The Effectiveness of Market-Based Social Governance Schemes: The Case of Fair Trade Coffee

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ABSTRACT: Market-based social governance schemes that establish standards of conduct for producers and traders in international supply chains aim to reduce the negative socio-environmental effects of globalization. While studies have examined how characteristics of social governance schemes promote socially responsible producer behavior, it has not yet been examined how these same characteristics affect consumer behavior. This is a crucial omission, because without consumer demand for socially produced products, the reach of the social benefits is likely to be limited. We develop a comprehensive model that links two characteristics of market-based social governance schemes—(1) stringency and enforcement of requirements, and (2) promotion—to two conditions required for governance schemes to generate significant social benefits: (1) socially responsible behavior of participating firms; and (2) consumer demand for socially produced products which, in turn, expands products produced according to social governance schemes, and thus, the quantity of social benefits. We discuss market-based social governance schemes in the context of fair trade coffee.

INTRODUCTION

MARKET-BASED SOCIAL GOVERNANCE SCHEMES such as fair trade have been touted as ideal solutions to social inequities resulting from international trade (DeCarlo, 2007). These schemes harness the benefits of free (i.e., liberalized) trade such as the specialization of production, consumer choice, and economic growth (Dollar & Kraay, 2004) while promoting social justice outcomes (Oxfam, 2002) and capacity building (Raynolds, Murray, & Taylor, 2004) that are absent from free trade under imbalanced market power conditions (Hira & Ferrie, 2006; Murphey, 1998). Market-based social governance schemes like fair trade aim to change the behaviors of producers and traders in international trade by establishing production and transaction standards such as environmentally-friendly production methods, minimum age for work, and fair prices paid to producers, as well as mechanisms to enforce these standards (Conroy, 2007; Moore, 2004), in order to improve the lives of the producers and their communities (Bartra, 2002). Market-based social governance schemes communicate this to consumers by marking the products manufactured and traded according to their standards (e.g., via fair trade labels), marking the shops in which these products are sold (e.g., the Fair Trade Federation's seal displayed at fair trade shops), or using other promotional tools. This allows consumers to identify responsibly traded products and to incorporate social considerations in their purchasing decisions. Thus, market-based social governance

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schemes can catalyze changes in producer, trader, and consumer behaviors in ways that may lead towards overall social benefits (Velasquez, 1992).

We develop a model that explores the potential and the limits of market-based social governance schemes to create social benefits. Our model explicitly considers how the design of requirements and the promotional activities of market-based social governance schemes affect both producer behavior and the purchasing behavior of consumers. Most of the research to date has explored how the design elements of market-based social governance schemes affect producer behavior, such as how the stringency and enforcement of the scheme's requirements influence producers' compliance with these requirements (O'Rourke, 2003; Kolk & van Tulder, 2002). What is missing from the analysis is how these design elements affect consumer behavior. This is a critical omission in so far as consumer demand is necessary for the functioning of market-based social governance schemes. Without high levels of demand, producers will likely not participate in market-based social governance schemes, leading to their decline. Our focus on the purchasing behavior of consumers also incorporates insights from the marketing and ethical consumerism literature. Taking into account that not all consumers are alike, we consider how a given consumer's "involvement" with the product (Petty, Cacioppo, & Schumann, 1983) affects how he or she might act towards a change in design or the promotion of the market-based social governance scheme. We develop several propositions about how design and promotion elements of market-based social governance schemes affect producer and consumer behaviors, and draw implications for the organizations which create and operate such schemes and illustrate these propositions using fair trade, one of the most well-known of the social governance schemes.

The paper proceeds as follows. We set the context with a brief account of fair trade, a specific example of a market-based social governance scheme. Next, we discuss market-based social governance schemes more generally and develop a model linking two design elements of these schemes (requirements imposed on producers and promotion) to producer and consumer behaviors. We offer a discussion as to the trade-offs that market-based social governance schemes face as they tighten requirements and enforcement as well as a discussion about the relationship between mainstreaming and low involvement consumers. We end with suggestions for future research.

A BRIEF TALE OF FAIR TRADE COFFEE

Much has been written about fair trade generally and how it pertains to products such as coffee (see for example, Bacon, 2008; DeCarlo, 2007; Hira & Ferrie, 2006; Hutchens, 2009; Moore, 2004). The purpose of our description is simply to set the stage for our model about market-based social governance schemes.

The modern fair trade movement reaches back primarily to religiously affiliated groups that were operating predominantly in rural areas of developing countries from the late 1940s through today (Low & Davenport, 2005). These groups were chiefly interested in improving the social welfare of the people with whom they worked, and they noticed that the direct sales of these people's crafts into rich foreign markets might be a way to raise incomes of these communities, thereby increasing social welfare. The middleman, who had earned the lion's share of profits in conventional trade, was eliminated, permitting the fair trade organizations to offer local artisans and farmers higher prices for their goods. The relief agency Oxfam also entered this market in the 1960s by establishing retail shops and mail order for the crafts of small-scale artisans from poor countries. By the 1970s, a worldwide system of "alternative trade" had been set up by several religious organizations and many NGOs (Low & Davenport, 2006). Sales occurred largely through non-traditional outlets, such as church bazaars, craft fairs, health food stores, and mail order organizations (Low & Davenport, 2006).

During the 1980s, falling commodity prices created new opportunities to expand fair trade (DeCarlo, 2007). In the 1980s, Dutch missionaries established a fair trade scheme, "Max Havelaar," aimed at assisting small coffee farmers in southern Mexico. The intention was to create a system to pay a living-wage price for the coffee, a social premium for the producers (more below), and to distribute and sell this product into the developed world as a fair trade item. By the late 1980s, two fair trade organizations, Max Havelaar and The Fairtrade Foundation in the U.K., introduced labeling schemes to inform consumers that the product was produced, traded, and sold in accordance with fair trade principles, laying the groundwork for fair trade products to be distributed through mainstream channels (Raynolds et al., 2004). Labeling remains the number one way to communicate to consumers who have not previously purchased fair trade products (Alter Eco, 2008: 27). In 1997, Max Havelaar, The Fair Trade Foundation, and several other national labeling initiatives, such as TransFair USA, joined into an international organization called the Fairtrade Labelling Organisations International (FLO).

