. The first refers to the extent to which outsiders are able to notice the signal. The second explains how in many cases the signalers are in a better position than receivers since they are able to absorb the associated costs of sending the signal. In figure 2.2 the different roles; characteristics and reactions between the signaler and the receiver are outlined. This theory helps us to analyze the different interactions that occur between small and medium producers (receivers) when selling their cocoa to intermediaries (signaler). Starting from the moment the producers decide to take their

production to intermediaries and finding out what the price of the day is, to how the producer reacts to the price and whether he/she decides to sell or not.

Figure 2.2: Signaling Timeline



Note: t = time.

Source: Signaling Theory: A Review and Assessment (Certo et al, 2011)

Arm's-length principle concept

While using the TCE theory together with 'information asymmetry' and 'signaling' theory, to understand the characteristics of the transactions between intermediaries and small and medium cocoa producers, it is important to determined how and what guides these transactions. To further understand how the cocoa market works in Ecuador the arm's-length principle, also known as 'pure market transactions' concept is used. "An arm's-length principle is a transaction that takes place between two completely unrelated parties. An Arm's-length transaction also implies that the final transfer of assets or services will be valued at the fair market value" (Wilkinson, 2013).

Arm's-length transactions are considered important in the market because it implies that these transactions provide consistent and meaningful information. Thus, this concept serves as a tool to assess whether the capacity to hold information such as the price of the day from the intermediary side, affects the bargaining power of small and medium cocoa producers in Ecuador. Similarly, it helps us to identify the limitations that producers may have in terms of profit generation. The arm's-length principle is highly correlated to the concept of

transaction cost which is analyzed later in this chapter. As Knorringa and Meyer-Stamer (1998:4) outline "[A]arms-length relationships require an elaborate contract which is costly to set up, negotiate, and enforce, thus causing high transaction costs". Looking at the interactions in arm's-length relationships, we are able to confirm or deny whether this principle offers opportunities for development within the Cocoa Value Chain in Ecuador.

Cocoa is the fifth most important export commodity of Ecuador and intermediaries are the main buyers of its production. Sturgeon and Lee (2001:83) contrast 3 types of supply relationships, based on the degree of standardization of product and process:

> (1) the 'commodity supplier' that provides standard products through arm's length market relationships, (2) the 'captive supplier' that makes non-standard products using machinery dedicated to the buyer's needs, and (3) the 'turn-key supplier' that produces customized products for buyers and uses flexible machinery to pool capacity for different customers.

Of relevance to this research is the 'commodity supplier' as arm's-length transactions are vital for their functioning. The buyer-seller relationship between intermediaries, and small and medium producers of cocoa is defined based on the framework mentioned above.

Long-term relationships

Similar to the arm's-length principle, the concept of 'long-term relationships' allows us to define how and what guides the transactions between intermediaries, and small and medium cocoa producers. Crawford (1988:485) states that "contractual relationships usually outlive the contracts that govern them. Long-term relationships are therefore normally governed by sequences of short-term contracts". Thus, this concept is used to evaluate whether cocoa producers have 'long-term relationships' with intermediaries or if they are just 'pure market' transactions. If this is the case this concept would help to define the characteristics of the relationship in place.

"Transactions or relationships are not planned in full, with the use of legal sanctions to enforce contracts / settle disputes" (Harrison, 2003:4). This is reinforced and complemented by the findings of Macneil (1980:9) where he claims that "self-enforcement in business relationships, such as norms, industry customs, reputation, or an assumption of continuity, can be alternatives to contractual practices". This, attempts to explain that 'long-term relationships' transactions are usually tied to relational contract norms and/or social norms, such as integrity. The 'long–term relationship;' concept serves as a tool to define the characteristics of the buyer-seller relationship between intermediaries, and small and medium producers of cocoa. It also contributes to the understanding of the reasons behind their behavior during a transaction.

Intermediaries/Middlemen concepts

To complement and strengthen the arguments of this research paper, it is important to give an accurate definition of the type of middlemen that participate in the Cocoa Value Chain in Ecuador. This allows for the theories and concepts mentioned above to be implemented in a more effective way. Whilst reviewing the literature regarding middlemen, many definitions and concepts arose, with definitions varying depending on the context of the market. Mainly these definitions are based on the role and/or function the intermediary has in the market that it participates in.

Gadde and Snehota (2001:2) explain that "a major problem is that the notion of a middleman is used to describe actors with quite different roles in the market system. Consequently, the interpretation of the concept becomes somewhat fluid and vague." Thus, for clarification the different definitions by various academics are outlined in this chapter. From these the one, which is best suited to represent the intermediary actors in the Cocoa Value Chain in Ecuador, is presented.

Frank Rose (1999) outlines two ways to define an intermediary. Firstly, based on the functions performed by intermediaries (Table 2.1) and secondly focusing on the roles taken by the intermediaries (table 2.2).

Table 2.1: functions performed by an intermediary in trade

Intermediary function	Intermediary activity
Spatial function	Location partner for the exchange of goods
Temporal function	Compensation of temporal differences between demand and supply of goods
Quantitative function	Augmentation or reduction of the quantities in contracts
Qualitative function	Classification of goods Arranging an assortment of goods
Credit function	Compensation of temporal differences between delivery and payment by arranging credits
Contact and advertising function	Increase of the intermediary's economic power. Acquisition of trading partners for multiple activities.

Source: Taken from Information Age Economy – the economics, concept and design of information intermediaries. Frank Rose (1999)

Table 2.2: Roles of an intermediary in trade

Intermediary Role	Intermediary activity	Description
Assortment builder	Selection of goods and combination to an assortment	The intermediary weighs out of the interest of producers, who only want their products in the intermediary's assortment, and consumers, who want an assortment as broad as possible
Organizer	Coordination of the different domains of the assortment and assignment of resources to these domains	The intermediary assigns personal, capital, and room for the exhibition to the parts of the assortment
Transformer of quantities	Transformation of quantities in supply and demand	The transformation of quantities is fundamental for the existence of intermediaries

Contractor	Contracting with suppliers and consumers	Independent intermediaries contract with sellers, acquire proprietary rights and the goods traded, and the goods to buyer

Source: Taken from Information Age Economy – the economics, concept and design of information intermediaries. Frank Rose (1999)

Rose (1999) makes an important differentiation between the functions and the activities that an intermediary could perform; this allows us to define more accurately the characteristics of an intermediary. Rose (1999) also specifies the variety of roles that an intermediary could have within trade, based on their positionality and interests. Table 2.1 and 2.2 serves as a framework, which gives an accurate definition of the actor 'intermediary' in the Cocoa Value Chain in Ecuador. In parallel, it is important to mention that the definition made by Gary Biglaiser (1993:214) is used as the main reference for this project, where he claims that "in many markets there are agents who trade but do not originally own a good, do not physically alter the good, and receive no consumption value from possessing the good. These agents are middlemen, who make profits by buying a good from one individual and selling it to another at a higher price". This definition was chosen because at first glance this concept encompasses the 'intermediary' that appears in the Cocoa Value Chain in Ecuador who directly interacts with most small and medium producers of cocoa.

The central function of the middlemen is to absorb part of the risks that buyers and sellers face (Driel, 2003:6). With regards to the selling activities of the middlemen, Gade and Snehota (2001:4) argue that "by creating a different bundle of resource elements offered to customers the middleman takes on the function to economize on costs of bridging the supplier-customer gap, i.e. lowering costs of transactions." There is a vast amount of literature reviewing the benefits that intermediaries generate for manufactures and exporters by reducing their transactions cost, uncertainty and the risks they could face when dealing directly with producers. Nevertheless, this research also focuses on disentangling the negative effects whilst recognizing the benefits of middlemen within

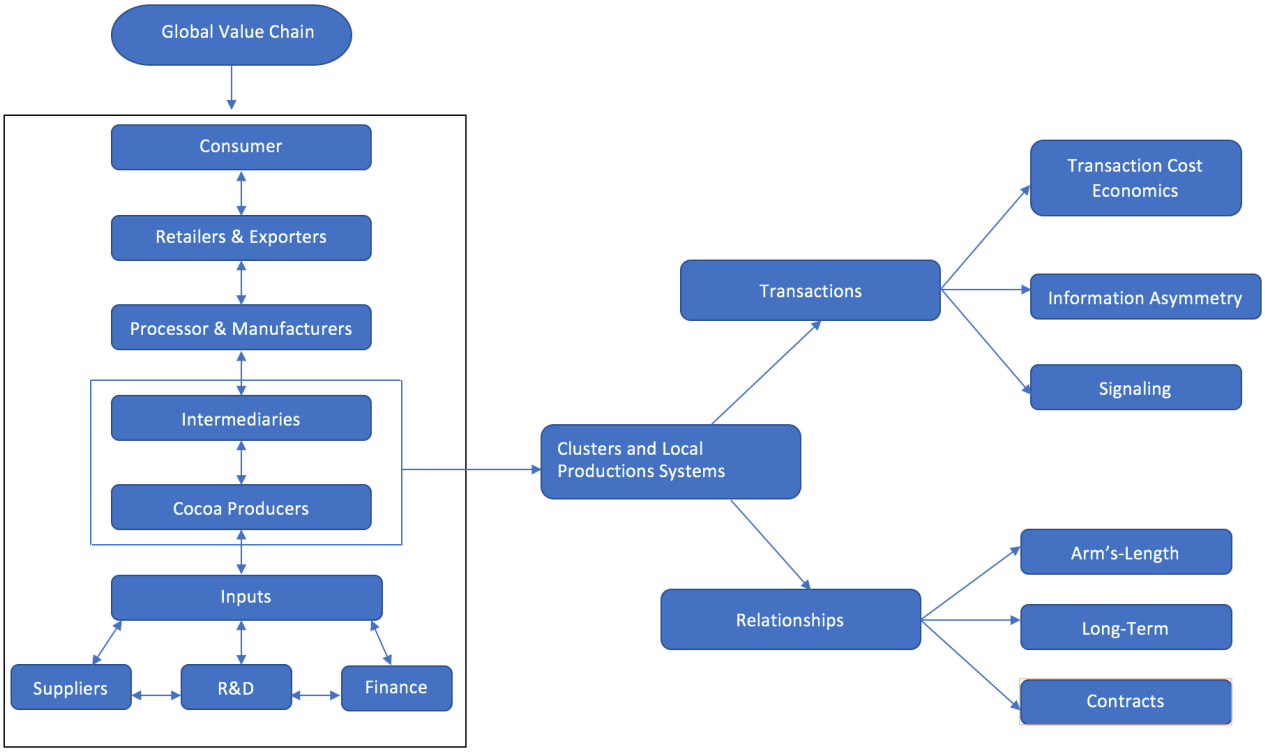
the Cocoa Value Chain, and their effect on small and medium producers. Moreover, the motivations behind why exporters and manufacturers allow middlemen to be part of the Cocoa Value Chain in Ecuador is addressed. This is done to gain further understanding as evidently if exporters and manufacturers would perform the actions made by intermediaries they would be able to collect the share of the price that intermediaries keep when re-selling the cocoa.

