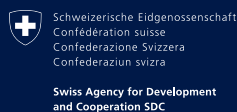


# Making the most of agricultural investment:

## A survey of business models that provide opportunities for smallholders



Sonja Vermeulen and Lorenzo Cotula



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IIED Order No: 12566IIED

Citation: Vermeulen, S. and Cotula, L., 2010, MAKING THE MOST OF AGRICULTURAL INVESTMENT: A SURVEY OF BUSINESS MODELS THAT PROVIDE OPPORTUNITIES FOR SMALLHOLDERS, IIED/FAO/IFAD/SDC, London/Rome/Bern.  
ISBN: 978-1-84369-774-9

*Cover photo: Woman harvesting rice with her daughters in Phalombe district, Malawi © Sven Torfinn/Panos Pictures*

*Design: Smith+Bell ([www.smithplusbell.com](http://www.smithplusbell.com))*

*Printing: Russell Press ([www.russellpress.com](http://www.russellpress.com))*

*Printed on: Greencoat Velvet 200 gsm and Greencoat Velvet 100 gsm*

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# ACKNOWLEDGEMENTS

This work has been jointly funded by the Food and Agriculture Organization of the United Nations (FAO), the International Fund for Agricultural Development (IFAD) and the Swiss Agency for Development and Cooperation (SDC). The views expressed do not necessarily represent those of the supporting institutions involved.

The authors would like to thank the following people for the helpful discussions in the preparation of this report and/or for the useful comments on earlier drafts of the report: Abbi Buxton, Carlos da Silva, Stephen Gitonga, Diana Gruszczynski, Ruth Hall, Rebeca Leonard, Harold Liversage, Paul Mathieu, Paul Munro-Faure, Garry Smith and Bill Vorley. Marie Jaecy ably steered proof-reading, design and production.

The report also benefited from experiences and insights shared at an international workshop organised by IIED, IFAD, SDC and Maputo-based Centro Terra Viva, in partnership with the government of Mozambique's National Directorate for the Promotion of Rural Development (DNPDR). The workshop took place in Maputo on 17-18 March 2010 and brought together about 30 participants, mainly from Africa but also representatives from South Asia, involved with inclusive business models. The literature review presented in this report helped identify workshop participants. Participants included practitioners from local and national support groups assisting local farmers in their negotiations with agribusiness; private sector operators; and observers with first-hand analysis of land deals and business models. After the workshop, some participants contributed short texts to share their experiences beyond the workshop; these texts and a full workshop report will soon be published separately.



# ACRONYMS

Asoproban	Asociación de parceleros y pequeños productores de bananos, Colombia
BBBEE	Broad-Based Black Economic Empowerment, South Africa
BEASB	Boustead Estates Agency Sdn Bhd, Malaysia
BSOC	Blue Skies Organic Collective Association, Ghana
DCSL	Delhi Cloth and General Mills Shiriam Consolidated Ltd
DFID	UK Department for International Development
DLPP	Department of Lands and Physical Planning, Papua New Guinea
DNPDR	National Directorate for the Promotion of Rural Development, Mozambique
FAO	Food and Agriculture Organization of the United Nations
GCMMF	Gujarat Cooperative Milk Marketing Federation, India
GDP	Gross Domestic Product
GLOBALGAP	Global Partnership for Good Agricultural Practice
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IIED	International Institute for Environment and Development
ILG	Incorporated Land Group, Papua New Guinea
INR	India Rupee
KDPL	Kieni Dairy Products Limited, Kenya
KES	Kenya Shilling

KIT	Royal Tropical Institute, The Netherlands
LCDA	Land Custody Development Authority, Malaysia
MBSA	Mali Biocarburant SA, Mali
MYR	Malaysia Ringgit
NBPOL	New Britain Palm Oil Ltd, Papua New Guinea
NCR	Native Customary Rights, Malaysia
NGO	Non-Governmental Organisation
NIB	National Irrigation Board, Kenya
PGK	Papua New Guinea Kina
PSOM	Programma Samenwerking Opkomende Markten, The Netherlands
R&D	Research and Development
REDD	Reduced Emissions from Deforestation and Forest Degradation
SALCRA	Sarawak Land Consolidation and Rehabilitation Authority, Malaysia
SLDB	Sarawak Land Development Board, Malaysia
SNV	Netherlands Development Organization
TWIN	Third World Information Network
UK	United Kingdom
ULSPP	Union Locale des Sociétés Coopératives des Producteurs de Pourghère à Koulikoro, Mali
UN	United Nations
US	United States of America
USD	United States Dollar
WBCSD	World Business Council for Sustainable Development
WWF	World Wide Fund for Nature
ZAR	South Africa Rand

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**EXECUTIVE SUMMARY**





## **About this report**

Recent years have witnessed a renewed interest in agricultural investment. In many cases, this new momentum has translated into large-scale acquisitions of farmland in lower- and middle-income countries. Partly as a result of sustained media attention, these acquisitions have triggered lively if polarised debates about “land grabbing”. Less attention has been paid, however, to alternative ways of structuring agricultural investments that do not involve large-scale land acquisitions. These include a wide range of more collaborative arrangements between large-scale investors and local small-scale farmers and communities, such as diverse types of contract farming schemes, joint ventures, management contracts and new supply chain relationships.

Drawing on a literature review, this report examines a range of business models that can be used to structure agricultural investments in lower- and middle-income countries, and that provide an alternative to large-scale land acquisitions. A business model is the way in which a company structures its resources, partnerships and customer relationships in order to create and capture value – in other words, a business model is what enables a company to make money. Business models are considered as more inclusive if they involve close working partnerships with local landholders and operators, and if they share value among the partners.

More inclusive business models encompass a wide range of arrangements. Some models involve large-scale farming but with closer involvement of local landholders. Others bring smallholder farmers into the value chain. Many are thoroughly tried and tested, while others are confined to narrow sectors and could be applied more widely, or else are still isolated, interesting pilots. None of these models is perfect – the intention here is not an overview of “best practice”, but a survey of a range of possible business models, considering their pros and cons, opportunities and constraints, and options for scaling up.

The report focuses on models for structuring agricultural investments. Models based on pure trading relations, for instance through direct relationships between retailers and farmer groups, are outside the scope of the report.

## **The business models**

Business models are discussed under six broad headings: contract farming, management contracts, tenant farming and sharecropping, joint ventures, farmer-owned business and upstream/downstream business links. Contract farming describes pre-agreed supply agreements between farmers and buyers. Usually, local farmers grow and deliver agricultural produce for specified quantity and quality at an agreed date. In exchange, the company provides upfront inputs, such as credit, seeds, fertilisers, pesticides and technical advice, all of which may be charged against the final purchase price; and agrees to buy the produce supplied, usually at a specified price.

Management and lease contracts refer to the variety of arrangements under which a farmer or farm management company work agricultural land belonging to someone else. Management contracts may take the form of a lease or tenancy, but carry the connotation of stewardship, of managing the land on behalf of the owner. To provide incentives for the farm management, the contract often entails some form of profit-sharing rather than a fixed fee. Tenant farming and sharecropping are versions of management contracts in which individual farmers, for example smallholders, work the land of larger-scale agribusinesses or other farmers. In tenant farming the usual arrangement is a fixed rental fee while in sharecropping the landowner and sharecropper split the crop (or its proceeds) along a pre-agreed percentage.

Joint ventures entail co-ownership of a business venture by two independent market actors, such as an agribusiness and a farmers' organisation. A joint venture involves sharing of financial risks and benefits and, in most but not all cases, decision-making authority in proportion to the equity share. Farmer-owned businesses are formally incorporated business structures for farmers to pool their assets to enter into particular types of business (e.g. processing or marketing), gain access to finance, or limit the liability of individual members. Such businesses are often owned by cooperatives in order to facilitate business transactions. Finally, "upstream and downstream business links" is an umbrella expression for the set of business opportunities beyond direct agricultural production that exist for both agribusinesses and smallholders and small local enterprises.

While the report discusses various models one by one, real-world investment projects may involve complex combinations of various models. For example, in the same investment project, the agribusiness company and smallholders

may set up a joint venture, in which the company contributes capital and smallholders land or other assets; smallholders may be organised in a cooperative or a company to hold their equity participation in the joint venture; the joint-venture company may enter into contract farming arrangements with individual smallholders for undertaking agricultural production; and management services may be contracted out to a specialised provider. In other words, rather than being necessarily alternative options, the models reviewed may be viewed as “building blocks” that can be combined into very diverse real-life hybrids.

### **Assessing value sharing**

While it is accepted that economic viability is a precondition for agricultural investments to benefit the local population and that the choice among alternative business models needs to be grounded on solid economic analysis, this report focuses on the way in which the different types of business models share value between the business partners – particularly between an agribusiness investor and local landholders and operators. Four criteria are used to assess value sharing:

- **Ownership:** of the business (equity shares), and of key project assets such as land and processing facilities.
- **Voice:** the ability to influence key business decisions, including weight in decision-making, arrangements for review and grievance, and mechanisms for dealing with asymmetries in information access.
- **Risk:** including commercial (i.e. production, supply and market) risk, but also wider risks such as political and reputational risks.
- **Reward:** the sharing of economic costs and benefits, including price setting and finance arrangements.

These four aspects are closely interlinked. Ownership can influence voice, though a perfect correlation between the two should not be assumed (e.g., in a joint venture, equity shares and board representation may not be perfectly aligned). Voice in price-setting crucially affects reward. Ownership influences risk, as a jointly owned business also involves sharing of business risks. So a model that gives smallholders more ownership of the business may also expose them to more risk. In addition, context is crucial: the same distribution of ownership, voice, risks and rewards may have very different practical

viability and implications in contexts characterised by different population densities, or with different levels of smallholder capacity to engage in commercial agricultural production.

### **Key findings**

Among the different business models reviewed here, no single model emerges as the best possible option for smallholders in all circumstances. Rather, what works best for smallholders while still being attractive to investors is very much context-specific, and is contingent on tenure, policy, culture, history as well as on biophysical and demographic considerations. Also, none of the arrangements reviewed here can be said to be perfectly fair, nor a holistic solution to rural development at local or national levels. By their very nature, these arrangements link two sets of players – agribusiness and smallholders – with very different negotiating power, which has direct implications for the design and implementation of the arrangements. Finally, the devil is often in the detail: in defining the extent to which an investment shares value with local smallholders, the detailed arrangements of the scheme may be more important than the abstract model.

For example, depending on its specific terms, contract farming may be a vehicle for providing support and improving market access for smallholders – or an exploitative relationship where smallholders are effectively providers of cheap labour, and expected to carry production risks. Better-resourced farmers may capture the contracts, while poorer farmers work as labour on the contracted farms. And the fact that a business model does not involve direct takings of land does not mean that it cannot trigger changes in land access in the longer term. Evidence from several experiences with contract farming suggests that, in the longer term, land access may shift from women, who cultivated subsistence crops, to men, who are more likely to sign contracts for cash crops with agribusiness. Shifts in land access may also favour local elites that are better positioned to make the most of the new market opportunities created by contract farming. Similarly, joint ventures can in principle offer a vehicle for enabling greater local control over business activities, and for granting local communities a regular stream of income in the form of dividends. But, if inappropriately structured, they can deliver very low dividends, as the bulk of revenues may be absorbed by suppliers controlled by the agribusiness company, and local influence over the decisions may in practice be nominal.

Even more fundamentally, no single business model seems fit for all purposes. The majority of the business models reviewed may be particularly relevant for labour-intensive crops, such as fruit and vegetables and some tree crops. But where economies of scale are significant, most of the models reviewed are likely to struggle in a competitive market. In these cases, leases and management contracts concluded directly with local communities may provide an avenue for exploiting economies of scale while still enabling local groups to participate in project benefits.

The willingness of the company to engage with more inclusive business models as a genuine economic component of their business, rather than as part of corporate responsibility programmes, is a key ingredient for more inclusive business models to work. Government policy and action can do a great deal to promote more inclusive business models. The negotiating power of smallholders in their relations with government and agribusiness is also key. While negotiating power is shaped by several factors (including for example the degree of collective action and the representativeness and effectiveness of farmers' organisations), security of local land rights is a crucial aspect. Where smallholders are engaged in agriculture production directly, secure rights over land are crucial for providing them with an asset in negotiations with agribusiness, and with incentives to invest, particularly in the case of long-term crops. If local land rights are insecure, smallholders would have little to negotiate with. Also, where agricultural production is carried out by agribusiness on the basis of leases or management contracts, secure land rights are a necessary condition for local landholders to contract the agribusiness company and allocate land rights for an agreed period of time.

Another central issue is smallholders' access to information concerning for example market trends, how product prices, royalties and dividends are calculated, the level of risk involved, how much debt they are taking on, or what legal protection and remedy they would have. Asymmetry of information, coupled with differential access to institutions (banks, insurers, law firms, courts), has proven to be a main constraint to the establishment of genuine business partnerships "of equals". Where levels of education, awareness and support are higher, there is growing experience with long-term, economically successful joint ventures between agribusinesses and companies belonging to indigenous people.



## **Moving forward**

A first key next step concerns *getting a more thorough understanding* of more inclusive business models – what works where and under what conditions. A proper assessment of concrete experiences would require much more detailed data than is available in the literature, particularly in three areas: the detailed structure of individual business models; issues of process, i.e. how a particular business model came to be chosen compared with alternative options, what conditions made the operation of that business model possible, what factors constrained it and how they were addressed by the company and smallholders; and socio-economic performance and outcomes, including the impacts of more inclusive business models on local livelihoods, incomes and empowerment. Generating solid evidence in these areas can help consolidate a robust business case for choosing more inclusive business models over large-scale land acquisitions. Development agencies can play an important role both in supporting case studies and in facilitating exchange of experience among practitioners.