The FLO system is the dominant fair trade scheme worldwide. The FLO standards cover three main areas: producer behaviors, trader behaviors, and promotion to consumers. FLO's standards were originally aimed at small producers (later expanded to plantations) and address a number of social issues in production such as labor conditions, including a prohibition on forced or bonded labor, minimum age requirements, freedom of association and collective bargaining, and workplace safety requirements (Fairtrade Labelling Organisations International, 2007: 22–24). FLO's producer standards also include environmental requirements for the use of sustainable farming practices, conservation of natural resources, prohibition of the use of certain chemical pesticides and fertilizers, waste reduction and recycling, soil and water preservation, prohibition of the use of fire to clear land, organic farming requirements, and prohibition of the use of genetically modified organism crops (Fairtrade Labelling Organisations International, 2007: 7–22).

FLO's trading standards aim to raise the prices that farmers receive for their coffee. FLO establishes minimum prices for coffee produced using the FLO standards that exceed current world market prices. For example, the current FLO minimum price is $1.25 per pound for Arabica coffee (or $0.10 higher than the market price, whichever is higher). Moreover, FLO dictates that traders need to provide up to 60 percent of the contract value as pre-finance to the producer anytime after signing the contract at the producer's request (Fairtrade Labelling Organisations International, 2007). Additionally, the FLO standard mandates that a social premium of $0.10 per pound be paid to the local producer cooperative, which can be used by the community for education, health care, and infrastructure projects, as well as to purchase farm equipment (Moberg, 2005). A system of third-party auditing is used to enforce compliance with these producer and trader standards (FLO-Cert, 2010).

Finally, FLO provides for the promotion of fair trade products to consumers. Its national labeling initiatives allow traders and roasters to affix the FLO "Fair Trade" logo on coffee that has been produced and sold according to the fair trade scheme's standards. In the U.S., TransFair USA, the U.S. affiliate of FLO, lists about 600 companies that license coffee through them. These exporters, importers, roasters, and retailers pay a licensing fee to designate their coffee as fair trade, which gives them the right to affix the TransFair USA logo to their products and to use other promotional materials. FLO's and TransFair USA's web-sites provide information about fair trade and links to other fair trade organizations. FLO also sponsors events to increase the public awareness of fair trade.

Several smaller fair trade schemes exist outside the FLO fair trade scheme. These schemes have established requirements and enforcement mechanisms that differ from FLO's standards. Many of these schemes are practiced by single companies, sometimes termed "direct trade" schemes, and they often boast of standards that exceed FLO's. Counter Culture Coffee, a direct trader, says that it uses higher standards on quality, transparency, and fair pricing than the FLO system (Counter Culture Coffee, 2010). As Green as It Gets, another fair trade company, discusses that its long-term commitment to farmers is superior to the FLO standard (As Green as It Gets, 2010). Intelligentsia Coffee's producer standard is to work directly with their farmers continually, "with both sides investing a lot of time and energy to make something great" (Intelligentsia Coffee, 2010) and to hold annually the Extraordinary Coffee Workshop to unite their farmers to share the best in technologies and agricultural techniques.

Sales of fair trade goods have grown vigorously over the past twenty-five years, and especially over the past decade (TransFair USA, 2010). Sales of all fair trade products—including coffee, tea, cocoa, fruits, vegetables, nuts, rice, sugar, spices, and wine—amounted to just over $3 billion in 2007, up nearly 300 percent from 2004 (Fairtrade Foundation, 2009). Coffee is the product with the largest share of fair trade (Fairtrade Foundation, 2009). In the U.S., in 2009, fair trade certified coffee imports were 109.9 million pounds, up 25 percent over 2008 (TransFair USA, 2009), with a 3.31 percent share of the overall coffee market (Fair Trade Federation, 2008). This relatively small share indicates that there is much room to grow.

MARKET-BASED SOCIAL GOVERNANCE SCHEMES

Market-based social governance schemes are part of a new voluntary infrastructure for controlling firms' social conduct in the global economy. This infrastructure is not designed and enforced by governments, but by private actors such as non-governmental organizations (NGOs) that desire to pressure participating organizations for greater social responsibility, accountability and transparency (Vogel, 2008; Waddock, 2008). This voluntary infrastructure has emerged in response to concerns over the effects of free trade on national governments' ability to regulate the conduct of firms in the global economy (Keohane, 2003; Strange, 1996). The increasing prominence and role of NGOs and civil society in global politics, and the fact that many NGOs have shifted their focus from influencing government regulations to directly targeting firms, have also contributed to the development of voluntary non-governmental mechanisms to regulate firms' conduct (Falkner, 2003). Approximately 300 international standards and codes now govern firms and industries competing and trading in the global economy (Vogel, 2008).

Market-based social governance schemes aim to harness the power of markets and consumer demand to create social benefits. These governance schemes generally establish a set of social and/or environmental requirements to which firms and other private actors participating in the scheme need to adhere and mechanisms to enforce firms' compliance with these requirements. For many market-based social governance schemes, products that are made by firms participating in the scheme display a label or other mark that is intended to inform external stakeholders such as consumers about the social and/or environmental conditions under which the product was produced. Product labeling increases the transparency of producers' and supply chain members' social conduct to external stakeholders and empowers consumers to engage in politics via markets (Micheletti & Stolle, 2007) by incorporating social and environmental considerations into their purchase decisions. For example, TransFair USA's logo can be found on bags of coffee that have been produced and traded in accordance with FLO's fair trade standards, allowing consumers with no direct contact with producers to incorporate social dimensions of production and trading into their criteria for purchasing coffee.

When evaluating the ability of market-based social governance schemes to produce social benefits, we need to acknowledge that defining the effectiveness of these schemes is complex (Terlaak, 2007). The stated goal of most market-based social governance schemes is to influence the socially responsible behavior of the participating organizations to create social benefits such as improving living, working, and environmental conditions. In addition, these schemes can provide a range of secondary benefits such as initiating a company and stakeholder dialogue, reaching global consensus on acceptable social responsibility practices (Hsieh, 2006), and increasing consumer and producer awareness of social issues (Strachan, Sinclair & Lal, 2003). For the purpose of this paper, we follow Terlaak (2007) and focus on the stated purpose of most market-based governance schemes—their ability to influence the socially responsible behavior of participating firms—as one criterion for evaluating their effectiveness. For example, FLO's Generic Fairtrade Standards for Small Farmers' Organizations (Fairtrade Labelling Organisations International, 2007) requires that producers form into cooperatives or associations, use a democratic governance structure, report upon its use of the social premium, adopt environmentally sound growing methods, and abide by specified labor standards. A governance scheme's quality of social benefits depends on the extent to which participating firms adopt practices that result in adequate living and working conditions for the people involved in producing the product or that mitigate negative socio-environmental effects of their operations or products.