Szcpepanik (1960:13) explains that "small and inefficient scale of operations, geographical dispersion, inadequacy of credit, collecting, storage, preservation, transport and marketing facilities has favored the entry of numerous middlemen in the industry". This statement was later confirmed by Spulber (1999:20) who outlined that "middlemen hold inventories of goods on hand and stand ready to sell to customers. They further have cash on hand and stand ready to buy from suppliers". Importantly, despite the 39-year gap between these two statements the actions performed by middlemen apparently has suffered little or none changes in this context. For these reasons, it is used to define and characterize the activities performed by intermediaries in the Cocoa Value Chain in Ecuador. It is also used to confirm, based on the findings of the fieldwork, whether intermediaries still perform the same activities described by Szcpepanik (1960:15) more than 57 years ago.

To further expand this assessment, the four dimensions outlined by Ogouma, et al (2010:32) are used. These are "conditions of supply and demand that include[d] place, time quantity and quality" (Ogouma, et al, 2010). Simultaneously, these four features help us to evaluate the relevance of intermediaries in the functioning of the Cocoa Value Chain in Ecuador. In parallel this also helps us to identify the reasons why small and medium producers of cocoa mainly sell their production to intermediaries.

2.1 Analytical Framework:

Figure 2.3: Theoretical Framework Diagram



Source: Author's personal Collection

Figure 2.3 portrays how the different theories and concepts outlined earlier are related to each other. A theory such as Global Value Chain allows us to understand on a macro level how the Cocoa Value Chain in Ecuador is established, its main actors and their role within it.

With regards to this research, the first sub-question (who are the actors within the Cocoa Value Chain in Ecuador?) is answered in Chapter 3. The concepts and definitions made by Rose (1999) are used to give a specific characterization of middlemen within the Cocoa Value Chain in Ecuador. Following this analysis, attention is given to the concept of clusters and LPS, in order to deepen the understanding of intermediaries, and small and medium cocoa producers and their positionality.

In order to analyze the activities of intermediaries and how these affect cocoa producers, a review of the features of the transactions and the relationships that exist between them is given. In order to analyze the different characteristics of these transactions the theories of Transaction Cost Economics, Information Asymmetry and Signaling is used. These concepts also allow us to evaluate the activities of intermediaries in the Cocoa Value Chain in Ecuador, whilst identifying the ways in which these affect the cocoa production of small and medium producers.

By defining the type of relationships that exist between intermediaries and cocoa producers, it helps us to understand why the latter continues to sell their production mainly to middlemen. Concepts such as the arm's-length principle and long-term relationships serve as tools to identify the features that structure these relationships. After identifying the kind of relationships and transactions that occur between intermediaries, and small and medium cocoa producers, it is then possible to evaluate what impacts they have on the local development opportunities of producers, and what steps can be taken by the other actors in the value chain to improve these conditions.

Chapter 3 Importance of Cocoa in Ecuador and its Value Chain

3.1 Background: Ecuadorian and worldwide cocoa market

Since 1995 the worldwide production of cocoa has been increasing at 2.4% per year, where its consumption in 2013 was approximately 4 million MT. It is estimated that the global production of cocoa beans was USD$10 billion in 2012, while the revenues for chocolate were up to USD$107 billion (ICCO, 2014). On a global level the cocoa global value chain shows a bi-polar system, with the chocolate market dominated by five firms that constitute 56% of the market and a second group of three other companies that concentrate half of the worldwide supply of cocoa ingredients.

The chocolate market is fragmented into two main sectors. The first, being the production of cocoa beans sector where most production comes from Africa (72,5%), followed by Latin America (18%) and Asia and Oceania (9.5%), where coincidentally most countries are still developing as we can observe in Table 3.1. While the cocoa processing industry is mainly located in Europe with a share of 37.4% followed by Africa (21.1%), America (21.1%) and Asia and Oceania with (20.4%) as shown in Table 3.2. It is worth mentioning that the price of cocoa beans is set daily by the London and New York cocoa future markets.

Table 3.1: Main producers of Cocoa beans in 2013/2014

	MT (Thousands)	**Participation %**
Africa	**3.068**	**72.5%**
Ivory Coast	1.796	42,5%
Ghana	740	17.5%
Cameroon	232	5.5%
Nigeria	195	4.6%
other	105	2.5%
America	**760**	**18%**
Ecuador	250	5.9%

Brazil	230	5.4%
Others	230	6.6%
Asia & Oceania	**401**	**9.5%**
Indonesia	325	7.7%
Papua New Guinea	36	0.9%
Others	40	0.9%
Worldwide total	**4.230**	**100%**

Source: ICCO (2014-Quarterly bulletin of Cocoa Statistics, Vol. XLII, No. 1

Table 3.2: Amount of cocoa processed by country 2013/2014

	MT (Thousands)	Participation %
Europe	**1.552**	**37.4%**
Netherlands	508	12.3%
Germany	415	10%
Others	629	15.2%
Africa	**876**	**21.1%**
Ivory Coast	559	13.5%
Ghana	234	5.6%
Others	84	2%
America	**873**	**21.1%**
USA	559	9.6%
Brazil	234	5.4%
Other	84	6.1%
Asia & Oceania	**873**	**20.4%**
Indonesia	398	8.1%
Malaysia	224	4.7%
Others	252	7.6%
Worldwide total	**4.146**	**100%**
Cocoa processed in country of origin	1.865	45%

Source: ICCO (2014- Quarterly bulletin of Cocoa Statistics, Vol. XLII, No.1

According to the Ministry of Agriculture (MAG, 2017) the average age of a cocoa producer is 55. There are two broad categories of cocoa beans: 'fine or flavor' cocoa beans and 'bulk' or 'ordinary' cocoa beans. Bulk cocoa beans come from Forastero trees while fine or flavour cocoa beans are produced from

Criollo or Trinitario. Fine or flavor cocoa beans are the ones that are generally used for premium quality chocolate and a limited number of relatively expensive, up-market finished products. "There are, however, known exceptions to this generalization. Nacional trees in Ecuador, considered to be Forastero type trees, produce fine or flavor cocoa" (ICCO, 2017:1). Ecuador and Trinidad and Tobago are the major fine or flavor cocoa producers.

According to the International Cocoa Organization (ICCO, 2015) the production of cocoa beans is highly fragmented since there are more than 5 million small plantations (1-3 Ha) worldwide. As a result small producers receive just 4-6% of the final consumer price, while the activities made by intermediaries and exporters such as processing give them 24% and the production and sale of chocolate retain from 70% up to 72% of the final consumer price. As we can observe this unequal division of earnings, just in terms of revenues, directly affects small producers. This will be discussed in further detail in relation to Ecuador in Chapter 5 and 6.

The demand for premium cocoa has increased over the past 10 years, with European countries such as Switzerland, Belgium, Belgium and the Netherlands as its main buyers, notably this is where the major chocolate producers are also located. This allows them to segment their markets even more, targeting a specific audience that would be looking for the finest chocolates. Premium cocoa covers up to 8% of the worldwide production, where 54% of its production takes place in Ecuador, making it the leader of this segment of the market.