The second set of next steps concerns *national policies and programmes* that can be put in place to promote and support more inclusive business models. Well thought out support to smallholders, aimed to tackle the power asymmetries that affect their dealings with agribusiness, can make a real difference to the process and outcomes of agricultural investment. Development agencies and other groups supporting smallholders (e.g. advocacy groups, public interest lawyers) can play an important role in that regard. Also, although most of the business models analysed in this report involve direct relationships between smallholders and agribusiness, action by government and other third parties can affect whether a more inclusive business model is chosen, its specific design, the way it works in practice, and its socio-economic outcomes.

Government policy is effective when it pushes for the progressive improvement of more inclusive models that bring real economic benefits locally and accord some degree of shared power to the smallholder partners. This may involve providing strong safeguards and remedies for local people, for example with regard to security of local land rights; increasing the set of choices open to agribusiness and smallholders; providing more detailed regulation for available arrangements, and flexible model contracts where relevant, particularly for the more complex ones such as joint ventures and

management contracts; and providing support (or at least establishing a framework for others to provide support) to smallholders in their dealings with agribusiness.

The third set of next steps concerns ***action at the international level***. Ongoing discussions about international guidance on agricultural investments should go beyond minimising the possible negative impacts of large-scale land acquisitions and provide pointers for promoting models of agricultural investment that maximise opportunities for local smallholders. With regard to individual investments, development agencies have played important roles in some of the experiences reviewed in the report – as providers of loan guarantees or of financing for the community’s equity participation in a joint venture, or more generally as brokers and facilitators. Scaling up these efforts can help replicate the more inclusive business models in a wider range of situations. Given the major power asymmetries in the negotiation of agricultural investments, international development agencies can further help by strengthening the capacity of host governments and smallholder groups to negotiate and manage contracts with agribusiness.



# I. INTRODUCTION





Recent years have witnessed a renewed interest in agricultural investment in lower- and middle-income countries (UNCTAD 2009). This trend is underpinned by several structural factors. Population growth, increasing rates of urbanisation (which expand the share of the world's population that depends on food purchases) and changing diets (such as growth in consumption of meat and fast foods in some large industrialising countries) are pushing up global demand for food (Godfray *et al.* 2010). Given supply constraints in parts of the world, including declining production and productivity (in the Gulf, for example), this is likely to put upward pressure on food prices in the longer term. Global demand for energy and agricultural commodities and increasing technological capacity for higher yields and returns also make agriculture an increasingly attractive investment option. In addition to market forces, agricultural investments are promoted by policy changes. Governments in some food-importing countries have supported agricultural investments in foreign countries as part of their national food security strategies. Economic liberalisation, including the lifting of restrictions on foreign investment, is facilitating entry into a wider set of countries. Policy incentives have also been a key driving force for investments in biofuels.

For people in recipient countries, this fast-evolving context creates opportunities to improve living standards, but also risks of losing land and being marginalised. Increased investment may bring macro-level benefits (GDP growth, greater government revenues), and create opportunities for raising local living standards. Investors may bring capital, technology, knowledge, infrastructure and market access, and may therefore play an important role in catalysing economic development in rural areas. But as outside interest rises, and as governments or markets make land available to prospecting investors, local people could lose access to the resources on which they depend – not just land, but also water, wood and grazing. Large-scale investment can also marginalise family farmers, who in many parts of the world have proved to be highly efficient and resilient producers. The way in which agricultural investments are structured shapes the outcomes of these investments – and the extent to which risks are minimised and benefits maximised.

In many cases, the renewed momentum behind agricultural investment has translated into large-scale acquisitions of farmland in Africa, Asia, Latin America and Eastern Europe. These acquisitions entail outright purchase of

land or long-term leases on land under the tenure of local communities and the state. Partly as a result of sustained media attention, these acquisitions have triggered lively if polarised debates about “land grabbing”. Less attention has been paid, however, to alternative ways for structuring agricultural investments. These include a wide range of collaborative arrangements between large-scale investors and local smallholders, such as diverse types of contract farming schemes, joint ventures, management contracts and new supply chain relationships.

Drawing on a literature review, this report examines a range of business models that can be used to structure agricultural investments in lower- and middle-income countries, and that provide an alternative to large-scale land acquisitions (plantations that are wholly owned by, or on long leases to, investors without inclusion of smallholders or small enterprises in the value chain). This focus does not imply that smallholders necessarily need to partner up with large outside investors in order to succeed. There is plenty of evidence that suggests that, where put in a condition to work, smallholders are able to produce competitively and seize new market opportunities. Equally, the focus of this report does not imply that the business models reviewed here are in all cases preferable to large-scale plantations. In some instances, plantations may be the best option for the investor, host country and the local community. For example, in areas with very low population densities and little local capacity to engage in agricultural production, it may be difficult to establish business models that include local ownership and operation. But as negotiations for large-scale land acquisitions evolve at rapid speed, the impression is that some countries are approving plantation-based projects without strong ideas of alternatives.

The term “business model” describes the way in which a company structures its resources, partnerships and customer relationships in order to create and capture value – in other words, a business model is what enables a company to make money. This report focuses on a specific aspect of a business model, namely the relationship between agribusiness, on the one hand, and local landholders and operators, on the other. It discusses arrangements for sharing ownership, decision-making, risk and reward between these two parties. Business models are considered to be more inclusive if they involve close working partnerships with local landholders and operators, and if they share value among the partners. In other words, for a business model to be

inclusive it must not only involve a collaborative relationship, but also fair and equitable terms.<sup>1</sup>

More inclusive business models encompass a wide range of arrangements, such as shared ownership of key assets, formalised joint ventures, profit-sharing arrangements, contract farming or local content schemes, community land leases and management contracts, or local service agreements. Some models involve large-scale farming but with closer involvement of local landholders. Others bring smallholder farmers into the value chain. Many are thoroughly tried and tested, while others are confined to narrow sectors and could be applied more widely, or else are still isolated, interesting pilots. None of these models is perfect – the intention here is not an overview of “best practice”, but a survey of a range of possible business models, considering their pros and cons, opportunities and constraints, and options for scaling up.

The focus here is on agricultural investments, covering food, fuels, fibre and other agricultural commodities. Besides agricultural production per se, this includes opportunities for partnerships upstream (e.g. in developing appropriate inputs, technologies, expertise, farming practices) and downstream (e.g. processing, distribution, service provision). But business models that do not involve an agricultural investment (for instance, those centred on direct trading relations between a retailer and smallholders) are not covered here as they are amply discussed elsewhere (see for instance Vorley and Proctor 2008 and more generally the materials available at [www.regoverningmarkets.org](http://www.regoverningmarkets.org)). Experience from sectors other than agriculture is referred to where relevant to discussions about agricultural investments.

The report is likely to be of interest to policy-makers concerned with regulating agricultural investments, whether in recipient or home countries or internationally; to investors seeking alternative models and to other interest groups including farmers’ organisations, development NGOs and donor agencies. In recipient countries, the report can feed into the vigorous public debate about the future of agriculture and food security that is needed before strategic choices about agricultural investment are made.

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**1. The term “inclusive business models” was coined by the WBCSD-SNV Alliance on Inclusive Business (<http://www.inclusivebusiness.org/>) and provides a useful shorthand for the variety of models that share value with small-scale producers and enterprises.**



Section II places the report in a broader context of historical developments and policy debates about agricultural investments. Section III outlines the features of inclusive business models in agriculture, developing a simple framework for assessing different models on the basis of how they share ownership, voice, risk and reward. The central section, section IV, presents and discusses an illustrative set of business models, drawing on experience documented in the available literature (including a set of 12 cases discussed in separate boxes). Due to time and space limitations, this section is not intended to provide complete theoretical and practice-based analyses of each type of business model. Rather, it draws out key features, new trends and potentials, and provides readers with links to recommended review materials. A conclusion summarises key findings and identifies possible next steps.

## **II. CONTEXT: RAPID RESTRUCTURING IN AGRICULTURAL MARKETS**





## **The pendulum between spot markets and vertical integration**

Over the course of history, the dominant patterns of agricultural production have shifted between two extremes: spot markets (whereby commodities are bought on the open market) and vertical integration (whereby a company controls the various stages of the value chain, from production to processing through to distribution).

In the 19th and 20th centuries, many agricultural investments in developing countries, led by companies based in Europe, the United States (US) and Japan, involved the establishment of large-scale plantations. Yet, from the 1960s onwards, with decolonisation and the ensuing nationalisations in Africa, and with land redistribution programmes in some Latin American countries, some agribusiness companies shifted away from the plantation model and the vertical integration it entails, and moved towards developing long-term contractual relationships with local suppliers (UNCTAD 2009). Increasing unionisation of estate labour forces and stricter labour legislation also encouraged a move away from plantations (Tiffen and Mortimore 1990).

In addition to political factors, economic forces prompted the shift away from direct involvement by agribusiness in production. The distribution of risks and returns plays a crucial role in business decisions about the degree of vertical integration. For much of the past few decades, agricultural value chains have tended to concentrate returns in processing and distribution, while the risks fell mainly on primary production (Selby 2009). This situation created incentives for agribusiness companies to concentrate on activities upstream (provision of inputs, seeds and machinery) and downstream (processing and distribution), and to source agricultural production from local suppliers. Sourcing produce through long-term contracts rather than plantations also offered greater flexibility in responding to fluctuating commodity prices – as renegotiating or even terminating contractual relations is easier than divesting land ownership (Tiffen and Mortimore 1990). These factors led to a shift away from plantations in diverse contexts from banana farming in Central America to tea in East Africa (UNCTAD 2009).

More recent experience over the past few years suggests that a return to greater vertical integration may be under way, due to the set of demand-side, supply-side and policy drivers presented in section I. With some exceptions, where sourcing from large-scale producers is an option, agricultural sectors are demonstrating a shift from small-scale to large-scale producers, for

example in export horticulture in Mexico and Kenya, and in dairy in Brazil and Argentina (Reardon *et al.* 2009).

Associated with this trend is a renewed interest in large-scale land acquisitions in developing countries. Land acquisitions for agricultural investments reached a total of about two million hectares in four African countries (Ethiopia, Ghana, Madagascar and Mali) between January 2004 and March 2009 alone. Further growth in the land areas acquired is anticipated, in light of the recent establishment of investment vehicles for acquiring farmland in developing countries, and of media reports about ongoing negotiations for large agricultural investments (Cotula *et al.* 2009).

### **Large-scale land acquisitions – key drivers**

The rationale for the direct acquisition of farmland is both economic and political. Changing agricultural commodity prices are shifting the distribution of risks and returns along the agricultural value chain, by increasing the downstream risks to processors and distributors, concerned about the security of their supplies, and boosting returns from production (Selby 2009). This increases the attractiveness of agricultural production as an investment option, including the acquisition of land as such, but also of shares in companies holding land, producing fertilisers, providing management services or otherwise involved in upstream agricultural activities (The Economist 2009).

Concentration in retailing, as supermarkets become dominant over traditional markets throughout the world, is changing the terms for wholesalers, processors and farmers (Reardon *et al.* 2009). Through determining quality and safety standards, packaging requirements, and consistency of supply, retailers have established higher levels of coordination and control over the value chain. In turn, this may favour concentration in upstream segments. For some produce, the volumes required by large retailers, and the transaction costs involved in dealing with large numbers of smallholders, create incentives for retailers to deal with large-scale agricultural producers. The costs of complying with quality standards may be prohibitive for smallholders. But effective producer organisation, limited economies of scale, and relative importance of labour as a source of competitive advantage can still enable smallholders to participate in agricultural value chains, particularly for crops that involve intensive labour, such as certain fruits and speciality vegetables (Vorley *et al.* 2007).

From the perspective of individual agribusiness companies, the decision to vertically integrate is function of the evolving comparative advantages of ownership of productive assets versus coordination along the value chain. While some companies (supermarkets, for instance) may be particularly efficient at coordinating the value chain, others may acquire a distinct comparative advantage in forms of more direct involvement in agricultural production.

Context-specific factors may also play a role in the economic considerations, for instance where new agricultural investments bring into production land areas with low population densities and weak local capacity to undertake agricultural production activities. In these cases, long-term contracts with local suppliers may be perceived as not economically viable. The need to guarantee a minimum level of throughput for processing plants may also push the company to establish more direct control of the production stage.

Finally, large-scale agricultural production may enable a company to reap the benefits of scale economies, technological innovation and modern farm management systems. From the point of view of a retailer or wholesaler, procurement from a smaller number of larger producers entails lower transaction costs, but with a higher risk of defaulting or side-selling as these producers have access to better market information and a wider choice of marketing outlets (Reardon *et al.* 2009). Procurement from small-scale farmers entails much higher transaction costs, but these may be offset by low labour costs, effective producers' organisations and greater willingness to follow intensive farming practices. There are advantages and disadvantages on both sides – these considerations form part of a larger, complex and long-standing debate about the comparative advantages of large and small-scale farming (see box).

### **SMALLHOLDERS VERSUS LARGE FARMS**

There has been long-standing debate about farm size and productivity. Some argue that the era of the smallholder farmer is over, and that for reasons of efficiency, small farms should be consolidated into fewer large holdings, allowing for economies of scale and increased mechanisation. They point on the one hand to impoverished peasant farmers on the margins of existence with little ability to generate a surplus for investment in the farm enterprise and limited capacity to adopt new technology, and on the other to profitable large farms, accessing world markets, and providing employment and good wages to the local rural workforce. Others refute such arguments and note that for many

crops there are few if any economies of scale in agricultural production. They point on the one hand to dynamic smallholder production, in which innovation and investment are very evident, as people adapt to new market opportunities and changing environmental conditions, and on the other hand to inefficient, extensive large farms with few workers, low wages and poor productivity.