Merely focusing on the social behaviors of participating organizations is, however, not sufficient for evaluating the ability of market-based social governance schemes to generate social benefits. Critics suggest that most market-based governance schemes reach only small “enclaves” in the global economy rather than gaining universal adoption (Pearson & Seyfang, 2001). If only a few firms participate in a scheme that gives rise to high *quality* social benefits, the overall social benefits of this governance scheme are limited as they only reach a few individuals. Thus, we also need to consider the *quantity* of social benefits created by the scheme. The quantity of a market-based social governance scheme’s social benefits depends on the governance scheme’s reach, i.e., the quantity of output produced by participating producers. Output can be increased by the expansion of already participating producers or by attracting new producers that decide to participate. As output expands, more individuals enjoy the social benefits arising from the production and trade of products producing according to the governance scheme’s requirements.

We argue that the quality and quantity of social benefits realized by different market-based social governance schemes are likely related to the design of these schemes. However, not much is known about the relationship between the design of these schemes and their ability to create social benefits (Vogel, 2008). While the literature has identified design elements of governance schemes that affect its influence on participating producers’ behavior, and hence the quality of social benefits, we do not know much about how design elements of governance schemes affect their reach, and hence the quantity of social benefits. Consumer demand is critical for increasing the reach of market-based social governance schemes, because demand drives the expansion of output by participating producers or attracts new producers to participate (Auger, Burke, Devinney, & Louviere, 2003). Without consumer demand for products with the governance scheme’s label, the scheme will not achieve the reach necessary to have a sizable impact on improving social conditions. We draw on the consumer behavior literature to explore the relationship between governance scheme design and consumer demand for the labeled product.

We develop a model with propositions that link the design of market-based social governance schemes to producer and consumer behaviors. This model can be seen in Figure 1, where the numbers on the arrows relate to the propositions we develop below. We focus upon two critical design elements: (1) the requirements of the scheme; and (2) the promotion of the scheme. The requirements of the scheme are primarily intended to affect producer behavior and the promotion of the scheme is intended to affect consumer behavior. The dark shaded arrows in Figure 1 show these intended effects. Research has shown that two characteristics of governance schemes’ requirements—stringency and the enforcement of compliance—affect the behavior by participating producers (Christmann & Taylor, 2006; Kolk & van Tulder, 2002; O’Rourke, 2003) and thus the quality of social benefits. Promotion affects the public’s knowledge of the governance scheme, which is important for consumer behavior (Schuler & Cording, 2006), and thus the quantity of social benefits. However, our model shows that the relationships between the requirements and promotion on the one hand and consumer behavior on the other are more complex and go beyond the intended effects. Requirements do not only have the intended effects on producer behavior but affect also consumer behavior as shown in the lightly shaded arrows in Figure 1. We also identify several moderating effects shown by the non-shaded arrows in Figure 1. Promotion activities moderate the relationship between requirements and consumer behavior. Furthermore, our model incorporates differences between types of consumers. We propose that consumer type moderates all relationships between the governance scheme design characteristics and consumer behavior.

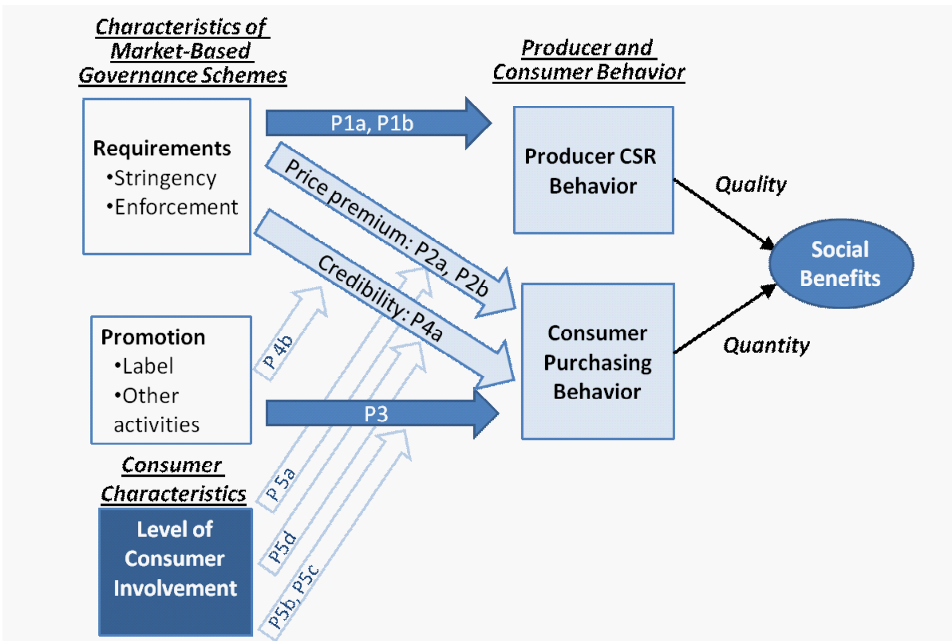

Figure 1: Effects of characteristics of market-based social governance schemes on social benefits

Behavior of Participating Producers

Two aspects of market-based social governance schemes influence the extent to which these schemes contribute to socially responsible behavior of participating firms: the stringency of requirements specified by the governance scheme and the enforcement mechanisms used to ensure that participating firms comply with the governance scheme's requirements (Hemphill, 2004; Kolk & van Tulder, 2002). First, given a particular issue (i.e., working conditions), market-based social governance schemes generally vary in the stringency of their requirements. For example, FLO's fair trade regimes prohibit producers from using pesticides and chemicals that are banned by the World Health Organization and other international conventions (Fairtrade Labelling Organisations International, 2007: 15) to increase yields, mitigating the negative human and animal health effects of many of these chemicals, while other fair trade regimes do not have such a prohibition. Another example is that some fair trade schemes mandate a minimum price per pound of coffee at \$1.25, while others pay \$1.60 per pound. The more stringent the requirements of a governance scheme, the higher the likelihood that participating firms will act in a socially responsible manner (Sagafi-nejad, 2005).