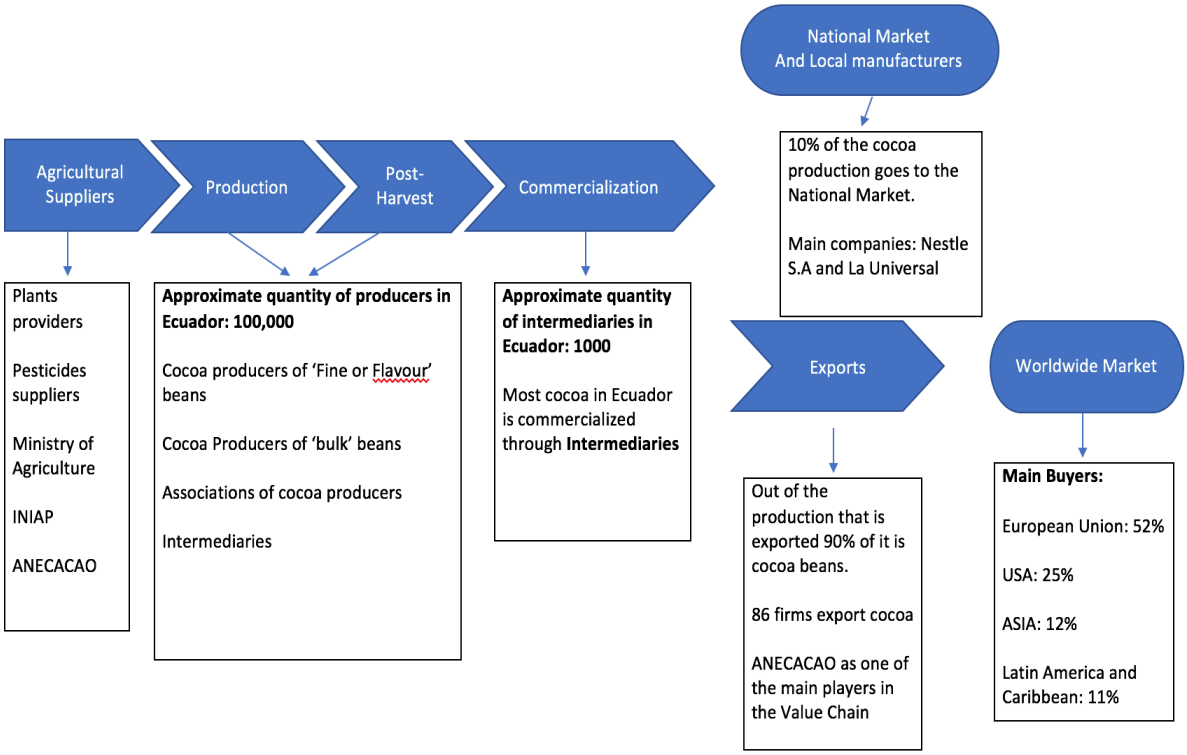
According to the National Association of Cocoa Exporters (ANECACAO, 2016) the total production of cocoa in Ecuador summed up to 250 thousand Metric Tons (MT) in 2014, of which 167 000 MT were of 'Fine or Flavor' and 82 500 MT were of the type CCN-51 (bulk beans). It is also estimated that approximately 600 000 people are directly related to the Cocoa Value Chain in Ecuador, meaning 4% of the population economically active (PEA). Around 90% of the Ecuadorian cocoa is exported as beans, with the USA as its main buyer followed by European countries. The other 10% is divided into two

local industries: 1) semi-processed products such as cosmetics and others, and 2) chocolate.

3.2 Ecuadorian Cocoa Value Chain

As mentioned earlier in Chapter 2, one of the aims of this research is to examine the Cocoa Value Chain in Ecuador. In order to achieve this the Global Value Chain theory is used, paying special attention to producers and intermediaries as relevant actors. Earlier it was explained that the process of exporting cocoa starts from its production and is fragmented from the beginning. The different actors and stages within the Cocoa Value Chain are specified in Figure 3.1, which serves as a map of the value chain.

Figure 3.1: Diagram of the Cocoa Value Chain in Ecuador and its actors



Source: Author's personal Collection

From Figure 3.1 it can be observed that there are seven main segments within the Cocoa Value Chain in Ecuador. This map is a general overview of how the Cocoa Value Chain in Ecuador is structured. ANECACAO appears as one of the most important players within this value chain, as 90% of cocoa bean production is exported. Similarly, it is possible to observe that the Government has little intervention in this value chain and mainly appears as an agricultural supplier since it brings support to producers. In order to tackle this low level interaction, in 2012 the Ministry of Agriculture created a department that would concentrate on the development and support of coffee and cocoa producers. According to the Ministry of Agriculture (MAGAP, 2012) there are approximately 100 000 cocoa producers in Ecuador where 90% of them owns less than 50ha and to which there are also 1000 intermediaries.

Regarding the export of cocoa beans, in 2015, 86 exporting companies were active, with 72 being individuals, 13 private firms and one public company. In the case of the exports of semi-prepared cocoa products there are 24 firms, with 22 being represented by individuals or private companies and two by a farmer's cooperative. In relation to the local market INIAP (2010) reports that in the case of the 'elaboration of chocolate' the market had revenues of USD$ 786 million, which belonged to 143 companies. This segment of the market is composed of local firms and subsidiaries from multinational enterprises. Nestle S.A. accumulated 66% of the revenues in 2010, followed by Confiteca S.A. (local firm) with 8% of the revenue.

As we can observe in figure 3.1 intermediaries play an important role within this value chain since they are strategically and geographically distributed around the major concentrations of small and medium size producers. In an effort to generate revenues, intermediaries punish the product presented by the producer and do not pay the official worldwide price set by the market. They compete aggressively amongst each other driving prices down and decreasing the earnings of these producers. The results of this interaction can be easily seen in the asymmetries within the distribution of the value added within the value

chain. Additionally, as is observed in figure 3.1 intermediaries not only participate in the area of commercialization, but also in the production and post-harvest segment. Intermediaries are deeply embedded in the Cocoa Value Chain in Ecuador. These characteristics and interactions are further analyzed in Chapter 5 and 6.

3.3 Land Structure in Ecuador

Since one of the main aims of this paper is to conceptualize the potential bargaining power of small and medium producers, an analysis of the Ecuadorian land structure is essential. It can be said that the size of production at the time of negotiation, can determine your bargaining power. The Ecuadorian Institute of National Statistics (INEC, 2016) outlines that the number of hectares with cocoa plantations in Ecuador is 559,617 with 445,876 of them (80% of the total) located in the coastal region. For the purposes of this study and in order to make a more accurate analysis producers are divided into three categories: small, medium and big. In table 3.3 the differences between them are outlined in terms of the area they have cultivated cocoa. This table, shows that even though, within the Ecuadorian market, small producers represent 58% of the total number of cocoa farmers their crops represent just 32,6% of the amount of area cultivated, while big producers represent 12% of the total number of producers and covers 22,8% of the area cultivated in Ecuador.

Table 3.3: Participation % of cocoa producers by size of crops

Type of producer	**Area cultivated**	**% of the total number of producers**	**% of the total amount of area cultivated**
Small	0.5≤5 ha	58%	32,6%
Medium	5≤50 ha	30%	44,6%
Big	>50	12%	22,8%

Source: Ecuadorian Institute of Nacional Statistics (INEC, 2016)

According to the data collected, there are just 104 firms/individuals that deal with the export of cocoa beans and semi-processed products, meaning that

regardless of the size of crops, as a farmer, you would have to sell them to another individual, who would later send it abroad. The differences would be whether this individual is an intermediary which would collect the different crops from different farmers and then re-sell it to the local companies/exporters, or a direct exporter. Most of the small producers have a direct relationship with intermediaries since, as claimed above, they are strategically and geographically located to make it more convenient in terms of transport and time for producers to sell their crops.

Chehab et al (2010:21) claim that "just 10% of the producers are organized in cooperatives that support themselves during the negotiation, certification and exportation (in some of the cases) processes and no more than 2% have a direct relationship with the semi-processed cocoa products industry". This also shows a lack of social capital and cohesion. Even though producers' crops are not significant in terms of volume produced, they do not form alliances to make it more representative and sell at a better price to the intermediary or an exporter. To support this claim Ramirez (2006:22) in an analysis of how cocoa crops are sold, specifies that "10% of the production are collected by intermediaries with a truck that would go around the different farms and bought the production on the spot, 76% would be bought by the intermediaries that are in the nearest town, and just 14% would be directly negotiated with exporters". These figures reflect that 86% of total production does not receive the international market price since, as mentioned above; producers receive a manipulated price from intermediaries who want to make a profit.

3.4 Production Levels in Ecuador

As mentioned earlier, in Ecuador, there are two main types of crops, premium cocoa beans which is 'Fine or Flavor' and 'Bulk' beans called 'Coleccion Castro Naranjal 51 (CCN-51)'. According to data shown by the MAGAP (2013), 49.7% of the cocoa crops in Ecuador have less than 10 years, while 13.3% of them are between 10 and 20 years old and 36.9% more than 20 years. As we already know most of the Ecuadorian crops are of the type 'Fine or Flavor' so it is fair to assume most of them are more than 10 years old. It is estimated that around 90% of the total production of cocoa 'Fine or Flavor' beans

are made in traditional or semi-industrial systems, while most of the CCN51 production have a semi-industrial or industrial system. It is worth mentioning that the CCN51 is a relatively new type of cocoa since it only appeared in the 1970s, but it only become widely planted in the 1990s.

According to Acebo (2016:15) "within this traditional cocoa production systems supplies and irrigation to maintain and improve the crops are not used generating very poor production level sometimes such as 136kg/ha which would still be exposed to losses due to plagues". At the same time in semi-industrial systems where activities such as irrigation and fertilization occur but in inefficient quantities, it limits the production to ranges of 272 kg/ha up to 544kg/Ha. While in industrial systems this is done properly improving the performance of the crops up to a range of 816 kg/Ha to 1814 kg/Ha.