There is ample evidence to support either case, depending on the type of crop, the policy context, and forms of support available to different kinds of farmer. Small farms are generally family-run, may be subsistence-based or market-oriented, using few or many external inputs, working manually or with machinery, and tend to be more labour-intensive. Large farms are generally market-oriented, may be family-run like small farms or corporate, and use few if any or many labourers. They may also rely on specialised management firms to run the agricultural business. Both small and large farms may be resource-poor or rich, use largely manual methods or machinery, and use the land extensively or intensively. Because of this great variation in farm types, any statements on the relative merits of small versus large farms can only be relevant within specific social, economic and biophysical environments. In addition, empirical research has documented a wide variety of business models involving diverse combinations of small to large-scale players; false dichotomies between small and large-scale should therefore be avoided (on biofuels, for example, see Vermeulen and Goad 2006).

Scale economies may be achieved by mechanisation and large-scale processing facilities in crops such as sugarcane, some cereals and soya. Many perennial crops such as rubber, fruit and vegetables may do better under intensive production with a significant proportion of manual input, though scale efficiencies may apply in packing and transport, with direct implications for production. In the absence of economies of scale, small farms may be more efficient than large ones because of the favourable incentive structure in self-employed farming and the significant transaction and monitoring costs associated with hired labour (de Janvry *et al.* 2001).

Even where there may be few economies of scale in production itself, there are increasing upstream and downstream economies of scale related to access to finance, inputs and markets. Purchasers of commodities prefer dealing with a few larger suppliers because of the transaction costs associated with handling produce from a large number of individual smallholders, relegating these to less profitable local market outlets. Such local markets are also under threat where local produce is in competition with food grains, often subsidised, from countries with surplus stocks (Vorley 2001). However, groups of smallholders may also organise themselves to jointly store, grade and sell their produce to gain access to large buyers.

Source: Cotula *et al.* (2009), drawn from Toulmin and Guèye (2003), with integrations.

But it is not just market forces that lie behind the new wave of large-scale land acquisitions. Governments in countries with high agricultural potential and competitive advantage are welcoming renewed commercial investment from domestic and foreign investors. Some governments have made specific efforts to identify “idle” lands, with a view to allocating them to agribusiness operators. For example, in July 2009 the government of Ethiopia reportedly marked out 1.6 million ha of land, extendable to 2.7 million, for investors willing to develop commercial farms (Reuters 2009).

In addition, governments in some food importing countries have created policy incentives for land acquisitions overseas as part of broader national food security strategies. Gulf countries have been particularly active in this respect. For example, Saudi Arabia’s “King Abdullah Initiative for Saudi Agricultural Investment Abroad” supports agricultural investments by Saudi companies in countries with high agricultural potential, with a view to promoting food security. Strategic crops include rice, wheat, barley, corn, sugar and green fodders, in addition to animal and fish resources.<sup>2</sup>

### **Acquiring land is a risky business**

While land acquisitions may be a rational response to these market and policy forces, purchases or long-term leases of farmland in lower- and middle-income countries are also associated with major risks for investors, and for host and home countries. From the investor’s perspective, running a plantation on the scale involved in some recent land deals is a major challenge for experienced agribusiness with long track records of working in lower- and middle-income countries, let alone for newcomers. In other words, the commercial risks involved in some of these investments are not to be underestimated. At the international level, the reputational risks linked to a perception of their being associated with corrupt regimes or poor business practices can also be significant.

In addition, holding large areas of land in countries that are foreign and often politically unstable, with poorly defined property rights, creates significant political risks. Once the bulk of the investment is made (once the irrigation infrastructure is developed, for example), the returns on investment depend on the successful implementation of the project over a long period of time,

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2. <http://www.mofa.gov.sa/Detail.asp?InSectionID=3981&InNewsItemID=88796>.



yet the investment is vulnerable to adverse action by the host state. It is not uncommon, for instance, for newly elected governments to renegotiate large foreign contracts. Land is a deep-seated socio-cultural issue in many societies, as it may provide the basis for social identity and the collective sense of social justice. Large-scale plantations are therefore also vulnerable to local contestation and redistributive efforts.

In home countries that support agricultural investments overseas as part of their domestic food security strategies, these commercial, reputational and political risks may have significant implications for national food security. Also, a future food crisis in the host country may force the host government to introduce food export restrictions, possibly in response to pressure from below, even in breach of promises made to the investor or its home country. In such an event, liquidating land-based investments and seeking alternative options may prove difficult and time-consuming.

From a host country perspective, the plantation model may be perceived as economically inequitable and politically unpalatable, being a throwback to colonial era. For local people, the main expected benefit in return for loss of land and access to grazing, water, wild and cultural resources is employment. But jobs may be unskilled and low-paid, and are often short-term or part-time without social security benefits. Plantations have historically demonstrated a tendency towards progressive mechanisation (with sugarcane being a strong example). Even strong proponents of the role of large-scale private actors in agriculture agree that the contribution to poverty reduction and rural development is maximised by people's participation as small farmers rather than as labourers (Poulton *et al.* 2008).

The long-term nature of typical large-scale acquisitions, involving leases of up to 99 years, would effectively lock communities and smallholders out of land for several generations. This may bring about the end of cultivation and livestock rearing as the traditional activities in affected areas, and thus adversely affect the capacity and resilience of local communities to ensure their own food security. Even when granted rights of participation in negotiation of contracts, communities and smallholders typically have a weak bargaining position to argue for higher levels of compensation or stronger involvement in emerging business models (Vermeulen and Cotula 2010).

Given these drawbacks of large-scale plantation models, are there alternatives to land acquisition that deliver opportunities for smallholders and local communities, while also offering economically attractive options for investors? Are there business options that enable smallholders to be active market participants, rather than passive recipients of compensation packages, while also offering investors a predictable investment environment, a lower risk profile and greater capacity for growth? The next few sections discuss these issues in greater depth.



### **III. FEATURES OF INCLUSIVE BUSINESS MODELS**





The majority of business models that link large-scale and small-scale economic operators have been in existence for some decades, and are therefore well documented and familiar to those working in agriculture. Section IV of this report presents the wide range of these business models under six broad headings: contract farming, management contracts, tenant farming and sharecropping, joint ventures, farmer-owned business and upstream/downstream business links. A working definition of each of these categories is given in the box below.

## DEFINITIONS

A **business model** is a way in which a company structures its resources, partnerships and customer relationships in order to create and capture value – in other words, what enables a company to make money. The degree of inclusiveness is measured by how ownership, voice, risk and reward are shared between the business partners.

**Contract farming** describes pre-agreed supply agreements between farmers and buyers. The agreements usually specify the purchase price, or how it will relate to prevailing market prices, and may also include terms on delivery dates, volumes and quality. In many cases the buyer, which is generally an agri-processing company, commits to supply upfront inputs, such as credit, seed, fertilisers, pesticides and technical advice, all of which may be charged against the final purchase price. In summary, there is a wide range of contract farming deals, from informal verbal purchase agreements through to highly specified outgrower schemes around large estates.

**Management contracts** refer to the variety of arrangements under which a farmer or farm management company work agricultural land belonging to someone else. Management contracts may take the form of a lease or tenancy, but carry the connotation of stewardship, of managing the land on behalf of the owner. To provide incentives for the farm management, the contract often entails some form of profit-sharing rather than a fixed fee.

**Tenant farming** and **sharecropping** are versions of management contracts in which individual farmers, for example smallholders, work the land of larger-scale agribusinesses or other farmers. In tenant farming the usual arrangement is a fixed rental fee while in sharecropping the landowner and sharecropper split the crop (or its proceeds) along a pre-agreed percentage. Sharecropping has historical negative associations with indentured labour in the US (e.g. as a system for freed slaves) but may be preferred to a fixed-rate tenancy because of the sharing of risk and better incentives for the sharecropper – and indeed sharecropping has historically provided the landless with land access in many parts of the developing world, such as Ghana.

**Joint ventures** entail co-ownership of a business venture by two independent market actors, such as an agribusiness and a farmers' organisation. A joint venture involves sharing of financial risks and benefits and, in most but not all cases, decision-making authority in proportion to the equity share.

**Farmer-owned businesses** are formally incorporated business structures for farmers to pool their assets to enter into particular types of business (e.g. processing or marketing), gain access to finance, or limit the liability of individual members. Such businesses are often owned by cooperatives in order to facilitate business transactions.

**Upstream and downstream business links** is an umbrella expression for the set of business opportunities beyond direct agricultural production that exist for both agribusinesses and smallholders and small local enterprises.

As a convenient shorthand, the report uses the term **agribusiness** to refer to companies working in the agricultural value chain that are not owned by smallholders or local community members. This includes companies involved in agricultural production, and businesses operating upstream or downstream in the value chain (UNCTAD 2009).

**Smallholder** is used here as a broad equivalent to family farmer, and captures the huge diversity of farming systems where agricultural activities are mainly based on family labour (Toulmin and Guèye 2003). It is worth emphasising the relative nature of the term "smallholder". As Dixon *et al.* (2004) aptly put it: "The term "smallholder" refers to their limited resource endowments relative to other farmers in the sector. Thus, the definition of smallholders differs between countries and between agro-ecological zones. In favourable areas with high population densities they often cultivate less than one ha of land, whereas they may cultivate 10 ha or more in semi-arid areas, or manage 10 head of livestock". The term **local communities** would include not only smallholders but also rural people not engaged in agriculture.

The choice among different business models does not add up to a simple either/or, based on the strengths, weaknesses and applicability of each. Nor can the set of choices be encapsulated in a decision tree. This is because the models overlap and can be combined into various hybrids. For example, a farmer-owned business can enter into a joint venture with an agribusiness and this legal partnership can undertake a management contract with a specialised provider. Also, the details of how ownership, voice, risks and rewards are shared within the business model can be just as significant to partners as whether the model falls within one broad categorisation or another.

Another important point is that business models typically involve more than two parties. Service providers, traders (“middlemen”), financiers and other private operators are in most cases likely to be crucial to the successful functioning of the scheme. Even more critically, government policies, legislation and direct participation in business models provide the basis for success or failure. This section finishes with a brief outline of the variety of market actors, institutions and policy areas that create the conditions to promote certain business models over others.

### **3.1. APPROACHES TO DIFFERENTIATE AMONG BUSINESS MODELS**

Instead of one universal typology of business models that include smallholders and communities in agricultural value chains, this section presents three different ways of distinguishing among models, based on:

- the match between landholder and day-to-day manager of farming operations;
- the degree of vertical integration in agricultural production; and
- the relevance to different stages of the value chain from producer through to consumer.

#### **Match between landholding and agricultural production**

A first, simple typology can be developed on the basis of the relationship between landholding and agricultural production. In a simple dualistic situation, land is either under the control of a large-scale agribusiness (on a plantation, estate or extensive commercial farm that is either owned by the agribusiness or on a long-term lease) or under individual or communal control of local residents including smallholder farmers.

Each of these types of land ownership can be operated by either the agribusiness or by smallholders. This gives rise to four different combinations of landholder and operator, each with a different set of possible models (Table 3.1). On land owned by smallholders, either the smallholders themselves can undertake contract farming, or they can allow an



**TABLE 3.1. BASIC TYPOLOGY OF INCLUSIVE BUSINESS MODELS BY LANDHOLDER AND FARM OPERATOR**

<i>Production led by</i> \ <i>Land held by</i>	Smallholders or community	Agribusiness
<b>Smallholders</b>	Contract farming – ranging from informal purchase agreements through to highly specified schemes	Tenant farming and sharecropping
<b>Agribusiness</b>	Management contracts Joint ventures	Labour arrangements predominantly – though can include opportunities for contractors and service providers

agribusiness to operate their land under a variety of management contracts or joint-venture arrangements (the differences among these depend on the combination of fees, cost-sharing and profit-sharing). On land owned by, or under long-term lease to, agribusinesses, the models to include smallholders are more limited, confined to tenant farming, sharecropping or paid labour, though with emerging opportunities for contractors and service providers (discussed in section 4.6).

**Degree of vertical integration in agricultural production**

As explained in section II, agricultural value chains fluctuate between greater and lesser vertical integration. At the production end of the chain, the recent trend has been towards more stringent standards for food safety, conformity and timing for most food crops and livestock products. This has proven a strong driver towards higher levels of coordination between producers and processing companies. What this means in practice for smallholders that sell into modern markets is more control by buyers (specialised wholesalers, processors and retailers) over the methods used in agricultural production.

Table 3.2 shows the continuum from spot markets through to full vertical integration (i.e. all activities from production to retail conducted by a single business entity). The sets of business models applicable to smallholder land are arranged along the continuum according to the degree of control that buyers exert over farming methods. In purchase agreements, buyers may specify quality standards, but do not specify farming methods. Contract farming arrangements vary from fairly loose terms through to highly specific

<b>TABLE 3.2. BUSINESS MODELS AT INCREASING LEVELS OF VERTICAL INTEGRATION</b>				
<b>Degree of vertical integration</b>				
← spot market		chain coordination		vertical integration →
open market	purchase agreement	contract farming	management contracts	fully incorporated land & production
<b>Types of business model</b>				

designation of which seed, fertilisers, pesticides and techniques must be used, and when. In certain cases, the agribusiness will use their own staff to spray the crops on smallholders' land.

At this point there is an overlap between contract farming and management contracts in which the agribusiness formally manages all operations on the smallholder's land. These management contracts may make economic sense for small-scale farmers but do remove them from all day-to-day farming decisions. Where the operating company is also the buyer/processor of the produce (which is not always the case), management contracts represent the most vertically integrated model available on land not owned by the agribusiness.