> PROPOSITION 1a: The more stringent the requirements of a market-based social governance scheme, the more likely participating organizations engage in behaviors that increase social benefits.

Second, enforcement mechanisms of market-based social governance schemes that generally include independent third-party auditing of participating organizations and sanctions for non-compliance (Conroy, 2007) differ across governance schemes. Some schemes require that participating firms undergo third-party audits, in which external auditors verify that the firm complies with the scheme's requirements and issue certifications for firms that pass. Other schemes rely on self-monitoring of the participating firms that declare themselves compliant with the requirements of the scheme. In fair trade, we see a range of auditing. For example, coffee roasters certified by TransFair USA use third-party auditors through an international system (FLO-Cert), Counter Culture Coffee hires a commercial third-party auditor to perform such a function, and Intelligentsia Coffee does not use an auditor at all. Generally, third-party auditing can be considered a more stringent enforcement mechanism than auditors working for the governance scheme because third-party auditors are likely to be more objective as they have less of a stake in the audit outcomes. Self-auditing by participating organizations is considered less effective than auditing by external parties, because the organization has a vested interest in passing the audit and also is less likely to have the auditing capabilities of a professional auditor.

Research has shown that without effective enforcement, participating organizations may not comply with standard requirements (Boiral, 2003, 2007). Some producers are more interested in the potential private benefits of participating in market-based social governance schemes such as increased legitimacy or sales than in contributing to the social benefits associated with implementing the schemes' required practices (Boiral, 2003). These producers have incentives to simply declare that they comply with a scheme's requirements or to do the minimum required to pass external audits without fully implementing the required practices in their daily operations. No or weak enforcement mechanisms allows these producers to provide the appearance of compliance with a scheme's requirements without actually adhering to the requirements on an ongoing basis (Boiral, 2003; Christmann & Taylor, 2001).

> PROPOSITION 1b: The better the enforcement of a market-based social governance scheme, the more likely participating organizations engage in behaviors that increase social benefits.

Behavior of Consumers towards Social Label Products

The quantity of the social benefits created by market-based social governance schemes hinges on consumer demand. Organizations will participate in these schemes only if sufficient demand for products with social labels exists. However, little is known about the effect of governance scheme design on consumer purchasing behavior and demand for socially labeled products.[1] This section draws on insights from the ethical consumerism and consumer behavior literatures to explore the effect of governance scheme design on consumer purchasing behavior towards labeled products. Ethical consumerism is a multidisciplinary literature that deals with the consumption of "ethical" products, such as fair trade, non-sweatshop, ecologically-friendly/green, and produced without cruelty to animals. We focus upon two major questions addressed in the ethical consumerism literature: (1) Are consumers willing to pay for ethical products? (Bird & Hughes, 1997; Creyer & Ross, 1997); and (2) Are consumers aware of ethical products and their attributes (Auger et al., 2003)? Our model also draws on the elaboration likelihood model (Petty & Cacioppo, 1990; Petty et al., 1983; Petty & Wegener, 1999) from consumer behavior to assess how the effects of requirements and promotion activities of governance schemes on purchasing behavior may differ across different types of consumers.

Willingness to Pay for Ethical Products

A critical question for ethical consumerism is whether consumers are willing to pay for ethical products. Creyer and Ross (1997) make the strongest claim in support of ethical consumerism showing that consumers will pay a premium for a company's good ethical practices (i.e., fair trade) and demand a discount for bad ethical practices (i.e., sweatshop labor). Auger and colleagues (2003) find in a series of experiments that subjects positively valued the ethical features of bath soaps and athletics shoes after controlling for other product features. However, a review of the literature softens these claims. Perhaps the strongest conclusion to emerge across studies is that consumers seem more willing to punish unethical business practices and products by refraining from purchases than to reward ethical practices and products with their purchases (Carrigan & Attalla, 2001; Folkes & Kamins, 1999). Furthermore, while many consumers form positive attitudes towards ethical products and negative attitudes towards unethical products, they are often unwilling to act upon these attitudes in their purchase behavior. Many studies strive to understand this attitude-behavior gap in ethical consumerism (Carrigan & Attalla, 2001; Chatzidakis, Hibbert, & Smith, 2007; Kalafatis, Pollard, East, & Tsogas, 1999), with several identifying that the consumer's ethical obligation, an individual-level construct, is significantly related to her attitude and behavior towards an ethical product (Ozcaglar-Toulouse, Shiu, & Shaw, 2006; Shaw & Shiu, 2003).

Producing and trading products with social attributes generally results in higher costs than employing conventional business practices (McWilliams & Siegel, 2001). These additional costs include the expenses associated with implementing the governance scheme's requirements and the enforcement costs such as for certification. To make participation economically viable for producers and other commodity chain participants, these added costs of producing and trading labeled products need to be passed up the commodity chain, so that market-based social governance schemes are mostly financed by consumers' willingness to pay a premium for labeled products (Taylor, 2005). The minimum price premium that producers require for products with social labels is the difference in the price between conventionally produced products and socially labeled products that covers the labeled product's additional costs that result from complying with the governance scheme. These costs are related to the scheme's design characteristics. The more stringent and better enforced a governance scheme, the higher are the costs of complying with the scheme's requirements and the enforcement costs such as obtaining and maintaining certification that participating firms incur and the higher will be the required minimum price premium. Fair trade schemes may increase the costs of production by, for example, prohibiting using children to harvest coffee—which adds to labor costs—or they may increase costs to traders by requiring minimum fair trade prices that exceed world-market prices to be paid to producers.

Although greater stringency and better enforcement of governance schemes results in labeled products with greater social attributes, many consumers may be unwilling to pay a large price premium for these additional social and/or environmental attributes (De Pelsmacker, Driesen, & Rayp, 2005; Vitell & Muncey, 1992), except for a small niche of consumers (Bird & Hughes, 1997). If the price premium for labeled products is high, consumers may shift their consumption to non-certified, "conventionally produced" products (McWilliams & Siegel, 2001). For example, consumers who said that they have never purchased a fair trade product identify high price as their top obstacle to purchasing a fair trade product (Alter Eco, 2008: 25). This suggests that as the governance scheme ratchets up stringency and enforcement, entailing higher costs for producers, this will likely retard the consumer demand for labeled products.