There is a clear tendency towards the use of semi-industrialized and industrialized systems with the cocoa 'CCN-51' instead of the 'fine or flavor', even though this is the type that international buyers prefer from Ecuadorian producers. Nevertheless, this is attributed to two important factors: first the 'CCN-51' offers a higher productivity in comparison to the 'fine or flavor' because the potential production of the CCN-51 is up to 2.268 kg/Ha and starts to produce after 18-months of being planted. Whilst the 'Fine or Flavor' has potential that ranges from 816 kg/Ha and 1.814 kg/Ha, it takes a minimum of three-years to start producing. This means a higher investment for lower productivity, and due to the size and small economies that small producers have, they would be looking for crops that could offer them the best results in the shortest amount of time. Second, currently within the Ecuadorian cocoa market there is a very small or zero differentiation between the prices that the producer is offered for the two types of beans. Similarly, this is the case with certified 'fair trade' beans where this added value to the production is not recognized by the buyers/intermediaries, reducing incentives as well as the adoption of new and more sustainable production techniques. These factors do not incentivize producers to make investments for the maintenance and renovation of plantations of the cocoa 'Fine or Flavor' beans.

Chapter 4: Hectare by hectare in search of answers. Interview results and findings.

In order to analyze the ways in which intermediaries affect the production of small and medium cocoa producers, an understanding of the main features of these actors is needed. In this section, small and medium cocoa producers are characterized based on the data collected from the semi-structured interviews as described in the methodology section. A similar technique is implemented to the middlemen interviewed. Also, using the concepts outlined in Chapter 2, the roles and functions that the 'intermediary' has as an actor of the Cocoa Value Chain in Ecuador is outlined. The focus of this section of the paper is to purely outline in a descriptive and detailed manner the findings of the fieldwork done. The contributions to the analysis of intermediaries and producers made in this chapter serves as a tool to challenge (in chapter 5 and 6) the hypothesis that this GVC is mostly guided by market transactions, in particular arm's-length transactions. In addition, it also serves to show how, in most cases, transactions of different kinds take place leaving little space for producers and their opportunities for development within the cocoa value chain in Ecuador.

4.1 Small and Medium cocoa producers in Ecuador

The sample size of this study is relatively small with just 30 producers and 10 intermediaries. All the producers and middlemen included in this study are located in Milagro, Simon Bolivar and Naranjal, which are cities that are next to each other and in the province where 60% of cocoa production takes place. Due to the nature and intensity of the fieldwork conducted as part of this research, the sample has been chosen based on key characteristics in relation to the wider population rather than on the basis of any standalone mathematical or statistical probabilities. This helps to characterize the average intermediary and, small and medium producers.

As observed in Table 4.1 for instance, of the total producers interviewed 17 fit into the description of 'small producers' (0.5ha<5ha), whilst 13 are described as 'medium producers' (5ha≤50ha). The small:medium ratio has been

carefully selected in an attempt to mirror the split seen across the wider population. Furthermore, of the 30 interviewed three are females and 27 males, which reflects the fact that 90% of the wider gender split of cocoa producers are male (MAG, 2016) as shown in Chapter 3. Five of the producers belong to some form of 'association', which turned out to be led by a person who acted as an intermediary but just gave a better price to its 'associates' in comparison to other intermediaries.

Table 4.1: Description of Producers interviewed

	Date of In-terview	Location	Education Level	Gender	Type of Cocoa	Age of planta-tion	Size of plantation	Transportation of cocoa	Irrigation System	Any type of loan with the intermediary	Application of Post-harvest method
Producer 1	22/07/2017	Milagro	High School	Male	Fine or Flavor	4 years	5ha	Rent vehicle	No	No	Yes
Producer 2	22/07/2017	Milagro	Primary School	Female	CCN51	10 years	2ha	Own vehicle	Yes	Yes	Sometimes
Producer 3	22/07/2017	Milagro	High school	Male	Fine or Flavor	7 years	2ha	Own vehicle	No	No	No
Producer 4	22/07/2017	Milagro	University	Male	CCN51	4 years	8ha	Own vehicle	No	Yes	Yes
Producer 5	29/07/2017	Milagro	University	Male	CCN51	6 years	5ha	Rent a vehicle	Yes	Yes	Yes
Producer 6	29/07/2017	Simon Bolivar	High school	Male	CCN51	8 years	8ha	Own vehicle	Yes	Yes	Sometimes
Producer 7	29/07/2017	Simon Bolivar	High school	Male	CCN51	5 years	4ha	Intermediary Picks it up	No	No	Sometimes
Producer 8	29/07/2017	Simon Bolivar	High school	Male	Fine or Flavor	9 years	3ha	Own vehicle	No	No	No
Producer 9	29/07/2017	Simon Bolivar	High school	Male	CCN51	5 years	1ha	Intermediary Picks it up	No	Yes	Yes
Producer 10	29/07 /2017	Simon Bolivar	High school	Male	Fine or Flavor	7 years	3ha	Intermediary Picks it up	No	Yes	Yes

Producer 11	29/07/2017	Simon Bolivar	Primary school	Male	Both	8 years	4ha	Own vehicle	No	No	Sometimes
Producer 12	29/07/2017	Simon Bolivar	Primary school	Male	CCN51	8 years	3Ha	Intermediary Picks it up	No	Yes	No
Producer 13	29/07/2017	Simon Bolivar	High school	Male	Both	5 years	6ha	Own vehicle	No	No	Yes
Producer 14	30/07/2017	Milagro	University	Male	Fine or Flavor	10 years	2Ha	Intermediary Picks it up	No	Yes	Sometimes
Producer 15	30/07/2017	Milagro	High school	Male	CCN51	12 years	5ha	Own vehicle	Yes	No	Yes
Producer 16	30/07/2017	Milagro	High school	Male	Both	7 years	12ha	Own vehicle	Yes	No	Yes
Producer 17	30/07/2017	Milagro	University	Male	Both	6 years	7ha	Own vehicle	Yes	Yes	Yes
Producer 18	30/07/2017	Milagro	University	Male	Fine or Flavor	7 years	4ha	Intermediary Picks it up	Yes	Yes	Sometimes
Producer 19	05/08/2017	Milagro	High school	Male	Both	6 years	5ha	Own vehicle	No	Yes	Yes
Producer 20	05/08/2017	Milagro	University	Male	Both	5 years	4.5ha	Own vehicle	Yes	No	Yes
Producer 21	05/08/2017	Milagro	High school	Female	Fine or Flavor	4 years	2ha	Rents a car	No	Yes	Sometimes
Producer 22	05/08/2017	Milagro	High school	Male	CCN51	3 years	3ha	Intermediary Picks it up	No	Yes	Sometimes

Producer 23	10/08/2017	Milagro	Primary school	Male	CCN51	4 years	3ha	Intermediary Picks it up	No	No	No
Producer 24	10/08/2017	Milagro	High school	Male	CCN51	10 years	5ha	Own vehicle	No	No	Yes
Producer 25	10/08/2017	Milagro	High school	Male	Both	12 years	6ha	Own vehicle	Yes	No	Yes
Producer 26	12/08/2017	Naranjal	High school	Male	CCN51	8 years	5ha	Rents a car	No	No	Sometimes
Producer 27	12/08/2017	Naranjal	High school	Female	Fine or Flavor	15 years	3ha	Intermediary Picks it up	Yes	Yes	No
Producer 28	12/08/2017	Naranjal	High school	Male	Fine or Flavor	12 years	4ha	Rents a car	No	No	Yes
Producer 29	12/08/2017	Naranjal	High school	Male	CCN51	5 years	4ha	Intermediary Picks it up	Yes	Yes	Yes
Producer 30	12/08/2017	Naranjal	High school	Male	CCN51	8 years	6ha	Own vehicle	No	No	Sometimes

Source: Fieldwork 2017

In terms of the breakdown of plantations by type: 13 of the units grow CCN51, nine grow 'Fine or Flavor' and eight have mixed plantations i.e. both CCN51 and 'Fine or Flavor'. The research also shows that cocoa producers are changing their current 'Fine or Flavor' cocoa plantations to CCN51, which reflects the statistics within the industry that suggest (see Chapter 3) that CCN51 is more efficient and takes less time to produce crops (CCN51 takes 1.5-3 years, whilst 'Fine or Flavor' takes at least 4 years on average). As Producer 13 (2017) states, "the Fine or Flavor cocoa gives me very little cocoa beans, production is way lower than with CCN51 and is weaker against plant diseases (figure 4.1), therefore I am currently changing my plantation hectare by hectare to CCN51".

Regarding the transportation methods used by the producers: 15 have their own vehicles, five rent cars to transport their cocoa, and 10 arrange for their cocoa to be picked up by an intermediary. Similarly, 16 out of the 30 producers admitted that they share more than a transactional relationship with intermediaries, meaning they have either received a financial loan or soil fertilizer that can only be repaid with cocoa production and not money. As Producer 9 explains "sometimes I need to go to the intermediary to request a small loan from the middleman to survive while I wait my cocoa grows again".