### **Relevance to different stages of the value chain**

Another way of assessing the applicability of different business models involves a value-chain perspective. In this context, much depends on the specific agricultural commodity. Table 3.3 gives a sense of the range of possibilities for biofuels, where options for smallholder inclusion in processing very much depend on how capital-intensive processing facilities are. Producer-owned processing (individual or collective) does exist in certain agri-industries, such as cheese-making, saw-milling and others. A wide range of other upstream and downstream business links may be possible. These can provide opportunities for non-land-based agricultural investment e.g. in high-tech input supply.

**TABLE 3.3. INCLUSIVE BUSINESS MODELS AT DIFFERENT STAGES OF THE VALUE CHAIN FOR BIOFUELS**

	<b>Farming →</b>	<b>Milling →</b>	<b>Refining →</b>	<b>Distribution →</b>	<b>End uses</b>
<b>Business arrangements to include small-scale owners and enterprises</b>	Outgrower schemes Purchase agreements Land leases Share-cropping Management contracts Joint ventures (e.g. community land inputs = shares in the business)	Cooperative mills Share ownership Small-scale facilities aimed at local end-uses Supply contracts with larger refineries and distributors	Limited options given high capital costs of biorefineries	Intermediary traders Transport contractors Utilising existing distribution systems (e.g. networks of rural retail outlets aimed at farmers)	Sliding-scale energy pricing for different categories of consumers Subsidised multi-function platforms Subsidised improved appliances Use of unrefined oil rather than refined biodiesel
<b>Options for government policy support</b>	Support to positive models through regulation, information, model contracts and brokerage Underwriting community business involvement	Active promotion of small-scale milling operations, e.g. via supply of prototypes Business support to shared equity models	Employment laws Holding developers accountable to job projections in approved investment contracts	Local content requirements	Support to off-grid energy schemes Subsidies as above
Subsidised finance and insurance schemes Cost incentives (e.g. tax breaks, reduced fees) Local supply quotas and local content requirements Active support: information, guidance, research					

Source: Vermeulen *et al.* (2009).

## 3.2. CRITERIA FOR APPRAISING THE INCLUSIVENESS OF BUSINESS MODELS

A more complex challenge involves identifying criteria for assessing the pros and cons of different business models. Economic viability is a precondition for agricultural investments to benefit the local population: without it, the project cannot be implemented unless supported by non-market forces. Proper due diligence by the agribusiness company, and robust scrutiny of investment proposals by the host government are key to assessing whether a proposed investment could withstand unexpected changes in agricultural commodity prices, for example. In this context, the choice among alternative business models needs to be grounded on solid economic analysis of rates of return and capital appreciation.

The focus of this report, however, is the way in which business models share value between the business partners – particularly between an agribusiness investor and local landholders and operators. Four criteria can be used to assess the way in which any business model shares value:

- **Ownership:** of the business (equity shares), and of key project assets such as land and processing facilities.
- **Voice:** the ability to influence key business decisions, including weight in decision-making, arrangements for review and grievance, and mechanisms for dealing with asymmetries in information access.
- **Risk:** including commercial (i.e. production, supply and market) risk, but also wider risks such as political and reputational risks.
- **Reward:** the sharing of economic costs and benefits, including price setting and finance arrangements.

These four aspects are closely interlinked. Ownership can influence voice, though a perfect correlation between the two should not be assumed (e.g., in a joint venture, equity shares and board representation may not be perfectly aligned). Voice in price-setting crucially affects reward. Ownership influences risk, as a jointly owned business also involves sharing of business risks. So a model that gives smallholders more ownership of the business may also expose them to more risk.

In addition, while this conceptual framework enables assessing business models in abstract terms, its application to any given investment project must be grounded in the concrete context within which the project takes place. For example, the same distribution of ownership, voice, risks and rewards may have very different practical viability and implications in contexts characterised by different population densities, or with different levels of smallholder capacity to engage in commercial agricultural production.

While the next section discusses various models in light of this conceptual framework, real-world investment projects may involve complex combinations of various models. For example, an agricultural investment project may involve a joint venture whereby local farmers contribute land or other assets in exchange for an equity stake in the project, a management contract for running the farm, contract farming between the joint-venture company and outgrowers, and other ancillary arrangements.

### **3.3. RELEVANT MARKET ACTORS, INSTITUTIONS AND POLICY AREAS**

This report focuses on types of business model and the policies and support that governments put in place to promote these specific models. But it is important to note that targeted business strategies and targeted policies are not sufficient to ensure successful implementation and outcomes. Business relationships between agribusinesses and smallholders operate within a much broader context of competing and collaborating market actors, formal and informal institutions, and macro-level policies. Relevant policies go beyond agriculture and land tenure to include areas such as decentralisation, foreign investment regulations and competition law. Space precludes a detailed discussion; more detail can be found in Vorley *et al.* (2007) and Vermeulen *et al.* (2008a).

**IV. BUSINESS MODELS IN PRACTICE**





## 4.1. CONTRACT FARMING

### **Brief description**

Contract farming describes pre-agreed supply agreements between farmers and buyers. It typically involves bundles of separate contracts between a company and (groupings of) local farmers. Contract farming arrangements vary widely depending on countries, crops and companies. Usually, local farmers grow and deliver agricultural produce for specified quantity and quality at an agreed date. In exchange, the company provides upfront inputs, such as credit, seeds, fertilisers, pesticides and technical advice, all of which may be charged against the final purchase price; and agrees to buy the produce supplied, usually at a specified price. The price is usually fixed through an amount indicated in the contract, but is in some cases determined by reference to spot-market prices.

In North America and Western Europe, contract farming was spearheaded by the vegetable canning industry in the 1930s and 40s (Little and Watts 1994). Its use spread to developing countries following the retreat of the plantation economy after World War II and decolonisation (see section II). With structural adjustment in the 1980s, some donor agencies promoted contract farming as “dynamic partnerships” between agribusiness and local farmers, and the World Bank’s “Berg Report” of 1981 identified contract farming as a promising example of ways to revive the agricultural sector (Little and Watts 1994). Parastatals in some developing countries have also played a key role in the spread of contract farming – for example, in Kenya’s sugar and tea sectors, or in Malaysia’s tree crop sector (Little and Watts 1994).

There is enormous diversity among contract farming schemes. Shifts between different models are possible over project duration. Schemes have been classified in five broad types (Eaton and Shepherd 2001; UNCTAD 2009):

- highly centralised models, where an agribusiness company buys produce from a large number of smallholders, with tight control over quality and quantity;
- the nucleus estate model, where the agribusiness company combines contract farming (“outgrowers”) with direct involvement in production through a plantation estate;



## Summary profile of ownership, voice, risk and reward

<b>Ownership</b>	<p>The business is entirely owned by the company, though company-smallholder joint ventures (with the joint-venture company then contracting local farmers) are also possible.</p> <p>Land rights (ownership or other) usually remain vested with smallholders. Where land is held by the company (for example, based on a government lease) and sublet to smallholders, as in some nucleus estate models, the negotiating power of local farmers is undermined.</p>
<b>Voice</b>	<p>Business decisions are taken by the company. The degree of smallholders' influence on those decisions varies across schemes. For instance, "pure" contract farming and nucleus estate models may have different implications for the negotiating power of local farmers: while in pure contract farming the agribusiness company relies entirely on smallholders, the degree of dependence on local farmers can be significantly lesser in nucleus estate models. Also, nucleus estate models often require a purchase monopoly to be viable, which further undermines local negotiating power.</p>
<b>Risk</b>	<p>Smallholders bear production risks linked to weather, pests and other factors affecting harvest. Clear commitments for the company to purchase produce (subject to agreed quality standards) at guaranteed prices shift market risk from smallholders to the company. But market risk for smallholders remains significant where contract farming arrangements determine purchase price through reference to (fluctuating) market prices, rather than to a fix amount.</p>
<b>Reward</b>	<p>Mainly determined by the purchase price for agricultural produce, but also by the terms and conditions for input supply from the company (e.g., whether/how seed and fertiliser costs are deducted from the purchase price). Depending on negotiating power, contract farming can be favourable to smallholders, or exploitative arrangements where smallholders are effectively wageworkers but carry production risks.</p>

- the multipartite model, whereby farmers sign contracts with a joint venture established between an agribusiness company and a local entity (a government agency, a local company, or a corporate body representing local farmers);
- the informal model, where more informal verbal purchase agreements are signed on a seasonal basis, with inputs provided by the company often being restricted to seeds and fertilisers; and
- the intermediary model, whereby an agribusiness company may have contracts with intermediaries, who then sign contracts with a larger number of farmers.

Contracts may be written or verbal. Written contracts vary hugely in format and content. A model contract for sugar beet from South Africa runs over 24 pages of detailed provisions, while a model contract for sugarcane in Honduras is much less specific – and two and a half pages long.

### **Prevalence and practice**

Contract farming has been widely used for a very long time in a range of different contexts – including tree and cash crops, but also fruits and vegetables, poultry, dairy produce and even prawns and fish (Eaton and Shepherd 2001). The relative importance of this arrangement within a country's different agricultural sectors can be very high. Contract farming accounts, for example, for 75% of poultry production in Brazil, 90% of cotton, 50% of tea and 40% of rice in Vietnam, 60% of tea and sugar in Kenya, and 100% of cotton in Mozambique (UNCTAD 2009). Use of contract farming for biofuel feedstocks such as jatropha is also increasingly common. Contract farming is particularly effective for highly perishable, labour-intensive crops, for which there is no alternative market other than the contractor (Rottger 2004).<sup>3</sup> There seems to be much less experience, however, with applying contract farming to crops that present economies of scale, such as grains.

Contract farming has historically been used by many agribusiness companies. But parastatals have made use of it too, for example in Kenya and Malaysia, and the International Finance Corporation (IFC) and the Commonwealth Development Corporation have played an important role in pioneering contract farming across Asia, Latin America and Africa (CDC 1989; Baumann 2000).

#### **CASE 1: LUVECO FRUITS AND VEGETABLES, VIETNAM**

Luveco is a joint-stock company belonging to a Chinese investor (55%) and to the Vietnamese state (45%). It exports canned fruits and vegetables to a dozen countries, of which Russia is the biggest. The main products are baby cucumbers, baby tomatoes and sweetcorn. 20% of the company's products are consumed domestically.

Luveco has implemented contract farming in Vietnam's Nam Dinh province since 1986. Contracts are signed with 20 farmer cooperatives, which in turn sign contracts with farmers. Before contract farming, local farmers cultivated rice. Cucumbers, tomatoes and sweetcorn were imported varieties. Luveco encouraged

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3. Where a product is not highly perishable (i.e. has a longer life), strict conditions regarding product supply and marketing may not always be observed (Rottger 2004).

smallholders to switch to the contracted products by providing inputs, training and stable prices. Contract farming proved attractive to many local farmers due to the higher and more stable income, and to the training opportunities.

Under the contracts, Luveco supplies the cooperatives with seeds, fertilisers and other inputs, for distribution to farmers. Payments for inputs are deducted from the purchase price. Luveco requires compliance with strict quality specifications concerning size, shape and firmness – produce not complying with these specifications is rejected.

The case is seen as a success story – the scheme has steadily grown over the past 20 years in terms of farmer numbers and contracted area. Farmers value the higher and more stable income provided by the contract, linked to access to export markets and to the guaranteed purchase price under the contract.

**Critical data:**

Population density: 1,170 people per sq km <sup>(4)</sup>

Size of investment and landholding: unknown

Date of establishment: 1986

Source: ADB (2005).



Jane Hahn/Panos Pictures

*What price will you pay? Pineapple growers in Akuapem South district, Ghana*

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4. Population 1,916,400, area 1,637 sq km.

## **CASE 2: BLUE SKIES AGRO-PROCESSING COMPANY LTD, GHANA**

Blue Skies Agro-Processing Company Ltd is a private company owned by a British national and established in 1998. It processes fresh fruits for export to some European markets, using a processing plant located in the Akuapem South district, about 25 km out of Accra. Products include pineapple (the main product), mangoes, watermelon, passion fruit and pawpaw. Much of the fruit is procured in Ghana on a contract farming basis, with pineapple mainly coming from the Akuapem South district.

Under the scheme, farmers receive technical training and advice from the processing company. No credit is provided, with the exception of a small number of trusted farmers. The company has also helped a number of pineapple farmers in the district establish an association, the Blue Skies Organic Collective (BSOC) Association, and obtain fair trade and organic certifications. The association currently covers pineapple cultivation over 112 ha, with an average farm size of about 2 ha. Quality specifications for agricultural produce are imposed, particularly with regard to sugar content. Produce is collected by the company at collection points, free of charge. Purchase prices are promptly paid to farmers (within two weeks of supply), an aspect that is appreciated by local producers. For products that are part of the fair trade scheme, the retailer pays a premium that goes into a fund managed by BSOC members. To date, two boreholes have been built with resources from this fund.

Blue Skies Agro-Processing Company Ltd has grown tremendously since its establishment, increasing its workforce from 38 to 450, 60% of which are permanent staff. The owner/general manager of the company is highly dynamic, committed and down-to-earth, and the working environment at the processing plant is friendly (for example, staff and management eat together at the canteen).

The lack of credit facilities, and farmer frustrations linked to rejection of fruits are among the reported challenges faced by the scheme. The processing company faces constraints in terms of high domestic tax regime and high inflation that erodes the benefit of exchange rate gains from exports.

### ***Critical data:***

Population density: 238 people per sq km <sup>(5)</sup>

Size of investment and landholding: unknown

Date of establishment: 1998

Source: Rottger (2004); [http://www.fairtrade.org.uk/producers/pineapples/blue\\_skies\\_products.aspx](http://www.fairtrade.org.uk/producers/pineapples/blue_skies_products.aspx)

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5. According to the 2000 census, the district has a population of about 120,000, 70% of whom are farmers. The surface area is about 503 sq km.