> PROPOSITION 2a: The more stringent the requirements of a market-based social governance scheme, the lower is the consumer demand for labeled products due to the higher the minimum required price premium.

> PROPOSITION 2b: The better the enforcement of a market-based social governance scheme, the lower is the consumer demand for labeled products due to the higher the minimum required price premium.

Consumer Awareness and Credibility of the Governance Scheme

If ethical attributes of a product's production and value chain activities are to influence consumer purchasing behavior, consumers must have knowledge about these product attributes (Schuler & Cording, 2006). It has been shown that consumers are willing to pay for ethical corporate behavior when they know about a firm's responsible business practices or the products' ethical features (Auger et al., 2003; Crane, 2001; Creyer and Ross, 1997). However, most studies report that generally consumers are unaware or have a very low awareness of ethical products (Auger et al., 2003).

Products with social labels differ from non-labeled products in the social and/or environmental attributes of their production and trade. While product labeling is intended to communicate these social and/or environmental attributes to consumers, many consumers are unaware of the various governance schemes and the meaning of their labels. This is because many different market-based social governance schemes exist, and many schemes' products are not widely available in mainstream retail outlets (Low & Davenport, 2006). Even when products with social labels appear in mainstream retail outlets, consumers generally need to be educated about the social and environmental attributes for which the label stands. The existence of different labels that convey similar social attributes, but that are associated with governance schemes which differ in the stringency and enforcement of requirements (including schemes that lack enforcement mechanisms), increase the search costs for consumers to obtain information about these labels.

To create consumer awareness of the social and environmental attributes for which labels stand, the organizations instituting market-based social governance schemes engage in promotional activities (Moore, 2004). Promotional activities include the dissemination of information related to the social and environmental benefits of the labeled products, including the governance scheme's requirements and enforcement mechanisms. Organizations use various tools to promote their schemes such as the label they place on products and other information about the governance scheme on the packaging of the product, as well as websites, print advertising, in-store literature, media campaigns, and event sponsorship (e.g., World Fair Trade Day 2010, sponsored by the World Fair Trade Organization). Because these activities raise consumer awareness, we can expect them to have a direct effect on the demand for products with social labels.

> PROPOSITION 3: Promotion of market-based social governance schemes increases consumer demand by increasing the information available to consumers.

However, consumers may not uncritically accept the claims made in the promotional activities of market-based social governance schemes. Even if consumers are familiar with the label and the social and environmental attributes for which it stands, they will alter their purchasing decisions only if they believe that the label is credible, i.e., that the social and/or environmental benefits signaled by the label actually exist. Therefore, another important condition for creating consumer demand is the credibility of the governance scheme.

Credibility of a market-based social governance scheme is likely influenced by the extent to which consumers believe that participating firms actually engage in socially responsible behavior. Stringent requirements and effective enforcement provisions will likely enhance the credibility of governance schemes with consumers, while governance schemes with weak requirements and lax enforcement are unlikely to gain credibility.

> PROPOSITION 4a: Stringency and enforcement of a market-based social governance schemes increase consumer demand by raising the credibility of the scheme.

In addition, the governance scheme's requirements and enforcement mechanisms should be transparent to consumers so that consumers have sufficient information to make judgments about the likely social and/or environmental benefits arising from the governance scheme. Without knowledge of the stringency and enforcement of requirements these design characteristics are unlikely to affect the governance scheme's credibility with consumers. Therefore, promotional activities that communicate a governance scheme's requirements and enforcement mechanism are likely to increase the effects of stringency and enforcement on consumer demand.

PROPOSITION 4b: The positive effects of stringency and enforcement on consumer demand resulting from increased credibility are larger when the market-based social governance scheme engages in promotional activities to increase the transparency of its requirements and enforcement mechanisms.

Incorporating Consumer Differences

So far, we have treated consumers as a homogeneous group in that they all respond to design and promotion activities of market-based governance schemes in the same way. This assumption may not be valid, because consumers differ in their basic concerns about social and environmental issues (Auger et al., 2003; Roberts, 1996). The consumer behavior literature's elaboration-likelihood model suggests that a consumer's degree of involvement with a product affects their willingness to pay for social attributes as well as their investments in searching for and processing information about a product (Petty & Cacioppo, 1979; Petty & Wegener, 1999), both of which ultimately affect consumers' purchasing decisions. Involvement is the personal importance that a consumer places on product attributes such as social responsibility which is related to a variety of self-relevant constructs such as one's values and goals (Petty & Cacioppo, 1990). High involvement consumers place high personal importance on the product. Conversely, low involvement consumers place low personal importance on the product. We focus on two key differences in the behavior among these types of consumers—their willingness to pay and their willingness to make investments in information search and processing.

First, high involvement consumers who place high personal importance on social responsibility are likely willing to pay more for products with social labels than low involvement consumers. In the case of fair trade, Bird and Hughes (1997) report that "ethical consumers," analogous to high involvement consumers, were willing to pay for charity alone, while "semi-ethical consumers," analogous to low involvement consumers, saw ethical benefits as an emotional bonus but were unlikely to pay extra for the producer's ethical behaviors. This suggests that the price premium for a product with a social label will likely have a different effect on the purchasing behavior between these two groups of consumers. Researchers have found that low involvement consumers require a smaller price difference to change their purchase preference from a higher priced product with a social label to a lower priced non-labeled (substitute) product than high involvement consumers (Gotlieb, Schlacter, & St. Louis, 1992). Thus, market-based social governance schemes with stringent standards and strong enforcement that require a high minimum price premium will be less likely to appeal to low involvement consumers.

PROPOSITION 5a: The negative effects of stringency and enforcement of market-based social governance schemes on consumer demand resulting from increases in the minimum required price premium are larger for low involvement consumers than for high involvement consumers.