Figure 4.1: Fine or Flavor Cocoa infected with "Escoba de bruja"

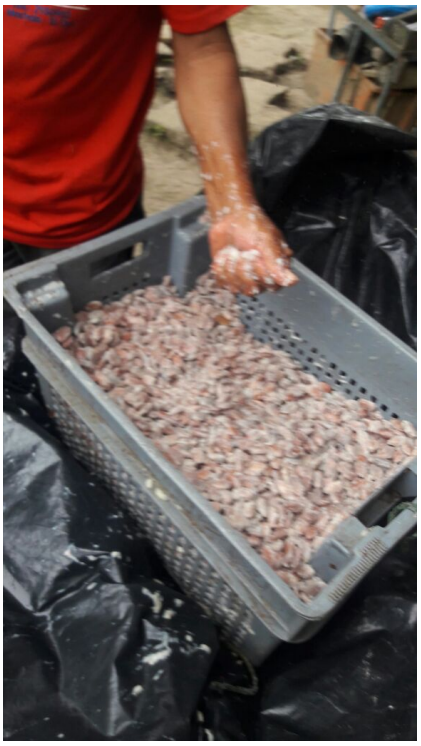
Source: Fieldwork 2017

Looking now at a description of the plantations themselves, the research shows that the overall average age of the cocoa plantations in the sample is 7.07

years and the average field size owned by the sample with plantations of cocoa on it is 4.84 ha. The average level of production per hectare from the sample is 46.99kg per month, which is perhaps skewed slightly by the lower yield of 'Fine or Flavor' cocoa as discussed above.

In relation to the level of technological use on the plantations, the research highlights that it is very low or non-existant as only irrigation systems are used, regardless not all have these in place - 12 out of the 30 have irrigation systems in place. A Producer 8 (2017) claimed that "an irrigation system is not needed because it is very costly and with the amount of profits I generated per sale it would not be enough to cover one. Besides I do not see how could this help me to improve my production". The post-harvest methods consist of drying and fermenting the beans, which usually takes between 3-5 days to complete. Of the producers interviewed 14 generally apply this post-harvest method (Figures 4.2 and 4.3), 11 sometimes and five mostly do not apply them at all. The application of the post-harvest method together with their lack of knowledge about what actions could improve the efficiency of their cocoa plantations could be related with their education level, which will be discussed in Chapter 6 when examining the producer's bargaining power. Through these interviews it was also found that there is substantial variation in the level of education obtained by the producers: four finished primary school, 19 finished high school and seven had a university degree.

Figures 4.2 and 4.3: Post-Harvest Fermentation and drying of the Cocoa beans after being collected



Source: Fieldwork 2017

4.2 Middlemen in the Cocoa Value Chain in Ecuador

The key findings related to the producers have now been concluded, and the observations relating specifically to the intermediaries will now be discussed. As explained at the beginning of this chapter, the sample consisted of a total of 10 middlemen. Table 4.2 presents the most important characteristics of the middlemen interviewed. As we can observe all intermediaries are male, who have spent an average of 18.5 years in the market (with the highest being 30 years, and the lowest 10 years). The geographical location of the sample is split across the three main cities of the coastal region of Ecuador: Milagro, Simon Bolivar and Naranjal. These cities are relatively near to each other in proximity, and are all within the Guayas province of the country. Four of the 10 intermediaries have their own cocoa plantations - one owns 5ha of 'Fine or Flavor' cocoa, whilst the remaining four own 10,7ha and 8ha of CCN51 respectively. Seven out of the 10 also buy and sell other commodities besides cocoa such as corn

and rice. Intermediary 7 (2017) said, "I had to start to buy other products such as corn and rice because throughout the years during a few months, production of cocoa was very low and I was not able to make profits."

With regards to the interaction between intermediaries and cocoa producers, six of the 10 middlemen claimed to offer transportation services to small and medium producers. In terms of support provided to the producers, four offer small loans, two offer transport and small loans, another two offer just transport and the last two offers nothing. The small loans generally tend not to exceed $300, with an interest rate between 0% and 20%. In all cases the intermediaries claimed they do not demand money as a repayment of the loan, they instead expect the loan to be repaid with cocoa beans. All intermediaries pay producers mainly in cash, with just three paying in cheque, in situations whereby the bill amounts more than $300. With regards to buying cocoa, 80% of the middlemen interviewed explained that they buy it in any state, meaning that they accept it even if no post-harvest method has been applied. Intermediary 6 (2017) claimed "it is even easier for me that producers bring cocoa to me right after they have collected it since I own machinery that would allow me to apply a most appropriate post-harvest method". These advantages that intermediaries have in comparison to small and medium producers will be reviewed in Chapter 6 with the objective of identifying the different reasons why producers mainly sell their production to middlemen

Table 4.2: Description of Middlemen Interviewed

	Date of Interview	Location	Gender	Do you pay cocoa in cash?	Offer cocoa collection services	Do you produce cocoa?	Do you export cocoa?	Do you offer loans to producers?	Do you just buy cocoa or other products as well?	Do you apply post-harvest methods to cocoa?
Intermediary 1	22/07/2017	Milagro	Male	Yes	No	No	No	Yes	Other products too	Yes
Intermediary 2	22/07/2017	Milagro	Male	Yes	Yes	No	No	Yes	Other products too	Yes
Intermediary 3	29/07/2017	Milagro	Male	Yes	Yes	Yes	No	Yes	Only cocoa	No
Intermediary 4	29/07/2017	Simon Bolivar	Male	Yes	No	Yes	No	Yes	Only cocoa	Yes
Intermediary 5	05/07/2017	Simon Bolivar	Male	Yes	Yes	No	No	Yes	Other products too	No
Intermediary 6	05/07/2017	Milagro	Male	Yes	Yes	No	No	Yes	Only cocoa	Yes
Intermediary 7	05/07/2017	Milagro	Male	Yes	No	No	No	No	Other products too	Yes
Intermediary 8	10/08/2017	Milagro	Male	Yes	No	Yes	No	No	Other products too	Yes
Intermediary 9	12/08/2017	Naranjal	Male	Yes	Yes	No	No	No	Other products too	Yes
Intermediary 10	12/08/2017	Naranjal	Male	Yes	Yes	Yes	No	Yes	Other products too	Yes

Source: Fieldwork 2017

Since middlemen are a focal point of this research, their specific features and activities within the Cocoa Value Chain in Ecuador must be defined. This definition is reached by using Rose's (1999) descriptions about the roles and function that an intermediary has, combined with the information gathered during fieldwork. The definition made by Biglaiser (1993:213) is taken as a starting point, where he explains that "middlemen are agents that make profits by buying a good from one individual and selling it to another at a higher price".

Rose (1999:47) identifies six functions that intermediaries could have. Starting from the 'spatial' function, which refers to the location of the middlemen. All the intermediaries interviewed were on the main roads of the small towns, very near to the entrance of the rural roads which are the unique access and exit point for small and medium producers to their cocoa plantations. The 'Temporal' function describes that an intermediary "compensates for temporal differences between demand and supply of goods" (Rose, 1999). This is the case for the middlemen in this study, as Intermediary 8 explains "even when exporters do not require cocoa but producers keep coming to me to sell it, I buy it and store it, since I know that by experience they would come later to ask for large amount of cocoa".

Regarding the 'Quantitative' function that explains that intermediaries decide about augmentation or reduction of the quantities in contracts. This is not the case for the middlemen interviewed since they all explained that they normally buy any amount of cocoa that the small or medium producer brings to them. The 'Qualitative' function (classification of goods) is performed by just three of the 10 middlemen, with the rest not differentiating between the different varieties of cocoa they buy. Middlemen usually put all the cocoa beans in one pile. Also, they do not recognize the premium that should be added to the producer's payment if 'Fine or Flavor' cocoa beans are being traded. Three intermediaries argued that they do this because the 'CCN51' cocoa beans have similar characteristics to 'Fine or Flavor' so there is no point in separating them.

The 'Credit' function is probably one of the main characteristics of intermediaries that helps the Cocoa Value Chain in Ecuador. This function explains that intermediaries compensate for temporal differences between delivery and payments by arranging credits. During the fieldwork eight out of 10 intermediaries explained that they offer loans to producers that could only be paid back with cocoa production. In parallel, 16 out of 30 producers admitted they have already taken a loan from an intermediary and had to pay it back with production. Lastly the 'Contact and advertising' function which explains that intermediaries liaise with trading partners for multiple activities. Besides working directly with exporters and producers, all the middlemen interviewed explained that they do not have any other ties with any institution neither public nor private. Thus, the functions performed by the Ecuadorian middlemen in the Cocoa Value Chain confirm what Driel's (2003:6) description, which states that "the central function of the middlemen is to absorb part of the risks, buyers and sellers face".

In terms of the roles that intermediaries could have, Rose (1999:48) outlines four: assortment builder (selection of goods and combination to an assortment), organizer (coordination of the different domains of the assortment of resources), transformer of quanta (transformation of quantities in supply and demand) and contractor (contracting with suppliers and consumers). After reviewing the functions that the intermediaries in the Cocoa Value Chain in Ecuador perform, it is clear that they only execute completely two of the four roles outlined above, i.e. 'assortment builders' and 'transformers of quantities'. The first role is fulfilled since the Ecuadorian middlemen buy from cocoa producers and distribute to exporters of cocoa beans. The second role is achieved since the intermediary needs to meet certain demands from exporters. Lastly the role of 'contractor' is partially fulfilled since the intermediaries do not engage in contracts with its suppliers, only with their consumers, which in this case are the exporters. The roles performed by these middlemen are in line with Rao's (2008:5) description, which states "middlemen are particularly suited to reduce uncertainty by bridging the gaps in the supply chain".

Chapter 5 Through 'the eye' of the middleman: what types of transactions take place between the middlemen, and small and medium cocoa producers?