### **CASE 3: MWEAN RICE IRRIGATION SCHEME, KENYA**

The Mwean Rice Irrigation Scheme is the largest rice irrigation scheme in Kenya, involving about 3,400 farmers. The scheme was established in 1955, and is managed since 1966 by a parastatal under the control of the ministry for agriculture – the National Irrigation Board (NIB). Local farmers are registered tenants on public land, and are expected to abide by the rules set by the NIB. The NIB has annual contracts with farmers concerning the provision of services and inputs (such as seeds and fertilisers), which are provided on credit. Water is also provided on credit. Debt repayment is ensured by deductions from the purchase price at harvest. No financial credit is provided.

Rice milling is undertaken by the Mwea Rice Mill, the joint venture between the NIB (55%) and the Mwea Farmers Multipurpose Cooperative Society Ltd (45%), a cooperative established by local farmers. The cooperative also plays an important role in facilitating farmers' access to financial credit.

Farmers feel they have no say in decisions concerning prices for inputs, services and water use, and purchase prices. Although they own a 45% equity stake in the milling plant, this does not translate into significant leverage vis-à-vis the NIB. Also, long delays exist between crop delivery and payment of purchase prices.

Since price and marketing controls were removed in 1993, a large number of rice mills have started to operate in the immediate surroundings of the irrigation scheme. This has offered new options to the farmers, who can now divert rice paddy to the private mills, but also raised questions as to the regularity of supplies to the NIB.

#### ***Critical data:***

Population density: 309 people per sq km <sup>(6)</sup>

Size of investment and landholding: unknown

Date of establishment: 1955, with successive institutional reforms

Source: Rottger (2004).

### **Roles of third parties and of policy support**

Contract farming is primarily a direct arrangement between agribusiness and smallholders. However, government can play a key role as well. At the very minimum, making contract farming work requires an enabling legal framework, including appropriate laws of contract, and legal/institutional mechanisms for local groups to get organised and be recognised as a legal entity (through cooperatives, for example). The organisation of farmers in

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6. Area: 1,478 sq km. Population (1999 census): 457,105, of which about 430,000 in rural areas.

associative forms, and proper support to farmer associations, is a key step to address two success factors for contract farming – namely, the need to balance asymmetries in negotiating power between the parties, and the need to reduce the transaction costs of dealing with large numbers of farmers (da Silva 2005).

Where local capacity is weak, governments and development agencies can play an important role by strengthening the business, managerial and other skills of local organisations. Governments can also play a key role by developing and disseminating model contracts for key crops, and by monitoring the performance of contacts so as to protect the rights of both parties. Credit support, tax benefits and other policy incentives can encourage companies to engage in contract farming (Guo *et al.* 2007). Appropriate pricing of land in agricultural investments would also create greater incentives for contract farming arrangements.

### **Pros and cons, opportunities and challenges**

Pros:

- Contract farming enables companies to ensure regularity and quality of supplies without taking on the commercial and political risks associated with acquiring land and running a plantation (Tiffen and Mortimore 1990). It is particularly relevant for land-scarce areas (Eaton and Shepherd 2001). When combined with a plantation (in the nucleus-estate model), contract farming can increase the political acceptability of the plantation (Baumann 2000).
- For high-value, labour-intensive crops, contract farming may promote efficiency in farming, compared to plantations. Evidence indicates that family farming units tend to achieve comparable or even better productivity, when compared with larger, commercially managed units (see section II). The main reasons are the incentive structures and the comparative advantage in micromanaging farming operations (da Silva 2005).
- Contract farming also enables farmers to gain access to credit, seeds and technologies; procuring inputs through the company may generate economies of scale that may be passed through to the farmers; credit may be accessed directly through the contract farming scheme, or indirectly through third-party banks using the contract as security (Glover and Kusterer 1990; Eaton and Shepherd 2001; da Silva 2005).

- Contract farming can help smallholders gain access to more lucrative but remote markets for high-value crops, and reduces market risk and hence increases income stability for farmers – especially where price is predetermined (Glover and Kusterer 1990; Eaton and Shepherd 2001; da Silva 2005).
- Smallholders may also develop management skills, and may benefit from by-products and residues such as manure from poultry production (da Silva 2005).

#### Cons:

- As with all business models, much depends on the specifics of individual deals, and thus ultimately on negotiating power – smallholders may not be able to secure a favourable deal (Glover and Kusterer 1990). Where contract farming accounts for a large share of the farmers’ income, or where the company is the only purchaser, monopsony undermines local negotiating power (Eaton and Shepherd 2001). A review of experience with contract farming found that many contracts were “heavily weighted against the smallholders and in favour of the project authority” (CDC 1989:85).
- Contract farming may be difficult to enforce: farmers may be tempted to sell produce on the open market if market prices rise above contract prices (Glover and Kusterer 1990), while remedies against a company not honouring its purchase commitments when market conditions change are limited (Little and Watts 1994; da Silva 2005).
- From a company’s perspective, a degree of supply risk may remain, particularly linked to insufficient or inconsistent quality and quantity, or even default by contract growers (Glover and Kusterer 1990); lack of land tenure security for local farmers may jeopardise incentives for them to invest so as to meet production targets (Eaton and Shepherd 2001).
- The transaction costs may be high, particularly when large numbers of farmers are involved (da Silva 2005).
- Where the company advances credit and deducts payments from purchase prices, growers may risk becoming locked into debt (Tiffen and Mortimore 1990). Risks of indebtedness are higher for long-term investment like tree crops, or where contract farming introduces the new crop to the area – as yields may turn out to be lower than expected (Eaton and Shepherd 2001).

- Poorly defined delivery schedules or quality standards may enable manipulation by the company or its employees. Companies may set delivery schedules so as to influence purchase prices – for instance, when prices are rapidly changing and companies adjust the delivery schedule to benefit from the market volatility (da Silva 2005). As for rent-seeking by employees, there have been reports of local inspectors demanding bribes from farmers (Glover and Kusterer 1990). There have also been reports of late payments for purchased agricultural produce in some schemes (Glover and Kusterer 1990).
- Inputs provided by the company (technical assistance, for example) may be of poor quality (Glover and Kusterer 1990), particularly where the relative importance of contract farming to the company is limited (in nucleus estate models, for example).

#### Opportunities and challenges going forward:

- Contract farming may bring associated employment opportunities, for example in processing plants, thereby increasing local incomes and self-confidence (for example, for women working in packing sheds, canning plants or freezing factories; Glover and Kusterer 1990).
- Contract farming requires a minimum level of local capacity to undertake agricultural production to specification.
- Whether smallholders decide to become involved with contract farming depends on the alternatives available to them. Where contract farming is an attractive option, more “progressive” farmers are more likely to participate. But where better options are available, contract farming is likely to attract less dynamic smallholders attracted by input supply and guaranteed market access (Glover and Kusterer 1990). Evidence suggests that contract farmers tend not to be the poorest of the poor and that access to the land required for cultivation excludes the landless (Baumann 2000). Research about tea farming in Kenya found that contract farmers tended to have twice as much land as smallholders outside the scheme, and that contract farming fostered social differentiation (Little and Watts 1994).



- Agribusiness may prefer larger farmers where they are available, so as to reduce transaction costs (Tiffen and Mortimore 1990). Where that is the case, labourers employed by local suppliers may have lower wages and social benefits than workers in plantations. This is partly due to the often lower level of unionisation in locally owned farms (Glover and Kusterer 1990), though even in large-scale plantations labour unions may be restricted.
- The stipulation of farming methods within contracts may be so strict that contract farmers effectively become suppliers of labour on their own farms, without any participation in farm management decisions.
- Although contract farming per se has no direct implications for the distribution of land rights, changes in land access may still occur in the longer term, as local elites may be better able to seize the opportunities created by the greater intensification and commercialisation of agriculture and by the ensuing shifts in land use patterns.
- Also, cash crops controlled by men may encroach upon lands previously used by women for food crops. Farming contracts are often with male household heads, and payments are made to men, even where it is women who do the bulk of the work. In a documented example, the introduction of contract farming for rice in an area previously used for sorghum, traditionally grown by women, led to conflict which was solved through negotiations between husbands and wives (Eaton and Shepherd 2001).

### **Future potential and options for scaling up**

Evidence as to whether contract farming benefits smallholders is mixed. As Guo *et al.* (2007) aptly put it: “Contract farming has a checkered history throughout the world. At its best, contract farming provides a means to manage complex production processes with greater precision than is possible through arm's length market transactions. This can result in higher quality, safer food with lower production and marketing costs. In some cases, particularly in developing or transition economies, contracting can overcome imperfections in input and output markets or institutional deficiencies by providing credit, seeds, machinery services, human capital and market access to farmers. However, without adequate competition among contracting firms, informed farmers and rule of law, contract farming may lead to economic serfdom for peasant farmers or a food system that meets the economic objectives of power elites.”

Also, contract farming seems particularly suited to highly perishable, labour-intensive crops. There is also some experience with rice. But there is less evidence on the potential of this model for other extensive crops such as sugarcane, maize and wheat, which are drivers of much recent agricultural land acquisition.

## 4.2. LEASES AND MANAGEMENT CONTRACTS

### **Brief description**

Lease and management contracts refer to the variety of arrangements under which a farmer or farm management company works agricultural land belonging to someone else. To provide incentives for the farm management, the contract may entail some form of profit-sharing rather than a fixed fee.

Management contracts can be applied to a wide range of contexts. They are commonly used, for instance, by holders of large estates to contract an agribusiness company to manage their plantation. Estate holders may be individuals, companies or state bodies, and may hold the plantation based on ownership or long-term leases. The focus here, however, is on use of lease and management contracts where land is held by smallholders and local communities.

Like lease contracts, which involve fixed rent, management contracts allow an agribusiness full control over farming operations implemented over land held by local communities. But management contracts provide a wider range of options for revenue-sharing. In addition, management contracts carry the connotation of stewardship rather than acquisition of land: farmland is managed on behalf of the community or individual landholder, rather than by an investor purely for self-gain. The holder of the management contract is the fiduciary representative of the farm owner or owners.

There is a wide range of possible models for lease and management contracts, depending on the desired share of risks and returns between the landholder and farm operator. The set of possible options includes:

- fixed cash rent – essentially, a straightforward lease contract whereby the lessee/operator runs the farm in exchange for payment of rental fees that are usually based on land area;
- profit-sharing (“net share”) schemes, whereby operator and landholder split profits from the sale of produce on the basis of an agreed formula;
- sharing of the crop or livestock produced, with each party being responsible for storage and marketing of its share;
- custom blends of the above or fully customised packages.

A farm management company that operates several farms in an area can bring in scale advantages such as bulk input supplies, as well as pooled value-addition through quality control, processing and marketing. The company may also help landholders gain access to emerging economic opportunities such as wind energy or recreational concessions.

### Summary profile of ownership, voice, risk, reward

<b>Ownership</b>	Land remains under tenure of smallholders or community landholders. Other assets may be owned by either party. There is no joint business venture. The agribusiness company acquires a land use right to operate the farm.
<b>Voice</b>	Management contracts differ from joint ventures in that landholders do not make decisions regarding farm management. Day-to-day management decisions are made by the contracted farm manager or management company (e.g. agribusiness). Well advised landholders retain the option to review the contract on a regular basis or to withdraw, given a stipulated notice period.
<b>Risk</b>	In profit-sharing and crop-sharing models, both parties share production and market risks. In other cases (e.g. fixed rent), risks are carried by the management company, while landholders shoulder the opportunity costs to land.
<b>Reward</b>	Contracts may specify benefit-sharing (e.g. crop share or profit share) or else give standard fixed rent terms.

### Prevalence and practice

Farm management contracts are prevalent in countries of high agricultural potential in which ownership and management of farms have become separated, including Brazil, US, Australia, Canada and South Africa. Overall about 40% of US farms are operated in this way, with the highest popularity along the Mississippi and Missouri Valleys, in the mid-West cornbelt and in the irrigated horticultural areas of California, where more than 50% of farms will be rented out or under some other form of management contract (Jerry Warner, personal communication). In Papua New Guinea, a form of management contract in which landholders receive royalties as well as land rental fees is issued as an alternative to a simple lease model (see case study box). In South Africa, a 2008 land lease between Mondi Ltd, a South African timber company, and the Siyathokoza Community Trust allows the company to grow and own timber and to conduct commercial forestry operations on the community's land. In return, the community trust receives indexed and periodically reviewed fees. This deal was concluded as part of a land restitution settlement involving the investor, the community trust and the South African government.

#### **CASE 4: NEW BRITAIN PALM OIL LTD (NBPOL), PAPUA NEW GUINEA**

Communities in Papua New Guinea own 97% of the land. One of the most economically advantageous land uses is production of palm oil. In order to put their land under commercial production, landowning clans enter into a type of management arrangement called “lease-leaseback”. The arrangement involves landholders, government and agribusiness, and provides a system by which government can standardise and monitor business models to ensure maximum benefits to communities.

NBPOL is Papua New Guinea’s largest oil palm plantation manager and miller and one of the first in the world to be certified by the Roundtable on Sustainable Palm Oil. It manages 40,000 ha of plantations on community land. The process for a community to enter into an agreement with NBPOL is first for the landowning clan, with assistance from NBPOL, to register an Incorporated Land Group (ILG) with the Department of Lands and Physical Planning (DLPP). The ILG has a Constitution, a Management Committee and a Disputes Settlement Authority. The area of land over which the ILG has usage rights is surveyed, assigned a number and the resulting plan registered with the DLPP. The ILG agrees to lease this registered portion to the state for an agreed time. The state in turn then leases it back to the ILG as a Special Agricultural and Business lease for a similar period (“lease-leaseback”). This legal instrument creates a standardised mechanism for communities to transfer land to agribusinesses.

Under conditions within a formal Agreement, the ILG then sub-leases this portion of land under a management contract to NBPOL, for a variable period, usually around 20 years. NBPOL manages all aspects of development and ongoing harvesting and maintenance of the mini estate.