Second, a consumers' degree of involvement with a product affects the way they search for and process information and form attitudes about the product (Petty & Cacioppo, 1979; Petty et al., 1983; Petty & Wegener, 1999). Consumer attitudes are changed in two ways: a central route and a peripheral route. Individuals with high involvement are willing to make efforts to gather, comprehend, and evaluate information about the product and its attributes. Their attitudes about a product are affected via a central route resulting from consideration of information that they feel is central to the true merits of their particular attitudinal position (Petty et al., 1983: 135). High involvement individuals are motivated to pay attention to the quality of the information presented and arguments made, as well as the perceived legitimacy of the source of the information (Petty & Wegener, 1999). High involvement consumers are likely focus upon issue-relevant information, i.e., "information relevant to the attitude object or advocacy" (Petty & Wegener, 1999: 46). Information relevance, quality, and legitimacy of the source have effects on the attitudes of high involvement individuals. On the other hand, low involvement individuals whose personal values and goals are not tied in any significant way to the product will not expend the effort to process and comprehend information about the product and its attributes. Instead, low involvement individuals pay attention to peripheral cues about the product, such as its form, color, logo, and where it is sold. In media advertising, low involvement consumers might pay attention to things such as setting, spokesperson, and music played. Their attitudes about the product are affected via a peripheral route based on cues, rules of thumb and heuristics (Chen & Chaiken, 1999), and less on argument quality (Petty et al., 1983).

How might the different types of consumers react to information generated by the promotional activities from the various market-based governance schemes? Let us consider a logo placed on a fair trade product. Since the elaboration-likelihood model suggests that high involvement consumers search for and evaluate issue-relevant information, a high involvement consumer is likely to scrutinize the logo, the product packaging and additional sources to gather other important information about the governance scheme itself, such as its stringency, enforcement and social benefits in evaluating the credibility of the promotional claims. In addition, the high involvement consumers are also likely to consider the certifying organization's reputation for accuracy and honesty. High involvement consumers' purchases of products are likely less influenced by the logos per se than how the logo fits into the totality of issue-relevant information about the product.

> PROPOSITION 5b: Promotional activities that emphasize issue-relevant information (such as information about the market-based social governance scheme's requirements, enforcement, and social benefits) are likely to have a greater effect on the purchasing behavior of high involvement consumers than on the purchasing behavior of low involvement consumers.

Low involvement consumers, in contrast, are more likely to respond to easily accessible cues such as logos without critically examining them. These consumers attend and react to cues about the product, i.e., what the logo looks like, place of purchase, or whether celebrities endorse the governance scheme (e.g., Spanish pop-music star Luz Casal endorses the World Fair Trade 2010 event), without making much effort to consider other features of the governance scheme. Because low involvement individuals are likely to change their attitude toward the product based upon these peripheral cues, they are more likely to react to symbols and non-verbal cues (that may or may not be issue-relevant) about the product than high involvement individuals. Therefore, we expect the following:

PROPOSITION 5c: Promotional activities that emphasize symbols and other non-verbal cues that are not issue-relevant (such as labels, celebrity endorsements, etc.) are likely to have a greater effect on the purchasing behavior of low involvement consumers than on the purchasing behavior of high involvement consumers.

We argued above that the credibility of a market-based governance scheme is affected by the extent to which the scheme engages in promotional activities that increase the transparency of the stringency and the enforcement of its requirements to consumers. Efforts to promote the technical details of a market-based social governance scheme's requirements and enforcement mechanisms should not have the same effect on the attitudes and purchasing behavior across all types of consumers. High involvement consumers are more likely than low involvement consumers to undertake the purposive effort to evaluate the credibility of the claims of market-based social governance schemes, while low involvement consumers are unlikely to make the effort to understand the nuances of different requirements and enforcement mechanisms. As a result, governance scheme design variables will likely affect credibility more for high involvement consumers than for low involvement consumers.

PROPOSITION 5d. The positive effects of stringency and enforcement of market-based social governance schemes on consumer demand resulting from increases in credibility are larger for high involvement consumers than for low involvement consumers.

DISCUSSION

We develop a model to identify how the requirements and promotional activities of market-based social governance schemes such as fair trade affect their ability to generate social benefits. While the existing literature on the effectiveness of market-based social governance schemes has primarily focused on the behavior of participating firms, our model additionally incorporates the effects of scheme requirements and promotion on consumer purchasing behavior. Consumer purchasing behavior is critical to the effective functioning of market-based social governance schemes, as consumer demand is the key consideration in firms' decisions to participate in these schemes. Without sufficient consumer demand, market-based social governance schemes will fail to obtain the expansion of output required to improve the living conditions of a large number of people. A better understanding of how governance scheme design characteristics affect demand for socially labeled products can aid the creation of more effective governance schemes. In this section, we discuss two key insights provided by our model for the design of requirements and promotion of governance schemes.

Balancing Stringent Standards and Enforcement with Maximizing Social Benefits

Our model highlights a key tradeoff that the designers of market-based social governance schemes face when determining the stringency and enforcement of their requirements: Increasing stringency and enforcement do not necessarily raise the overall social benefits created by the governance scheme. On the one hand, stringent requirements and effective enforcement lead to a deepening of the socially responsible behavior of participating producers and traders, and therefore to an increase in the quality of social benefits. More stringent requirements might, for example, result in the use of more democratic processes in producer organizations, higher prices received for the coffee, and more ecologically sustainable growing practices. On the other hand, the effect of stringency and enforcement on consumer demand, and thus on the quantity of social benefits, is indeterminate because two opposing effects are at work. Given that higher levels of stringency and enforcement entail higher costs for participating producers and traders, the minimum price premium required by producers and traders to cover the additional costs of complying with the scheme's requirements will rise, which will depress demand for the certified product. At the same time, however, increasing the stringency and enforcement of standards elevates the credibility of a governance scheme in the eyes of consumers which should lead to an increase in demand.

To determine which of these two opposing effects is larger, we need to consider how these two effects affect different types of consumers. First, the elevation of the minimum required price premium is expected to especially reduce the likelihood of purchase by for low involvement consumers who are more price sensitive and have a lower willingness to pay than high involvement consumers (Bird & Hughes, 1997). Surveys of consumers indicate that high prices of fair trade products are a major obstacle in attracting low involvement customers. A survey of 461 potential fair trade customers across seven U.S. cities found that, price is the most important deterrent to purchasing fair trade products for those who have not previously bought fair trade products (Alter Eco, 2008: 25). Similarly, another survey of 400 consumers, showed that 34 percent of those consumers, who did not buy fair trade products regularly or at all, mentioned price as the reason (Newcastle City Council, 2007: 3). Second, low involvement consumers are likely to pay little attention to the governance scheme's stringency and enforcement as an indicator of credibility, and hence stringency and enforcement are likely to have less of a positive effect on the purchasing behavior of low involvement consumers. Both of these effects suggest that governance schemes with stringent and enforced requirements are unlikely to sway low involvement consumers. Given that the majority of coffee drinkers are likely to fall in the low involvement group,[2] we can conclude that the net effect of stringency and enforcement of consumer demand is likely negative.