The transactions that occur between small and medium producers, and middlemen are analyzed in this chapter. The Transaction Cost Economics (TCE) theory together with the concepts of information asymmetry and signaling are used for this analysis. In addition, the different power asymmetries that exist between exporters, intermediaries and, small and medium producers within the Cocoa Value Chain in Ecuador are discussed. This puts into context the resources and dynamics of the market. The route of the daily price of cocoa is an important aspect that needs to be considered in order to perform this evaluation. This chapter will also delve into the potential bargaining power of small and medium producers in relation to the middlemen within the Cocoa Value Chain in Ecuador. The concepts of Local Production Systems (LPS) and Clusters are used to perform a meso-level analysis since the scope of fieldwork covered just three neighboring cities. The aspects analyzed in this chapter contribute to an understanding of the ways in which intermediaries affect the production of small and medium cocoa producers.

5.1 The route of the price: how each actor finds out about it

Continuing with the analysis of the Cocoa Value Chain in Ecuador, the route of the price is detailed, as well as, how transactions generally occur between intermediaries and, small and medium producers. As previously mentioned cocoa is a commodity, and as such its price varies daily. In an interview with a representative from Olam, which is one of the biggest exporter companies in Ecuador, he explained that there are three referential prices: the London Futures Exchange, New York Futures Exchange and the ICCO daily price. He went on to say that Olam normally chooses the price that the New York Futures offers since it is the one used by international buyers.

From an academic point of view, using the GVC theory, it is possible to observe how even the exporters, who could be considered the owners of the Cocoa Value Chain in Ecuador at a national level, depend on the decisions that international actors make. The signaling concept helps us to understand how international buyers, alert cocoa exporters about the sources they should verify in order to find out the referential price. In this sense the international buyer is the signaler and the exporter the receiver. This is an example of the different power asymmetries that exist within the GVC of cocoa, as even though both actors hold the same information, international buyers are the ones that have the final word about the daily price. Cox (2004:7) explains that "power asymmetry in supply chain relationships is inevitable, there is need to understand the nature of and effects of power structures to provide win–win situations for all partners in the supply chain exchange or network".

In the case of intermediaries all of them revealed that they get the price from the exporters even though some have access to the Internet. Daily, the intermediaries call exporters to find out the price they are paying per ton. They call different exporters and generally offer their production to the one they consider offers the best price. Signaling is also present between these two actors, where the exporter behaves as the signaler and the intermediary as the receiver.

Six out of 10 intermediaries admitted they have access to the Internet and because of this are also able to check the daily price. This enables them to negotiate if they do not agree at first with the price that is offered by the exporter. Similarly, in the case of international buyers and exporters, power asymmetries are present in the relationship between exporters and intermediaries since even though both actors probably hold the same information about the price, exporters are the ones that would impose the daily price to the middlemen. Ambrose et al (2013:42) claims "the powerful partners may assume greater influence in the supply chain network, thereby providing some stability, or they may leverage their power advantage at the expense of weaker partners."

Of the middlemen interviewed, 80% of them admitted that they signed into contracts with an exporter they chose, setting a price and a certain number of tons in advance. These contracts are formed weekly. When asked whether there is a particular month or season that the intermediary is required to purchase an increased level of cocoa the most common response was, similar to the one given by intermediary 5 (2017) where he explained "the demand of cocoa that I require is depending on what the exporters ask from me. Generally, is bound to the price, the higher the price the more the exporter requires from me. This time last year I was buying more cocoa than now and the price was $130 per qa now is $75 per qa. The demand does not depend on the month I generally buy all the cocoa that producers come to offer me at all times".

On the other hand, producers heavily rely on intermediaries or their neighbors that also have cocoa plantations, for finding out the daily price. As Producer 17 explained "when I am in town I pass by the different intermediaries' collection centers and ask for the price of the day, if I have a production to sell, after hearing the price I decided based on that, whether to sell or not". All the producers interviewed gave a similar statement, with some saying that they also ask their neighbors to whom they sold their production and at what price. It is worth mentioning that none of the producers who were interviewed had access to the Internet in their house.

Stiglitz (2002: 469) explains that "information asymmetries arise between those who hold certain information and those who could potentially make better decisions if they had it". This dynamic is identified, within the TCE literature, as 'information costs' since the information flow is limited and there are certain barriers for the producer to get the price before reaching the buyer of its production. "If the price information is not correct, sellers could mistakenly select a market or transaction and be selling their produce at a lower price, thereby losing some of the possible profit" (Maltsoglou and Tanyeri-Abur 2005:4). This is also an illustration of information asymmetry with the intermediary being the signaler and the producer the receiver.

If producers would have access to the price that has been set by the exporter they would be able to bargain a better deal with middlemen since they would be aware of the real price. Certo (2011:41) states "individuals make decisions based on public information, which is freely available, and private information, which is available only to a subset of the public". Nevertheless, intermediaries prefer to take advantage of this situation increasing the transaction cost for the producer, reducing their potential profit and denying them the opportunity of being able to make a higher investment in their plantations to increase their productivity.

Williamson (1989) defines these actions within the TCE theory as 'bounded rationality' and 'opportunism'. From the side of the producer they have 'bounded rationality' since the information they hold about the price and the state of the market is very limited or non-existent. Thus, they are unable to understand correctly the business situation that is taking place. The fact that middlemen are taking advantage of the limitations of small and medium producers is an example of 'opportunism', where their actions are mainly guided by their interests, creating uncertainty and possible mistrust between these two parties. Ambrose et al (2013:50) confirm this by stating "the weaker firm may be more vulnerable to opportunism because it may not have effective mechanisms to monitor or its weak position in the relationship, it is also likely to comply with stronger partner requests for fear of losing business."

5.2 Relationships within the Cocoa Value Chain in Ecuador

At this point, after reviewing some of the dynamics that take place between exporters, intermediaries and small and medium producers it is possible to position these actors within the Local Production System of cocoa in the cities of Milagro, Simon Bolivar and Naranjal. These actors are operating within the same province and are specifically dedicated to the production, trade and exportation of cocoa, making them valuable actors of the value chain as portrayed in Chapter 3. Gomez (2011:190) explains that a LPS is "the territorial agglomeration of economic, political and social agents dedicated to a specific production

sector, no matter how strong or weak the connections among them may appear". Subsequently, the cluster concept helps us to understand the possible vertical and/or horizontal relationships that could exist between linked firms. Considering that these actors are operating in the same line of business and co-located in a specific geographic region (being exporters further away of intermediaries and producers which are closer to each other) it is fair to say that they are within the same cluster.

It is easy to deduce that within the Cocoa Value Chain in Ecuador there exist vertical and hierarchical relationships between its actors. This is observed when the actor that is above another within the Value Chain takes advantages of the need of the one below it by buying the cocoa production from the intermediary and/or the small and medium producers and imposing a price that is the most convenient for them. As Belaya et al (2009:48) point out, "the nature of power in supply chain relationships presupposes an asymmetrical distribution of power among partners because of differences in expertise, size, switching costs, dependence, contract structure and others". These characteristics could be attributed to the fact that since there are more than 100 000 cocoa producers, intermediaries can use the argument that if a producer does not want to sell to them another would. A similar dynamic takes place between exporters and middlemen since there are more than 1000.

5.3 Selling the Cocoa Production- Transactions between producers and intermediary

The transactions between intermediaries and, small and medium producers usually occur as follow: after the producer collects its production, independently if it applies a post-harvest method, they bring it to the center of town where most of the intermediaries are, after selecting to whom they would sell their cocoa based on the price, they allow the intermediary to weight their production. As explained earlier intermediaries apply a deduction between 15% and 35% on the weight of the production if the cocoa received a post-harvest method. If it is in 'pulp' state it would receive a deduction of 66%. After weighting it, the middlemen or person in charge of the collection center 'checks'

the level of humidity of the cocoa beans by taking a sample by hand of 10 to 20 beans and opens them in half (Figure 5.1). Subsequently, after deciding what the level of humidity is by 'observing' the beans, the intermediary tells the producer the level of deduction that will be applied. A process of negotiation starts, assuming the producer is not happy with the deduction level and after an amount is agreed upon, the intermediary pays the producer, in cash on-the-spot.

It is important to point out that all the intermediaries interviewed indicated that this is the only way they measure the level of humidity of the beans, meaning they do this 'by eye'. Equally, all the producers explained that they accept this method since it is a common practice in the market since many years ago and they do not know any other intermediary that measures the level of humidity of the bean in another way. The analysis made above also confirms the definition made by Biglaiser (1993:213) about intermediaries where he explains "that middlemen are agents who make profits by buying a good from one individual and selling it to another at a higher price".

Figure 5.1: Intermediary showing how he calculates the deduction that would apply to a producer

Source: Fieldwork 2017

By focusing on the transactions described above, that occurs between intermediaries and, small and medium producers, it is possible to identify the extent to which these affect cocoa production. Firstly, it should be noted that some producers are not interested in applying post-harvest methods (which on average would take 3-5 days). In the case of this research, of the sample 36% claimed they sometimes apply post-harvest methods and 17% admitting that they never do. Producer 2 (2017) explained that "it is easier for me to sell to the middlemen my production as soon as I collect it, even though I know I would receive a deduction on the money I should receive of 66%, since if I apply post-harvest method I would lose 3-5 days and I need the cash immediately to cover my bills".