Direct benefits to the ILG are: annual land rental payment of PGK 50 (USD 19) per planted ha paid quarterly in advance; monthly pre-negotiated percentage on all fresh fruit bundles harvested that month; free transfer of a quotient of NBPOL shares, the number of which depends on planted area and term of lease. In addition, the company provides employment and preferential access to supply contracts for local residents. NBPOL is currently expanding from its portfolio of 13 mini estates sub-leased from ILGs on 12,000 ha up to 20 mini estates, with a total planted area of 24,500 ha.

#### ***Critical data:***

Population density of West New Britain: 9 people per sq km

Size of investment and landholding: value unknown, 12,000 ha

Date of establishment: 1998

Source: <http://www.nbpol.com.pg/about/smallholder.html>; Mayers and Vermeulen (2002).

## **Roles of third parties and of policy support**

Leases and management contracts are primarily deals between the farm manager (the agribusiness company) and the landholder (smallholders). Governments provide the regulatory framework governing these deals. Virtually all countries have legislation that frames the terms of contracts, including leases, though not all have specific legislation regulating more sophisticated forms of management contracts. Some countries, such as Papua New Guinea, have additional terms and services to regulate management contracts for farmland.

Third parties are not major players in these arrangements, as the management company in general provides or sources necessary services, though NGOs may provide business, negotiation and livelihood support to local communities.

## **Pros and cons, opportunities and challenges**

Pros:

- Management contracts can be simple to implement and economically viable for both parties.
- They provide potentially better returns and wider sets of options to smallholder and community landholders.
- They can also provide landholders with access to new economic opportunities in which the management company has experience, such as windfarms, the voluntary carbon market or other non-agricultural land uses (e.g. tourism).

Cons:

- Some forms of management contracts are functionally very similar to long-term land leases and can suffer the same problems – they can confine local landholders to long-term contracts with minimal opportunities for renegotiation at flat-rate returns that do not reflect market prices, and they may render landholders passive recipients of payments in cash or in kind, rather than active participants in the management of the business.
- Landholders are not involved in decision-making over farm management, which excludes options such as combining commercial farming with small-scale subsistence plots.



Aubrey Wade/Panos Pictures

*We like our crop. Women harvesting in Liberia*

### Opportunities and challenges going forward:

- The range of options for combining lease and profit-sharing models, and multiple land uses, in agricultural investments in lower- and middle-income countries can be further extended; this is exemplified by experience from the US, where a very wide range of options is available to landholders.
- From the landholder's perspective, it is important to ensure that the management contracts are over short enough terms to allow review and renegotiation; very long-term leases separate landholders from control over their land for generations.
- Where large areas of land managed by agribusiness were previously farmed by large numbers of people, tackling unemployment may be a key challenge, particularly where high levels of farm mechanisation result only in few, highly skilled jobs being created.

### **Future potential and options for scaling up**

Management contracts that specify a crop-share or profit-share may be an improvement on flat-rate leases in many cases, in terms of providing greater incentives for managing company performance and fairer returns to landholders, particularly as land values rise. There is good potential for scaling up given the relative simplicity of these arrangements.

## 4.3. TENANT FARMING AND SHARECROPPING

### **Brief description**

In general terms, tenant farming and sharecropping are a sub-set of the lease and management contracts discussed in the previous section. However, within the context of collaborations between agribusiness and smallholders, they are effectively the mirror version of those arrangements. While the previous section discussed mechanisms for agribusiness to run farms on land held by smallholders, the focus here is on arrangements for smallholders (or medium-sized farmers) to farm on land held by a larger-scale agribusiness.

In tenant farming the usual arrangement is a fixed rental fee, while in sharecropping the landowner and sharecropper split the crop (or its proceeds) along a pre-agreed percentage. These arrangements do not provide an alternative to large-scale land acquisition, as they occur primarily on land under large-scale ownership or leasehold. They may be used in conjunction with other business models discussed in this report (for example, contract farming in its nucleus estate variety).

### **Prevalence and practice in different countries**

Sharecropping is a main form of land rental in developing countries but has been widely criticised – both by economists, for being less efficient than cash rental contracts, and by campaigners for social justice, for being exploitative. Nevertheless, whereas effort supply and intensity of input use may be higher under fixed rental contracts, under uncertain seasonal farming conditions, and with limitations on working capital and access to credit, share tenancy is a favourable option for tenants and minimises risks for tenants as well as for landlords (Lavigne Delville *et al.* 2002).

Indeed, in many parts of the developing world sharecropping is seen as a valuable alternative to fixed-rate rentals because it enables farmers to share production risks with their landlords, and because it creates better incentives for the sharecropper. Sharecropping has historically provided the landless with land access in many parts of the developing world, for instance in coastal West Africa. However, as land becomes scarcer, the terms and conditions of sharecropping in this part of the world are being transformed. In Ghana, whereas share contracts were a means by which land-poor but labour-rich households could gain access to a plot, those seeking to sharecrop



## Summary profile of ownership, voice, risk, reward

<b>Ownership</b>	Land is owned by a large-scale agribusiness or individual landowner. In tenant farming, the tenant usually provides all unfixed inputs (machinery, seed, fertilisers, etc.), while in sharecropping these may be provided by the landowner.
<b>Voice</b>	Day-to-day management decisions are taken by the tenant farmer. Sharecropping may involve either independent decision-making by the sharecropper, shared decisions, or complete managerial control by the landowner. In both tenant farming and sharecropping there may be contractual limitations to land use and production methods (e.g. sustainability plans), which may be stringent. Compared to contract farmers that cultivate their own land, tenants on land rented from the company tend to be in a weaker negotiating position – as they may lose the land if they do not comply with the conditions imposed by the company.
<b>Risk</b>	In tenant farming, production, market and financial risks are shouldered by the tenant. Sharecropping shares the risks between the parties, and protects smallholders from the full brunt of production risk – if the crop fails no rental fee or proportion is payable to the landholder.
<b>Reward</b>	In tenant farming, the tenant keeps all returns and pays set fees to the landowner. In sharecropping either the crop itself or profits from the crop are shared proportionately between the sharecropper and the landowner.

land must now put forward a significant fee in order to gain access (Amanor 2001). This would imply that poorer, more marginal groups are finding their position more difficult – an expected trend as demand for land becomes stronger and land values rise.

Tenant farming is widespread in Europe and Asia. It is also a favoured arrangement for management of high-value multi-use farmland (see case study).

Within the context of agribusiness-smallholder partnerships, tenancies and sharecropping have been used in a number of settlement schemes for irrigated sugarcane cultivation since the 1970s. Parastatals or private companies, in some cases with support from agencies like the Commonwealth Development Corporation, would develop irrigation infrastructure and undertake costly land levelling. Recovering these costs required high yields – yet it was seen as politically and socially important to involve local farmers. The solution was to divide the farm in blocks (e.g. of 5 ha each) that were farmed by local farmers. Cane planting, mechanical operations and harvesting were usually undertaken by the management company, while irrigation, fertilising and weeding were carried out by the farmers under strict control from the company. Several of these schemes proved successful, though tenants were effectively closer to profit-sharing hired labourers than to genuinely independent farmers (Tyler 2008).

### **CASE 5: LOWER ST LAWRENCE MODEL FOREST, CANADA**

This timber-producing forest, owned by a large newsprint company, is partially rented out to about 26 tenant farmers on about 1,000 ha each. They manage the timber resources in their units individually and the non-timber forest products (hunting, fishing and recreation) collectively. The tenant farmers pay rent not on the land per se but rather in the form of stumpage fees on harvested timber, which they can sell on the open market so long as they adhere to pre-agreed sustainable management plans. The revenues from these fees go into forest protection, infrastructure and government land fees. A socio-economic survey of the scheme after a decade demonstrated successful economic performance and a very high level of satisfaction among tenants.

#### ***Critical data:***

Population density of Lower St Lawrence: 35 people per sq km

Size of investment and landholding: value unknown, 112,000 ha

Date of establishment: 1993

Source: Mayers and Vermeulen (2002), Masse (2002), Laurentian Forestry Centre (2004).

### **Roles of third parties and of policy support**

Like the management contracts discussed in the previous section, the primary role of government policy is to set the regulatory framework regulating tenancy and sharecropping.

The prohibition and excessive regulation of land rental markets, long in force in many developing countries on grounds of social justice, may restrict land access opportunities for landless groups. While clear and secure tenancy rights and the elimination of exploitative practices are important, it is now accepted that there is a compelling case for liberalising restrictions on both fixed rental and share tenancy contracts (Deininger 2003). Several countries across the world have indeed adopted reforms to ease restrictions on land rentals and sharecropping (Deininger 2003).

Nevertheless, there remains a strong case for regulating tenancy in favour of the poor, providing some measures of security of tenure and curbing the potential for exploitative practices of landlords – and the government can play a key role to that effect (Srivastava 2004).

## **Pros and cons, opportunities and challenges**

Pros:

- Tenancy and sharecropping allow redistribution of income-generating opportunities to landless, often small-scale, farmers.
- They also maximise intensive management of land and resources, often important to maintaining the value of the asset to landowners.

Cons:

- The model does not solve political and other problems associated with large-scale landholdings.
- In some cases, the incentives to landholders and to tenants or sharecroppers to maximise production, or to manage the resource sustainably, are not clear, for example when there is no link between the payments made and environmental upkeep.
- Compared to smallholders that cultivate under contract on their own land, contract farmers settled on land rented from the company tend to be in a weaker negotiating position – as they may lose the land if they do not comply with the conditions imposed by the company (CDC 1989; Baumann 2000). Tenants in sugarcane settlement schemes are effectively closer to profit-sharing hired labourers than to genuinely independent farmers (Tyler 2008).

Opportunities and challenges going forward:

- Greater policy support needed in most countries for both tenants and sharecroppers.

### **Future potential and options for scaling up**

On the whole, sharecropping is limited in its applications, except in its more modern incarnation as profit-sharing management contracts (see section on management contracts). Tenancy is a strong option for forest management in extensive forest areas, for example in emerging arrangements for Reduced Emissions from Deforestation and Forest Degradation (REDD).

## 4.4. JOINT VENTURES

### **Brief description**

Joint ventures are extremely versatile arrangements whereby two or more parties jointly run a business venture. Each party contributes to the joint business, whether in cash (capital) or in kind (e.g. land/natural resource rights, technology, know-how), and participates in any profits (or losses) made by it. There are two key features of joint ventures: (a) the partners share ownership of the venture, not just benefit-sharing, and (b) the partners do not merge into a single entity but retain their individual legal status.

Joint ventures may have varying degrees of formalisation. At one extreme, they may entail setting up a jointly owned, incorporated company (i.e. a company with legal personality), which is co-owned by the joint venture parties according to agreed shares. Incorporation (i.e. creating a body with a separate legal entity) enables the joint-venture parties to limit their liability, and the joint-venture company to own property, enter into contracts, sue and be sued. Many joint ventures are not incorporated, i.e. they are run without a separate joint-venture company with distinct legal personality. Unincorporated ventures have the advantage of greater flexibility. Even looser forms of business alliances may be considered as joint ventures. A joint venture may or may not be time-bound – i.e. concluded only for a fixed period of time.

Since terminology and legal provisions differ from country to country, this section considers the range of joint venture models between agribusinesses and smallholders together. The joint venture model is intrinsically attractive because it includes smallholders as full business partners in agribusiness activities, granting them shares of realised profits (rather than just one-off compensation, land rent or farmgate crop prices) and, in most cases, a legally recognised decision-making role in the business. As the case studies and discussion below demonstrate, however, there are considerable differences among models in different contexts, and between intention and practice.

### **Prevalence and practice in different countries**

Because of their versatility, joint ventures between agribusinesses and smallholders, or landholders, are now fairly widespread and well established globally. They occur in both temperate and tropical regions and in high-,

## Summary profile of ownership, voice, risk, reward

<b>Ownership</b>	Agribusiness and smallholders co-own the business, sometimes with other partners such as government. Where complex systems of parent and subsidiary companies are in place, the practical implications of joint business ownership depend on which company along the parent-subsidiary chain is jointly owned. Specific assets used by the business, such as land or equipment, may be owned by one of the parties only. In these cases, ancillary contracts between the joint-venture company and its shareholders may grant the joint venture access to assets or services held by the shareholders (e.g. technology transfer agreements or land leases). Land may constitute the smallholders' investment in the business.
<b>Voice</b>	Strategic decisions are usually taken jointly by the parties – in incorporated joint ventures, through a board of trustees or equivalent organ. The deciding vote is usually in the hands of the majority shareholder, but representation in the board is not necessarily proportional to equity shares (e.g. it may be possible for smallholders to obtain a higher number of trustees than their equity participation would seem to allow). Minority board membership may in practice give limited say in key decisions, but mechanisms can be established to protect minority rights (e.g. by requiring special majorities for key decisions). Minority participation in the board can still enable smallholders to access key information about the business. The board appoints and supervises the manager, who runs the joint venture on a day-to-day basis. In joint ventures incorporated as joint-stock companies, shareholders elect the board and have annual shareholder meetings.
<b>Risk</b>	Production, marketing and financial risks are shared proportionately with ownership – taking on these risks without prior experience of business is perhaps the major drawback for smallholder partners. Governments may underwrite risks to cushion more vulnerable partners.
<b>Reward</b>	Costs and returns accrue to the joint business. Profits that are not reinvested in the business (dividends) are shared proportionately with ownership. Payment of dividends is an advantage of joint-venture arrangements for smallholders. However, allocation of costs, risks and profits can be complex so that inexperienced business partners may be deprived of dividends if the accountancy within the business is insufficiently transparent. Also, when growers/shareholders are numerous, dividends per capita may be very small both in absolute terms and relative to the agricultural wages or produce price received by the growers.

middle- and low-income countries. These kinds of models have become more prevalent in recent decades as governments have enacted legislation and policy to provide economic opportunities for rural communities and smallholders.