This negative effect of stringency and enforcement suggests that market-based social governance schemes need to pay attention to the costs that complying with and enforcing their requirements impose on participating organizations. The costs of compliance to achieve a certain level of social benefits may be lower for schemes that institute more flexible requirements that can be customized to the situation of different producers. As most fair trade products are agricultural commodities[3] grown under vastly different conditions around the world, imposing standardized requirements that need to be met by all producers may impose higher costs on producers who are forced to implement and document required practices that may not apply to their particular situation. Requirements that are customized to specific growing situations avoid these costs, while potentially allowing for the same level of social benefits. Of course, there are also costs associated with customization, such as the administrative costs incurred by governance schemes that need to incorporate a wide diversity of requirements for different producers, and the costs of determining which requirements should apply to specific producers. But overall, customization may result in lower costs of generating the same level of social benefits.

Market-based social governance schemes can also reduce costs by lowering production and transaction expenses, by reducing their enforcement costs, and by reducing the costs associated with marketing and promotion (Bacon, Méndez, & Fox, 2008; Bartra, 2002). This implies that fair trade standards promoted by an umbrella organization, such as FLO, linking many smaller and/or national fair trade initiatives, and monitored by the umbrella organization, such as FLO-Cert, could be the most economical method to get widespread adoption by consumers, because such an organization will likely benefit from economies of scale in administrative overhead and promotion expenditures, so that these costs are lower per pound of coffee. Lower costs would result in a lower price premium, which should appeal to low involvement consumers.

Finally, market-based social governance schemes can leverage the relationship they have with producers by helping producers to improve their efficiency and the quality of their products. For example, some fair trade schemes educate participating producers about farming practices to increase their yields and lower their costs. Counter Culture Coffee's fair trade scheme involves working with farmers to improve coffee quality, which creates an additional product attribute that should increase consumers' willingness to pay. About half the consumers surveyed indicated that product quality is an important motivation to buy fair trade (Alter Eco, 2008: 14).

Demand by high involvement consumers is less negatively or even positively affected by ratcheting up the governance schemes' requirements and enforcement techniques (Petty & Wegener, 1999). These consumers are less price sensitive (Bird & Hughes, 1997) and perceive stringent standards and enforcement as indicators of credibility. For example, a high involvement coffee consumer is more likely to believe that the claims of socially responsible behaviors made by Equal Exchange because of its third-party monitoring than similar claims made by Intelligentsia Coffee, which, like many other fair trade organizations, does not use third-party monitoring. For the fair trade organizations that attempt to target such high involvement consumers, the quality of their requirements and enforcement practices and the transparency of such requirements and enforcement through labeling and other promotional activities can be expected to raise credibility with consumers and lead to more sales.

The diversity of customer preferences and the resulting differences in customer responses to the design and promotion of market-based governance schemes suggest that the overall social benefits of all market-based social governance schemes can be maximized by having different schemes targeting different consumers. Less stringent schemes with weaker enforcement will likely appeal to a large base of consumers including low involvement consumers. While these schemes will likely generate a large quantity of social benefits and thus, reach many producers, the quality of social benefits of these schemes is lower. One the other hand, stringent schemes with tough enforcement will appeal to high involvement consumers. These schemes produce a large quality of social benefits for their participating producers but are likely limited in scope and hence their quantity of social benefits. Thus, weak schemes maximize the quantity of social benefits, while stringent schemes maximize the quality of social benefits. Given that different types of consumers exist that value different schemes, it may be desirable to have multiple market-based social governance schemes addressing the same issue that target groups of consumers with different involvement levels to maximize overall social benefits. Governance schemes with different levels of stringency can be administered by a single organization. For example, the LEED Green Building Certification of the U.S. Green Building Council provides four certification levels (Certified, Silver, Gold, and Platinum). A clear identification of different levels by a single organization administering the different schemes and a clear explanation of the different levels will likely reduce customer confusion about the meaning of different certification levels.

The Quantity of Social Benefits and "Mainstreaming"

The social benefits of a market-based social governance scheme result from both the quality as well as the quantity of the socially responsible behaviors. Increasing consumer demand and the associated expansion of fair trade products into "mainstream" distribution and retail channels increases the quantity of social benefits by attracting more participating producers. Within the fair trade movement, there has been considerable acrimony over bringing fair trade products into mainstream distribution and retail channels, such as McDonalds, Dunkin' Donuts, Starbucks, Sam's Club, Costco, Safeway, and Kroger and having fair trade products produced and marketed by companies such as Procter & Gamble and Nestlé. Many have questioned whether the expansion of fair trade by such large companies is consistent with the values of solidarity to producers and their communities and the ideological critique of liberal capitalism and free trade upon which the fair trade movement was launched (Low and Davenport, 2006; Murray & Raynolds, 2000). However, these critics must acknowledge that consumer demand is a necessary condition for the generation of social benefits by market-based social governance schemes. The overall social benefits that can be created though market-based social governance schemes are limited by consumer demand. With limited consumer demand for products with social labels the prospects of social governance schemes to address the inequities caused by globalization and free trade remain limited to a small number of producers. Fair trade products' lack of availability in mainstream distribution channels in an important factor limiting demand. In a 2007 survey of consumers, 64 percent responded that they would purchase fair trade products more often if they were available in the stores that they shop (Alter Eco, 2008: 24). Without mainstreaming, fair trade products are likely to remain niche products that appeal to the high involvement consumer, which limits the quantity of social benefits of fair trade.

Our model suggests that as mainstreaming occurs, fair trade will increase its encounters with low involvement consumers. High involvement consumers undertake the purposive search to find fair trade products that satisfy their needs and visit a variety of non-mainstream outlets (web-sites of fair trade roasters and retailers, world shops, natural food stores, cafes, etc.) to purchase these products. When fair trade started, it was able to grow by tapping into its "natural" constituencies of high involvement consumers: members of faith-based organizations, leftist political groups, and groups committed to "third world" justice (Low & Davenport, 2006: 318). To reach low involvement consumers, however, two conditions will be important. First, since low involvement consumers are more price-sensitive (Bird & Hughes, 1997), the cost of compliance with the standard needs to be low. At its worst, this suggests that standards will be weakened or that monitoring will not occur to minimize such costs. A recent development is that many major companies announce that they are fair trade without making major commitments towards it, a practice sometimes referred to as "fair washing" (Fridell, Hudson, & Hudson, 2008). For example, Starbucks has been criticized for claiming to be fair trade while purchasing only 6 percent of their coffee beans from certified fair trade sources (Organic Consumers Organization, 2008). A more positive solution, however, is to reduce the costs of compliance with standards without compromising the stringency of the standard. We already detailed some ideas on how this could be achieved.