As Maltsoglou and Tanyeri-Abur (2005:2) outline "the spectrum of the buying and selling decision made by the household are based on the difference between the market price and the actual cost faced by the household". This is also an example of the power asymmetries that exist in the Intermediary-Producer relationship. Using the 'signaling' concept and considering that 100% of the middlemen interviewed owned machinery to apply post-harvest methods in a more efficient way (figure 5.2), it can be interpreted that intermediaries would prefer to buy the cocoa in 'pulp' state and thus increase their profit margin. This signal is purposely sent at the time of sale when producers, that did apply a post-harvest method, receive a deduction between 15% and 35% in their payment, that the middlemen measure with their eyesight, representing a high level of inaccuracy.

The former activity illustrates the 'opportunistic' behavior that intermediaries have based on the TCE theory. After this, the percentage of deduction to the price is shared by the intermediary to the producer. If the producer disagrees with the deduction level a negotiation process starts. Generally, the intermediary holds the upper hand in these negotiations since, as explained earlier; the producers are regularly in financial need. These negotiations commonly finish on good terms. Five out of 10 intermediaries admitted that generally they give a high deduction on purpose to later start reducing it to give the feeling to

the producer that he is winning in the negotiations. Williamson (1989:139) confirms this by stating that "economic agents are permitted to disclose information in a selective and distorted manner. Calculated efforts to mislead, disguise, obfuscate are thus admitted".

After engaging in the bargaining process with an intermediary, it is very unlikely that a producer would disengage, since as told by Producer 12 "most intermediaries deal in a similar way, so there would not be any point in me leaving to another one, I would waste my time". Regarding this last aspect, subconsciously the producers acknowledge that they would reduce their negotiation cost (according to the TCE theory) by selling their production to one intermediary instead of looking for a different one since the probability of them receiving a similar treatment is very high. "Time spent at the market waiting to sell the produce is another negotiation cost, given that the time spent at the market could be exploited for other activities" (Matsoglou and Tanyeri-Abur 2005:6).

Figure 5.2: Industrial machine to dry the cocoa beans owned by an intermediary

Source: Fieldwork 2017

"A transaction that takes places between two unrelated parties, which is valued at a fair market value and that provides consistent and meaningful information is considered an arm's-length transaction" (Wilkinson, 2013). From the description above detailing the sale of cocoa from small and medium producers to intermediaries, it is possible to deduce that it is an example of a 'pure market transaction'. Even though the intermediary is the actor holding most of the information, he has to share it with the producer allowing both parties to have the opportunity to bargain and agree on a price. As Sturgeon and Lee (2001:83) state "the 'commodity supplier' (in this case the cocoa producers) provides standard products through arm's-length market relationships".

The description of how the sale of cocoa beans generally occurs is an example of the low level of bargaining power that small and medium producers have. This could also be associated briefly with the level of education that the producers in the sample have since they are not aware of any tool such as the Internet that could help them get information in order to improve their position at the time of negotiation. Being unaware of the inaccuracy of measuring humidity 'by eye' and accepting it just because it is a (informal) rule in the rural areas directly hurts their ability to generate profits and with this directly impacts the production of cocoa. Strauss et al (1997:20) explains that "pricing policies can have vastly different effects on the welfare of the household depending on whether the household is a net-seller or net-buyer". Adding to the low level of education, there is also the fact that the level of associativity between small and medium producers in Ecuador is very low, thus allowing intermediaries to deal individually with each producer.

Chapter 6 A sweet deal or bitter disappointment? Why do producers sell mainly to intermediaries?

This research paper has, up to this point, focused its analysis on the characteristics of the actors participating in the Cocoa Value Chain, the dynamics and the transactions that occur between them specifically intermediaries and, small and medium producers. Now, the main reasons behind producers mainly choosing intermediaries, as the buyers of their cocoa production will be analyzed. Factors such as location of the buyers and any other services offer by them will be considered. This section will also evaluate whether the transactions that happen between middlemen and, small and medium cocoa producers are mainly guided by the arm's-length principle or if there could be another type of dynamic such as long-term relationships. The power asymmetries that exist between intermediaries and, small and medium producers within the Cocoa Value Chain will be evaluated, as well as, the effect that these have on the transactions that take place between these actors. The Transaction Cost Economic theory will be the main tool to perform these analyses. This chapter sets out to review the opportunities for development of small and medium producers.

6.1 Behavior of intermediaries and producers during a transaction

As explained earlier in chapter 3, intermediaries are mainly located in the cities or small towns, which are surrounded by cocoa plantations. For a transaction to take place between the intermediary and the producer, the cocoa beans need to be transported to the collection center of the middlemen. Of the producers interviewed, 33% of them explained that an intermediary picks up their cocoa production. What is interesting to note here is how heavily reliant producers are on the intermediaries, to the extent that they may perhaps struggle to transport their produce without such actors. As producer 29 stated, "without the intermediary picking up my production on a weekly basis, my profits would be reduced substantially if I have to hire a car to take it to the city and then use my time to see to which middleman I would sell it and taking into account my production is very low."

As indicated earlier in Chapter 5, intermediaries hold the bigger share of power within the relationship with producers. For those producers who do not own a car, they recognize that their 'information cost' would increase if they did not arrange with an intermediary to pick up their production. This shows an adaptive behavior from the producer's side giving space for a new type of relationship. Ambrose et al (2013:43) claim that "it is not merely the possession of power that may drive partner adaptation and collaboration; rather, it is the way that power advantage is perceived to be exercised and in what context".

This research also suggests that small and medium cocoa producers set their price based on the different intermediaries they visit, and they generally accept this price, either because they trust the intermediary or they do not have any other choice as discussed earlier. 'Information costs' is one of the small and medium producers' most important issues to tackle, since it could greatly reduce their profit generation capacity. Nevertheless, both actors within this exchange transaction would always look for ways to increase their gains. Rindfleisch and Heide (1997:32) confirm the former statement by saying that "TCE stipulates that firms seek, from a feasible set of alternatives, the arrangement that safeguards their relationship at the lowest total cost".

Producer 26 (2017) claimed that "one of the main reasons why I decided to plant cocoa is because when you go and sell it to intermediaries you get paid by cash on the spot, while with other commodities such as rice or corn they would tell you to come back next week to collect the money". This was confirmed by all producers and intermediaries interviewed. It would be easy for the intermediary to leave the producer hanging with the payment and wait until the exporter pays him. Nevertheless, there are norms within the agricultural society in Ecuador that must be met in order for the Cocoa Value Chain to function. Ambrose et al (2013:43) explains that "buyers' and suppliers' willingness to make relationship adaptations and collaborate in joint activities is influenced by social obligations that develop during their transactions over time".

6.2 Exporters and, small and medium producers

All the producers within the sample confirm that it is very important for them to be paid in cash when they sell their production. There were four out of 30 small producers that attempted to sell their production directly to the exporter, but in each case the producer attempted to do so just once. The key reason behind this is that the exporters are located far away from the producers' crops, and they are willing to pay just $4-5 more per Qa. This discourages producers to deal directly with exporters, as they do not consider the increase in price (in comparison to the price intermediaries offer) substantial enough due to other costs such as shipment, which need to be cover. "TCE stipulates that the risk of partner opportunism creates the need for formalized governance structures, that is, the risk of opportunism limits the effectiveness of relational governance in exchange relationships" (Lambe et al., 2001:16). The former claim helps to explain why producers are more willing to sell to the middlemen around them as producer 19located in Milagro explains, "during two months I was selling my production directly to an exporter but every time I had to go there, fuel was costly and also, they generally paid in cheque and not in cash. This meant that every time I had to go inside the city centre of Milagro and cash it back. So, the $4-5 extra that I made per qa were not worth it at the end since I had to invest a lot of my time to make a sale".

Exporters also have tighter regulations and higher standards when buying cocoa beans, as well as a minimum amount per transaction. That said, they do use accurate methods for calculating the level of humidity and quality of beans, which in theory would increase the profit margin of the producer. This would include 'Fine or Flavor' cocoa where they would receive a premium, however my interviewees explained that in some cases their production was rejected because it did not meet the high standards. While intermediaries are willing to buy cocoa beans regardless of their state and in any amount as confirmed by all interviewees. Nevertheless, none of them receive a premium for 'Fine or Flavor' cocoa. Ambrose et al (2013:44) explain that "when firms make process, product

or service adjustments to help out their partners, the recipient firms become indebted, not necessarily contractually but socially." The former statement explains how the intermediary-producer relationship is shaped by social contracts and it reinforces the assumption that there is a stronger relationship than just arm's-length.

The different informal and formal rules that are in place within the Cocoa Value Chain in Ecuador are based on the level of communication that exists between the different actors within it. Ireland and Webb (2007:486) indicate that "communication refers to the formal as well as informal sharing of meaningful and timely information between firms. It helps supply chain partners to establish norms, values and expectations in a given relationship". Using the TCE theory regarding information costs and negotiation costs it is possible to identify that even though exporters could offer a higher price for the cocoa production from small and medium producers, factors such as the cost of transportation, the quantity produced and the quality of the beans, increase the risk of decreasing the profit margin. Pushing, up to a certain extent, the small and medium producer to sell to the buyer that is nearest to them and who has less strict regulations, which normally is a middleman. "Social obligations are developed and/or embedded in the prevailing power structures and relationship dynamics between the partners" (Ambrose et al, 2013:44).