Some joint ventures have become quite successful from a commercial point of view. For example, Divine Chocolate Company is a joint venture between the Kuapa Kokoo Farmers' Union (currently 45% of shares), a union of cocoa farmers in Ghana, TWIN Trading, a UK-based fair trade body, and Oikocredit, a microfinance institution. Divine has expanded rapidly over the past few years. While benefiting from fair trade certification, it made special efforts to sell its



Aubrey Wade/Panos Pictures

*This is my share. Kuapa Kokoo is a cocoa farmers' cooperative in Ghana which owns 45% of the London-based company Divine Chocolate*

chocolate bars through mainstream retailers. Body Shop had a 14% stake in the business for a number of years, and provided access to the UK market through its extensive retail network. Comic Relief and Christian Aid have also supported the marketing of Divine's produce, and are represented in Divine's board (de Koning and de Steenhuijsen Piters 2009).

Land-based joint-venture models, in which smallholders' asset contribution to the joint venture is their land, require some type of formal legal recognition of communal ownership of land, or a legal means for small individual land areas to be pooled for the purposes of the business venture. Countries having documented experience with land-based joint ventures include Canada, Mexico, South Africa, Tanzania, Papua New Guinea, Malaysia and Sweden. Further information is given below on experience in South Africa and Malaysia. Case studies are provided for each of these countries, supplemented by a further case study from Mali.

**South Africa:** Under the land reform programme, the South African government has encouraged joint ventures between local farmers and agribusinesses. This includes two different situations: schemes in which holders of equity shares in the joint venture are existing employees; and schemes in which the joint venture is established between a company and beneficiaries of the land restitution programme (which may be different to

current employees). The focus here is on the latter case. The rationale for government support to schemes linked to land restitution has been to maximise economic benefits to land reform beneficiaries by linking them directly into well-established, professional farm management companies. Between 1994 and 2002, 50 joint-venture schemes were established with the help of government grants, of which 20 were in the Western Cape province, the area of greatest potential for high-value export horticulture (Mayson 2003). A further 38 were developed between 2002 and 2009 (Greenburg 2009).

The business model was designed to allow entry of previously disadvantaged people into highly competitive commercial agriculture. The Department of Land Affairs (now reconstituted as the Department of Rural Development and Land Reform) provided considerable guidance to the schemes. The standard model was for government to pay for land that was then held by a community trust owned by the beneficiaries. Management of the farm was contracted out to an operating company. Typically, 49% were owned by the former landowner (an agribusiness or individual commercial farmer) and 51% by the trust. A contract stipulated the terms for farm management and sharing of costs and benefits, usually with terms to gradually transfer technical and financial skills to the majority shareholders. The model provided a material incentive for effective farm management by the ex-owner along with three benefit streams to beneficiaries: dividends, land rental fees and wages for continued labour (Greenburg 2009; on joint ventures established in connection to South Africa's land reform programmes, see also Lahiff 2007).

Even without government support, many commercial farmers and agribusinesses sought to enter joint-venture schemes (Mayson 2003). Motivations included rationalisation of operations, improvement of the company's marketing credentials, corporate social responsibility and, most importantly, raising much-needed recapitalisation via the land beneficiaries' land reform grants (i.e. indirect access to government funding).

These joint venture schemes are a good idea in theory, as they provide beneficiaries with a tangible commercial asset that can yield good dividends and grow in value over time. But they have also been heavily criticised. Farm worker equity share schemes tend to be structured so that individual share ownership is linked to continued employment. As such, workers may be dismissed and hence lose their access to land. Secondly, the schemes do not involve major changes in production systems, and as such do not meet



people's demand for small plots on which to produce food for own consumption and small-scale enterprise. Furthermore, in almost all cases the original commercial farmer or agribusiness has retained effective control over all business decisions. Employee shareholders have been offered few if any alternatives. In some land restitution-based joint ventures, tensions have ensued between existing farm workers and new landowners hungry for jobs (Ruth Hall, personal communication).

Of 88 shared equity agriculture schemes established in South Africa between 1996 and 2008, only nine have declared dividends. In one widely discussed case, the Levubu citrus estate in Limpopo province, the largest source of income for beneficiaries was not dividends or land rental but wages, paid at the same rates as on other commercial farms, an average of ZAR 1,385 (USD 185) per month according to the most recent agricultural census in 2007 (Greenburg 2009). The sense was that the management company found ways to conceal profits within elaborate accounting structures and avoid any significant transfer of technical skills. The management company in this case went into liquidation in 2009. In addition to the loss of dividends, the land beneficiaries were given little choice in outcomes. According to some observers, when the Levubu restitution claim was processed in the early 2000s, the government effectively imposed the joint-venture scheme so as to prevent a negative impact on the commercial agricultural sector, and did not allow beneficiaries to move back onto any portion of the land (Greenburg 2009).

#### **CASE 6: BONAGUDE-MANZINI PARTNERSHIP, SOUTH AFRICA**

In 2004, a partnership comprising the company Manzini Estates and the Bonagude Trust purchased the farm Spes Bona from Mondi Business Paper (part of the Mondi group). Manzini Estate is a family-owned company that runs Manzini Estate, the farm neighbouring Spes Bona. The Bonagude Trust is an organisation formed by the workers of Manzini Estate as the business vehicle necessary to contract with Manzini Estate in order to form the partnership. Spes Bona and Manzini Estate are managed as a single operating unit, with common equipment and labour. As one of the conditions of sale, all the timber harvested on Spes Bona for the next 30 years will be sold to Mondi Business Paper.

The capital required for the purchase of Spes Bona, ZAR 10 million (USD 1.7 million, using 2004 conversion rates from oanda.com), was raised from Standard Bank of South Africa, using the value of the timber on Spes Bona as surety. The Bonagude Trust secured ZAR 3 million as a loan to purchase 20% of the shares, and Manzini Estate, which already had investment capital, secured ZAR 7 million



to purchase 70% of the shares. Further shares will be made available to investors in future to allow for further black economic empowerment.

Dividend payouts are in the order of ZAR 500,000 per year, with each member of the Bonagude Trust receiving approximately ZAR 500 (USD 85). Where more than one member of a household is employed on Manzini Estate, each member is a beneficiary of the Bonagude Trust (i.e. shareholding is not limited to one member per family). To qualify, employees must have worked for Manzini Estate for a minimum of three months. Every Trust member has to nominate beneficiaries in the case of their death so that their share of the dividends can be paid out to the nominated beneficiary should they die. The shareholders of the Bonagude Trust have formal land rights based via land reform, and hold the title deeds to approximately 820 ha of land under timber, for which all permits and 34 licenses have been obtained.

There is little opportunity to expand the area under plantation on the existing farm. However, there is an opportunity to improve timber yields through improved management and the planting of well-matched genetic material. While the Bonagude experience appears unique, it has the potential to be widely applied. What it requires is a willing commercial partner with technical and financial experience, a motivated community partner and workforce, a supportive financing institution, and a willing seller.

**Critical data:**

Population density of Mthonjaneni Local Municipality: 43 people per sq km  
Size of investment and landholding: ZAR 10 million = USD 1.7 million, 820 ha

Source: Howard *et al.* (2005).

**Malaysia:** The Malaysian government introduced the Konsep Baru (New Concept) scheme in the mid 1990s as a strategy for rural land development on land under Native Customary Rights (NCR) in the non-mainland areas of Malaysia (Sabah and Sarawak). A Konsep Baru arrangement is a three-way joint venture. A private plantation company, selected by the government, holds 60%. The plantation company does not need to buy land; it provides financial capital for landowners to develop the land for palm oil production. The local community that holds the Native Customary Rights to the land is awarded a 30% share in the joint venture, representing their contributing land into the project. A Land Bank mechanism allows farmers to register their land in a bank as an asset. This enables the private company to use the land as a deposit to borrow money locally or abroad. Finally, the government, acting through a parastatal agency, acts as trustee with power of attorney, and holds the remaining 10% (Majid-Cooke 2002).

The NCR landowners are required to relinquish all day-to-day decision-making power within the joint venture, as they are required to sign over power of attorney to a parastatal agency that acts as guarantor. Land titles are issued to the joint venture for 60 years. On expiry, the NCR landowners can apply to the Superintendent of the Land and Survey Department to renew the lease or opt out of the scheme. A caveat exists in the agreement that allows the company to extend the land lease after 60 years if no profit from the venture has been made. An alternative version of Konsep Baru is the mini-estate, in which a farmers' association rather than an NCR landowner community enters into the joint venture. Mini-estates tend to have shorter contract periods of 25-30 years (Vermeulen and Goad 2006).

To date, 26 joint ventures have been signed in Sabah and Sarawak for production of oil palm. A further 23 joint ventures currently in the pipeline will bring the total area under these arrangements to 250,000 ha, of which 46,000 ha has already been developed (New Straits Times 2009a). In some cases, the government contributes further land to the scheme.

Konsep Baru constitutes an innovative way to promote joint ventures in which smallholders have a significant stake. While many experiences with joint ventures are isolated or pilot cases, Konsep Baru has the ambition and potential to cover significant areas of law. Benefits from these schemes have been documented in some cases (see Case 7).

However, many participants have expressed dissatisfaction with the Konsep Baru schemes, either for reasons of insufficient mechanisms for full consultation and fully informed, free consent from landowners (which ultimately are rooted in shortcomings of the land tenure system and its governance, rather than/as well as the behaviour of individual agribusiness companies); or because of inadequate returns yet negative social and environmental impacts from the plantations. More than a hundred legal suits have been filed by groups of landholders, either against agribusinesses or against the government-owned holding company Pelita. For example, 168 landholders have recently filed a suit against Pelita for failing to defend the interests of local landholders of the 53,000 ha Block D1 in Kanowit (Malaysian Mirror 2009), which along with its neighbouring Boustead Pelita Kanowit plantation (see case study below) was held up as an exemplary model when established in 1996.

National statistics quoted in the media suggest that only four of the 26 established joint ventures have yet paid dividends to landholders (New Straits Times 2009b). Others are in early stages of establishment or are reporting annual losses. In 2009, the government introduced a new requirement that the joint ventures pay out an annual rental fee of MYR 150 (USD 45) per hectare to landholders, so as to provide a benefit from the plantations prior to harvest (Banji 2009).

Landholders and local residents make up a minority of employees on the plantations and in the mills. Official figures state that the oil palm industry had employed 369,290 foreign versus 196,480 local workers in Sabah and Sarawak in 2008 (Bernama 2009b). Local people are reportedly unwilling to work for the perceived low rates of pay in the industry, though government claims that harvesters can earn up to MYR 3,000 per month (USD 890), while Malaysian nationals from the mainland are reluctant to work in Sabah or Sarawak even in professional positions such as medicine or engineering. Instead, many employees come from other Asian countries (Bernama 2009b).

#### **CASE 7: BOUSTEAD PELITA KANOWIT JOINT VENTURE**

Boustead Holdings Berhad is a Malaysian diversified conglomerate, which has 133 subsidiaries and total assets in excess of MYR 8 billion (USD 2.4 billion). Boustead Estates Agency Sdn Bhd (BEASB) is a wholly owned subsidiary that offers a range of estate management services including engineering consultancy, design, construction and marketing for oil palm estates, mills and rubber factories. BEASB directly manages more than 100,000 ha, of which 78,000 ha are owned by the Group.

Its major investment in palm oil production is the Boustead Pelita Kanowit plantation in Sarawak, considered one of the most successful palm oil joint ventures under the Konsep Baru scheme in Malaysia. When the joint venture was formed in 1996, the Chief Minister promoted it as a major driver for poverty eradication in the area, saying “Under this concept, there will be a combination of capital brought in by people who have the money as well as regimented labour and management expertise by those trained in modern methods of plantation agriculture.”

As is standard for Konsep Baru schemes on NCR land, the plantation is run as a joint venture with profit-sharing of 60% to BEASB, 30% to the landowners and the remaining 10% to Pelita, the government-owned holding company of the Land Custody Development Authority (LCDA). LCDA/Pelita acts as a trustee for the landowners. The landowners have relinquished all decision-making rights to the trustee, again a condition of all Konsep Baru schemes. The joint venture and land lease are for a period of 60 years.

Between 1996 and 2009, oil palms were planted on 12,600 ha of the 14,000 ha estate. The plantation area may be further increased up to 30,000 ha. In 2005 the harvest was 160,000 tonnes of fresh fruit bunches. While figures on dividends are not available for all years, in 2009 the 1,701 landowners received a total of MYR 1.678 million in dividends (about USD 300 each). In addition, local government officials claim that other improvements have also occurred. One official noted, “If social indicators are anything to go by, we can see a higher standard of living among the longhouse folk.” They were able to afford bigger refrigerators, television sets, motorcycles, cars and electricity generators. They were also supplied with treated water and power supply infrastructure. Based on official statistics, the project created 76 local contractors who earned between MYR 3,000 and MYR 8,000 (USD 2,380) a month. The average monthly income for each family rose from MYR 296 in 1996 to MYR 720 (USD 214) in 2006.

***Critical data:***

Population density of Sibu Division: 31 people per sq km

Size of investment and landholding: MYR 200 million (USD 67 million), 14,000 ha

Source: Stephen (2006); Banji (2009); Bernama (2009a); Boustead Group (2009).

**CASE 8: MALI BIOCARBURANT SA, MALI**

Mali Biocarburant SA (MBSA) is a private company that works with more than 4,000 small-scale jatropha farmers in three regions of Mali (and two regions in Burkina Faso). MBSA is setting up sustainable decentralised biodiesel processing facilities in West Africa. MBSA provides technical assistance to farmers through a network of field staff to improve their agricultural practices. Jatropha is integrated into existing farming systems, for example through intercropping.