Another implication of our model with respect to mainstreaming relates to the promotional activities required to reach low involvement consumers. By definition, low involvement consumers will not engage in costly information searches or critical analyses of the information. They are more readily influenced by visceral cues—a catchy logo, a celebrity spokesperson—as they consider a purchase (Petty & Wegener, 1999). Over four in ten of those surveyed in 2007 identified label/certification as the top item for identifying fair trade products (Alter Eco, 2008: 27) and, in another survey, over 60 percent of respondents said that they saw the fair trade logo in the store or in national media advertising (Newcastle City Council, 2007). For organizations that desire to reach such consumers, this means more attention must be paid to promotional schemes and less to other areas like improving the stringency of the standards and monitoring. Critics of promotion might lament resources diverted from community development and other producer-oriented activities towards reaching these low involvement consumers who are assumed to have a low commitment to the producers. Others might view these efforts to expand the customer base more positively as the purchases by low involvement consumers help to drive the demand to support more farmers to produce according to social standards.

DIRECTIONS FOR FUTURE RESEARCH

All in all, our model argues that while market-based social governance schemes have the potential to generate social benefits by increasing the quality and quantity of socially responsible behaviors by participating producers and traders, we need to pay special attention to the their effects on consumer behavior, highlighting the important role played by consumers for the functioning of market-based social governance schemes. In this section, we introduce two pathways of future research suggested by our model—a greater focus on how consumer behavior is important for driving the quantity of social benefits and a more formal exploration of the tradeoffs between quality and quantity of social benefits to design schemes that maximize overall social benefits.

Consumer Behavior and the Quantity of Social Benefits

The primary message of our study is that designers of market-based social governance schemes need to pay attention to both producer and consumer behaviors in order to maximize the scheme's social benefits such as improving the working conditions and terms of trade of farmers in developing countries. While the effect of scheme requirements on producer behavior has been explored in the literature (e.g., Conroy, 2007), we know less about the effects of scheme design and promotion on consumer behavior. Empirical research on the effects of design and promotion of market-based social standards on consumer behavior can help the designers of market-based social certification schemes to more effectively design and promote their standards so as to attract consumers to certified products.

Our model suggests that promotion generally increases consumer demand because it increases the available information to consumers about the existence and the benefits of socially-labeled products. Researchers might wish to examine which specific promotion activities or combination of activities are most effective in reaching different types of customers. Do consumers favor socially-labeled products more if they are promoted one way over another? How do promotion activities affect customers' willingness to pay for products with social attributes? What are the differences across types of customers in the effects of different promotion activities on their purchases?

We postulate that promotion also affects a consumer's perception of the credibility of the market-based social scheme. Again, researchers might study which types of promotions raise (or lower) a consumer's perceptions of credibility, the persistence of credibility, and possible interactions with the scheme's standards and enforcement and third-party reporting about the scheme. For example, would a third-party endorsement enhance a consumer's perception of the credibility of the market-based social scheme, and if yes, by how much? Which types of third parties would be seen as most credible? Will more credible schemes be reflected by the prices paid and quantities demanded by consumers for socially-labeled products?

The expansion of the quantity of social benefits through mainstreaming seemingly increases the heterogeneity of the types of consumers (high and low involvement) exposed to socially-labeled products. Researchers might wish to determine how these heterogeneous consumers are segmented and the differential effects of changes in social standards, enforcement, and promotion across these segments. This may allow better predictions about the net increase of consumer demand to changes, for example, in standards (i.e., by making standards more strict), which may be costly to the producer.

Maximizing the Overall Social Benefits from Market-Based Social Governance Schemes

Another important insight from our model is that stringency and enforcement of requirements differ in their effects on the quantity and quality of social benefits. Formal models of the tradeoff between increased social benefits for producers from stringent and well-enforced requirements and the effects of the resulting increased prices on customer demand may provide more insights into the magnitude of these tradeoffs and into the key variables that affect the size of the tradeoff. Such models may help designers of market-based social governance schemes to design mechanisms to reduce these tradeoffs and to determine the optimal stringency of requirements of the scheme. Furthermore, formal models could explore how social benefits could be maximized by designing different schemes that differ in their levels of social benefits for producers and in their prices for customers. Assuming that there are additional costs of the design, administration, and promotion activities for each scheme, one could model whether an organization such as FLO may benefit from designing and administering fair trade schemes with different levels of requirements and social benefits. Such diversity of schemes would allow producers to select a level that matches their preferences, capabilities, and cost structure, and would provide the different types of customers a choice between the different levels. How many levels of schemes should a fair trade certification organization such as FLO consider to maximize social benefits? What would be the cost differences across different levels of requirements and how would consumers respond to each of these different levels?

In conclusion, we believe that our model opens up several intriguing avenues of future research that can contribute towards increasing the overall social benefits from market-based certification schemes.

NOTES

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1. We use the term "labeled" products to indicate a product that has been produced according to a market-based social governance scheme such as fair trade. Most of these products are marked with a label to connote compliance but some are denoted in other ways such as by promotional materials.

2. We were unable to find data that separates coffee drinkers into high involvement and low involvement groups. We deduce, however, that most fair trade coffee drinkers fall into the high involvement group. First, in a recent survey of fair trade consumers by GlobeScan, Rob Cameron, the CEO of FLO, states that the unique marketing strength of fair trade comes from its loyal, dependable and global grassroots' supporter base (Trading Visions, 2009). Second, although the market shares vary across countries, fair trade generally occupies less than 10 percent of overall coffee sales while conventionally produced and traded coffee has the other 90 percent. This is probably due to a number of factors including availability, convenience of retail outlets, price, and quality. The majority of the other 90 percent of coffee drinkers are most likely to be in the low involvement group.

3. Thirteen of the fourteen products that use the FLO's fair trade standards are agricultural products (Fairtrade Labelling Organisations International, 2010).

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