6.3 Small and medium producers, and their finances

Small and medium producers are in constant financial need since sometimes during the year their crops do not produce enough to cover their bills. As was gathered during fieldwork, 18 of the 30 producers have up to five seasonal employees (November to February), whilst 12 have no employees. It is important to mention that many of these plantations are family based, where family members are part of the work force but do not get paid and every producer is considered a household. Regarding this issue, producers 4 and 18 (2017) mentioned that "with the current low productivity of the crops it is very hard to hire people since that would decrease the amount of profits I could make or not even

cover the costs of production, besides there is no support from the government, private institution or NGO".

To tackle the low productivity of cocoa plantations 17% of the producers interviewed grow plantains in addition to cocoa, whilst the remaining 83% grow cocoa alone. The research findings suggest that the reason why the five within the former category grow both plantains and cocoa is due to the shelter that the plantain trees provide, that it is thought to create better production yields for the cocoa plants. All five producers also agreed on the idea where they said, "I planted plantain next to my cocoa because when there is little or no production of cocoa beans the plantain helps me to generate profits to survive and wait until the cocoa grows again".

Another way in which small and medium producers generally tackle these financial deficits is by receiving a loan from intermediaries as discussed in Chapter 4. Six out of 10 middlemen claimed that besides their willingness to help producers to overcome their financial situation, their interest is to focus on ensuring these producers sell to them. It is well known within this cluster that any monetary loan from any intermediary must be repaid with cocoa production and not with cash. With the exemption of how the deduction level that intermediaries apply to the production of small and medium producers is measured selling the cocoa to an intermediary is less risky and more convenient for a small and medium producer.

As Benton and Maloni (2005:173) explain "non-mediated power sources are more relational and positive and consist of expert and referent power. The target (recipient) firm decides whether and how it will be influenced by the firm wielding the power". This also means that the intermediary would naturally search for ways to take care of their interest, for example by increasing their profit margins by measuring the humidity level in a subjective manner. Since middlemen control information such as the price and can decide where, when and how to make it available to producers, their bargaining power increases.

6.4 Long-term relationships and opportunities for development for cocoa producers

Harrison (2003:4) states that "transactions or relationships are not planned in full, with the use of legal sanctions to enforce contracts/settle disputes". Throughout this chapter, it has been made clear that between intermediaries and, small and medium cocoa producers exist interactions that go beyond 'pure market' transactions. All the intermediaries interviewed indicated that they are not involved in any formal contracts with producers due to the volatility of cocoa production in the country. This volatility is also one of the reasons why middlemen loan money to producers in exchange for them to guarantee they will sell their production to them when it is ready. Two of the unwritten rules within the Cocoa Value Chain in Ecuador, as claimed by all the producers and intermediaries interviewed, is that cocoa is paid in cash on-the-spot and that a loan that is given to a producer can only be paid back with production. These types of interactions support the existence of a 'long-term relationship' between intermediaries and, small and medium producers. To support this Macneil (1980:9) claims that "self-enforcement in business relationships, such as norms, industry customs, reputation, or an assumption of continuity, can be alternatives to contractual practices".

It is important to note that middlemen work as enablers for the functioning of the Cocoa Value Chain, since they offer their assistance to producers in terms of transport, financial aid or accepting to buy any amount or quality of cocoa as contrary to exporters. Nevertheless, it is evident that power asymmetries favour intermediaries within this value chain. Due to this, during each transaction middlemen intend to increase their gain by taking advantage of whatever situation the producer may be in. Their main way of doing this is by applying a significant deduction to the transaction that takes place at the time of sale. "Although the use of power advantage may be beneficial to the stronger partner in terms of enabling it to appropriate greater relationship value, it may negatively impact the value-generating potential of the relationship and/or irrevocably damage the relationship" (Gulati and Sytch, 2007:38). In other words, intermediaries work as a conservative force to small and medium producers within the Cocoa Value Chain since their opportunities for development are limited due to their low capacity of profit generation during each transaction.

Chapter 7: Conclusion

The main objectives of this research paper have been to understand the relationship between intermediaries and, small and medium cocoa producers, as well as to identify the ways in which intermediaries affect the production of cocoa from small and medium producers. In this regard, my main assumption was that intermediaries harm in a significant level the profit generation capacity of small and medium cocoa producers. The fieldwork was conducted in the Guayas province, where 40% of the cocoa production of the country takes place. The interviewees were from the cities of Milagro, Naranjal and Simon Bolivar. These cities are nationally known as hubs for the trade of cocoa securing a high level of representativeness in the sample. To answer the main research question of this paper, the sub-questions proposed were: who are the actors within the Cocoa Value Chain in Ecuador? What types of transactions take place between middlemen and, small and medium cocoa producers? And why do producers sell mainly to intermediaries in Ecuador?

A mapping of the Cocoa Value Chain was made in order to reach accurate answers for the questions proposed in this paper. The Cocoa Value Chain in Ecuador is divided into seven main segments starting from Agricultural Suppliers, Production, Post-harvest, Commercialization, Worldwide Market and National Market, and Local Manufacturers. This paper focused on the segments of Production and Post-Harvest where mostly cocoa producers and middlemen intervene. From this segmentation, the former two actors together with exporters were located within the Local Production System of cocoa, which Gomez (2011:190) defines as "the territorial agglomeration of economic, political and social agents dedicated to a specific production sector, no matter how strong or weak the connections among them may appear".

With the assistance of Rose's (1999) definition of the roles and functions that an intermediary generally has, an accurate characterization of the middlemen participating in the Cocoa Value Chain in Ecuador was made. These inter-

mediaries have spatial, temporal, qualitative and advertising functions. After reviewing the functions of intermediaries in the Cocoa Value Chain in Ecuador, it was found that they execute completely only two of the four roles outlined above as 'assortment builders' and 'transformers of quanta'. This definition of Ecuadorian middlemen contributed to the analysis of the reasons why small and medium cocoa producers mainly sell their production to intermediaries. It also helped to understand the relationships and what guides the transactions that exist between these two actors.

Detailing the route of the price in the Cocoa Value Chain in Ecuador was essential for understanding the different power and information asymmetries within this network. Exporters are the ones that mainly control the information about the price even though it could be accessed through the Internet. This information is transmitted to intermediaries and they are the only source for small and medium producers to find out about the price. This paper has formulated academic knowledge about the hierarchical and vertical relationships that exist between intermediaries and, small and medium cocoa producers. The type of transactions that exist between intermediaries and, small and medium cocoa producers, were analyzed under the Transaction Cost Economics theory to understand how these affected the profit generation capacity of producers. This analysis showed that intermediaries take advantage of the information asymmetries in this Value Chain and send deceiving signals to producers in terms of the price, applying different deduction levels that are measured 'by eye'. Producers explained that they accepted the level of deduction given by intermediaries because this is the only way it is 'done' within the agricultural *sector* in Ecuador. This supports the belief that norms and values are respected within the Cocoa Value Chain in Ecuador.

There are a variety of reasons why small and medium cocoa producers mainly sell their production to intermediaries. Even though exporters could offer a better price and technology to measure in a more accurate way the deduction level for the price of crops, producers prefer middlemen. Intermediaries are conveniently located near the cocoa production hubs. They are outside the main

roads. Producers do not generally own their own car so they are not able to transport their production without depending on someone else. Due to this some intermediaries also offer transport services free of charge or just charging the amount of fuel. Middlemen also offer loans to small and medium producers and ask to be paid back with production. Intermediaries also pay for cocoa only in cash and accept any quality or quantity while exporters have tighter regulations regarding these items. These interactions show that the relationships and transactions that exist between intermediaries and producers are not only guided by the 'arm's-length principle' but they also have a long-term relationship.

Reading this research paper would allow policy makers to be better informed on the rationale of intermediaries and their role within the Cocoa Value Chain in Ecuador. Also, to know the actual position of small and medium cocoa producers within this Value Chain and their low bargaining power in front of buyers. One of the conclusions this study has reached is that higher control over the pricing practices within the agricultural sector is needed. The lack of control on the pricing methods that intermediaries apply is what allows them to take advantage of producers and diminish their profit generation capacity.

Equally, policy makers and actors such as the Ministry of Agriculture should increase their efforts in empowering the small and medium cocoa producers. The fact that they only have access to the price through intermediaries puts them in a disadvantageous position at the time of negotiation. Policies that would make producers acknowledge the importance of applying a post-harvest method since these would improve the quality of the bean and their profit generation capacity should also be developed taking into account that most of the producers in this sample had a low education level. There are a lot of measures that could be taken from the different actors within the Cocoa Value Chain in order to increase the profit margin of producers but after interviewing government officials and exporter companies' representatives it appears that there is very little willingness to commit to changes in this value chain.

In this research paper, it has been made clear that intermediaries work as enablers for the functioning of the Cocoa Value Chain in Ecuador since they offer a variety of services that help the cocoa producer to sell its production. Nevertheless, they also work as a conservative force that limits the profit generation capacity of the small and medium cocoa producers due to their subjective manner in measuring the level of deduction at the time of sale. This limits the opportunities for development of the Ecuadorian small and medium cocoa producer.

To finalise, this study has help to uncover the blind spot in academic research about intermediaries in Ecuador. Contributing to the literature about middlemen with the dynamics and the defects that exist in the relationship between intermediaries and cocoa producers. These defects could also be mirror in other agricultural commodities value chains within developing countries with similar interactions. For this reason, this study could be taken as a reference for policy makers and academics to develop local development strategies that would have the aim to empower the small and medium producers of any agricultural product, as well as, reduce the economic inequalities within a given value chain.

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