The main innovative feature of MBSA is that a union of local farmers in Koulikoro, Union Locale des Sociétés Coopératives des Producteurs de Pourghère à Koulikoro (ULSPP), owns 20% of the shares of the company. Thus farmers have direct benefits through the sales of products and they also share in the increased value of the shares as well as dividends that are foreseen. MBSA promotes a pro-poor carbon offset scheme and reinvested 75% of its 2007 carbon credit income in strengthening the capacities of its farmers.

The company is financed by the government of the Netherlands (through public investments of 60% via PSOM, the Programme for Cooperation with Emerging Markets), and its shareholders include KIT (Royal Tropical Institute), a pension fund and a private company, as well as ULSPP.

***Critical data:***

Population density of Dongorona: 55 people per sq km

Size of investment and landholding: unknown

Source: Mali Biocarburant (2009).

## **Roles of third parties and of policy support**

Joint ventures depend on strong support from policy and government agencies. Governments provide the basic policy frameworks for joint ventures and related models. In-country experience shows that governments have a variety of additional important roles to play as:

- joint equity owners (e.g. in Malaysia, and in schemes involving municipal land in South Africa);
- provider of business advice and support (e.g. South Africa: model contracts, assistance with business plans, technical extension);
- provider of brokerage services and capacity building (e.g. Canada, Papua New Guinea, South Africa, Malaysia);
- underwriter or guarantor of smallholder or landholder business risk (e.g. Malaysia);
- power of attorney on behalf of landholders (e.g. Malaysia).

Government support can be complex. For example, in the Konsep Baru schemes in Malaysia, multiple agencies are involved. The three main agencies spearheading this development in Malaysia are the Sarawak Land Development Board (SLDB), Sarawak Land Consolidation and Rehabilitation Authority (SALCRA) and the Land Custody Development Authority (LCDA), which also operates through a holding company Pelita.

Third party roles are also critical. The Bonagude-Manzini scheme in South Africa, for example, would not have been possible without the willingness by the bank to provide substantial loans to both community and commercial joint-venture partners. Many joint venture schemes also depend on providers of professional services (either NGOs or consultants) to help with business plans, negotiations, monitoring and accounting.

Development agencies can play an important role in supporting joint ventures. The commercial success of Divine Chocolate, mentioned above, depended in the early stages on support from Christian Aid and Comic Relief, especially in terms of marketing. A bank guarantee by the UK Department for International Development (DFID) allowed a GBP 400,000 (USD 600,000) loan from a major UK commercial bank, which gave Divine access to start-up finance at a

competitive rate (de Koning and de Steenhuijsen Pijters 2009). Similarly, the International Fund for Agricultural Development (IFAD) helped to establish the Nshili Tea Corporation, a joint venture between a private investor and smallholders in Rwanda (de Koning and de Steenhuijsen Pijters 2009). In a recent joint venture for an eco-tourism lodge in the Manica Province of Mozambique, the local landholding community has a 60% stake in the joint-venture company; this equity participation was funded through a grant from a multilateral development bank.<sup>7</sup>

### **Pros and cons, opportunities and challenges**

The country profiles and case studies demonstrate that joint venture models are ambitious in their goals of combining commercial excellence with equitable returns to smallholders and landholders, but that they may be very difficult to implement successfully due to their complexity and reliance on strong business acumen. Pros, cons, opportunities and challenges are summarised below.

Pros:

- Joint ventures enable smallholders and local communities to have co-ownership of the project, as first class citizens. Board representation enables them to have a say in business decisions and have access to valuable corporate information.
- Smallholders and communities can in theory receive dividends. Even where amounts are small (e.g. due to the large number of smallholders involved), payment of dividends can still have an important symbolic value (de Koning and de Steenhuijsen Pijters 2009).
- Agribusinesses benefit from clear terms of engagement, reducing legal and political risks and increasing motivation among suppliers. Joint ventures may also help with branding and reputation.
- Both sides work as nominally equal partners with clear legal frameworks and access to mechanisms of dispute-resolution and redress, rather than outside of business law and norms.

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7. Personal communications from people involved in this project.

## Cons:

- Accounting is complex and it can be easy for the agribusiness to engage in practices that artificially depress profits for the joint venture to the benefit of other subsidiaries controlled by the agribusiness companies – through sales at below market prices, for example. As a result, smallholders may receive little in the form of dividends. Individual dividends to smallholders can be very low also due to the large number of households or individuals within a scheme.
- If the joint venture is successful, additional financing may be required for expansion. This may involve new shareholders coming on board, or existing ones contributing more. If smallholders/shareholders are not able to pay for additional capital requirements, they may see their equity shares decrease.
- In spite of good intentions, empowerment and choice to smallholders may be low – e.g. in South Africa joint ventures have been used to perpetuate large-scale commercial farming operations, while in Malaysia there is the sense that communities are forced into joint-venture deals (because if negotiations fail the land could be compulsorily taken under other sections of the land law).
- The level of risk may be too high for smallholder and community partners, though this depends very much on conditions for insurance, underwriting of risks and partitioning of liability.

## Opportunities and challenges going forward:

- Strong support is needed for smallholders and community landowners to raise their capacity as decision-makers within business structures, including support from third-party independent advisors on a non-profit basis.
- Underwriting of financial risks taken by smallholder or landholder partners is also key, including through government-supported insurance.
- There is a need to ensure immediate returns or livelihood benefits to smallholders or community partners, especially in long-term crops.
- It is important to factor in and properly value all contributions that smallholders or communities make to the venture – including not just their



Tom Pilston/Panos Pictures

*Aiming high. Workers stack hessian sacks of basmati rice in India*

land but also water rights, preferential access to sources of credit or local knowledge, so as to increase local leverage and equity shares.

- When negotiating joint ventures, smallholders and support groups should pay particular attention to transfer pricing – the business practice of transferring profits through artificially inflating or deflating prices in transactions with companies linked to the agribusiness joint-venture partner. As discussed, inflating the cost of supplies provided by companies affiliated to the agribusiness enterprise would depress profits for the joint-venture company and thus dividends for the smallholder partner. To address this problem, contracts may explicitly require that sales to affiliates take place at fair market prices, and may index sales prices to international spot market prices where these exist and are publicly available.
- Proper assessment of risk to smallholders is also important, particularly where they contribute land and resource rights into the joint-venture company. Should the company go into liquidation, their land would come under threat – although much depends on the transferability of land rights under national law and on the political acceptability of foreclosure.



- Extending shared equity to processing, not just primary production, can make a real difference to profits shared – but most joint ventures are currently vague on these aspects.
- Allowing subsistence farming to co-exist alongside commercial production can help improve local food security and small-scale enterprise opportunities.

### **Future potential and options for scaling up**

Joint ventures based on community landholders committing land as an equity share are an attractive alternative to fixed rate long-term land leases, and may have enormous potential in any country where there are legal mechanisms for using land as a collective economic asset. However, experience from Malaysia and South Africa shows that these schemes need high levels of oversight by government and business capacity among local-level shareholders in order to succeed. These models can be successful and sustainable where the right business and legal environment is in place; for example joint ventures set up in the early 1970s between First Nation (indigenous peoples) companies and forestry companies in Canada continue to thrive today.

## 4.5. FARMER-OWNED BUSINESSES

### Brief description

In dealing with agribusiness, groups of farmers may choose to formalise their alliance, or legally incorporate into a company, including to enter into particular types of business (e.g. processing or marketing), sign contracts, gain access to finance, or limit the liability of individual members.

While terminology and legislation differ among countries, the main forms of organisation can be summarised as (adapted from Boyd 2005):

- **Associations:** organisations for grouping and representing people, but usually not applicable to profit-driven activities.
- **Trusts:** legal devices for holding and protecting gifted assets in the interest of either named beneficiaries or some kind of charitable or philanthropic purpose, but not representing people nor available for trading.
- **Enterprises** such as cooperatives, partnerships, community enterprises, farmer-owned companies: range of diverse corporate bodies that may be used for trading, for holding member's assets and for representing the interests of their members – but not for representing non-members or the local community, or for carrying out charitable work.

A **cooperative** is defined as “an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise” (ICA 2009). Cooperatives have in some circumstances been criticised for their slowness in decision-making, due to their highly democratic governance, and for historical connotations of state imposition in some countries (e.g. Kyrgyzstan, Indonesia, Vietnam).

As a consequence, some farmers' associations or cooperatives may choose to incorporate as a **farmer-owned company** limited by shares or by guarantee. These business structures may enable cooperatives to manage their collective assets and production more nimbly and with reduced risk to individual members, but also entail loss of democratic process.

## Summary profile of ownership, voice, risk, reward

<b>Ownership</b>	Cooperatives and farmer-owned businesses allow smallholders to collectively own and run a business entity that has the same legal rights and business opportunities as a non-farmer-owned agribusiness. This allows for more equal business terms when working with agribusinesses and other partners.
<b>Voice</b>	Decisions are taken on a “one member, one vote” basis in cooperatives and companies limited by guarantee and on a “one share, one vote” basis in companies limited by shares.
<b>Risk</b>	The “limited liability” of companies protects individual shareholders or members from personal financial risk. In addition, companies and cooperatives pool risk among members or shareholders. On the other hand, complex business structures will also introduce new financial risks for smallholders.
<b>Reward</b>	Costs and returns accrue to members or shareholders. In large cooperatives and companies, however, accounts are likely to be complex with much less clarity on a fair split between reinvestment, operating costs and dividends to members.

### Prevalence and practice

Cooperatives and farmer-owned businesses are globally widespread. Business models for these organisations are as varied as the reasons for which they are established. Common types are marketing agencies or marketing boards, to promote and manage collective sales; processing companies, to provide farmers with better sales prices and added value; distribution agencies, to manage collection and transport of produce; and service-provision companies, to allow members to enter new areas of business such as management consultancy. In Ghana, Kuapa Kokoo Farmers Union, mentioned above, is a broad-based membership organisation of cocoa farmers. The Union controls other corporate entities for trading activities (the Ghana-based Kuapa Kokoo Ltd and the UK-based Divine Chocolate Company), for service provision (Kuapa Kokoo Credit Union, which provides credit) and for the management of fair trade premiums (Kuapa Kokoo Farmers Trust).

The following two case studies give one example each of a small-scale farmer-owned business and a farmer cooperative. Farmer-owned businesses and cooperatives can, however, be very large. For example, Arla, the largest dairy distributor in Scandinavia and the UK, is a farmer-owned company, while Gujarat Cooperative Milk Marketing Federation (GCMMF) is India's largest food products marketing organisation, with a turnover of USD 1.5 billion in 2008-2009 and a membership of nearly 3 million producers (Amul 2010).

### **CASE 9: KIENI DAIRY PRODUCTS LIMITED (KDPL), KENYA**

Kieni Dairy Products Limited is a farmer-owned company with 3,600 registered shareholders, located in Kieni West division of Nyeri North district in Central Kenya. The company hopes to be an effective milk chilling enterprise with a long-term vision of processing specialised niche-market dairy products. KDPL was formed by six farmers' cooperatives coming together to register a company in 1995. Individual members subscribe for shares directly from KDPL through their respective cooperatives, with a total share value of KES 6 million (USD 77,000). A board of 13 directors elected from the membership of equity shareholders govern KDPL. The company has recently secured a plot of land, well positioned on the Nyeri-Nyahururu highway to develop a chilling plant, in which it will invest KES 1 million. Members currently produce and bulk 16,000 litres per day, selling on to a variety of processors, and expect their chilling hub to handle 15,000 litres per day in its first year of operation.

#### ***Critical data:***

Population density of Kieni West Division: 109 people per sq km

Size of investment and landholding: USD 77,000, 5 ha plot for chilling plant

Date of establishment: 1995

Source: EADD (2009).



*Eduardo Martino/Panos Pictures*

*Strength in union. A cooperative in Costa Rica enables coffee farmers to get a better price*

### **CASE 10: ASOPROBAN BANANA COOPERATIVE, COLOMBIA**

Asoproban (Asociación de parceleros y pequeños productores de bananos) is a first-level banana producers' cooperative comprising 133 small producers and plot holders. It was established in 1984 and Fairtrade certified in 1998. Asoproban provides a range of services to members, including transport, packing and export. Average weekly production and export is 15,000 boxes, and farmers derive 95% of their income from bananas, farming average areas of 3 ha. The cooperative structure includes an Executive Board (elected every three years), an Administrative Board, a Vigilance Board and an Agricultural Committee, which oversees all technical and logistical issues. The annual general meeting and regular meetings enjoy 80%-100% attendance rate. The cooperative disburses 50% of the Fairtrade premium as dividends to members, and invests the remainder in community infrastructure, medical insurance and training courses for members.

#### ***Critical data:***

Population density of Magdalena Division: 49 people per sq km

Size of investment and landholding: value unknown, 333 ha

Date of establishment: 1984

Source: Fairtrade Foundation (2009).

### **Roles of third parties and of policy support**

Policy has a fundamental role in setting the terms under which companies and cooperatives operate in any country, including regulation of contracts, banking, acquisition of land and other assets, receipt and use of loans, grants, gifts and legacies, employment and use of the courts.

Many countries have simple regulations and procedures for cooperatives to register and operate, so as to enable democratically run small-scale enterprise. Cooperatives may also enjoy other privileges, such as lower taxes or licence fees, or special export credit guarantee schemes for agricultural commodities (Boyd 2005).

At the same time, cooperatives in most countries are subject to far greater powers of intervention by government than companies are. The government may be able to merge and separate cooperatives, instruct on investments, or rule on internal disputes.

A number of international organisations exist to provide support to cooperatives, associations and member-owned businesses, such as the International Cooperative Alliance. Further, some countries have enacted

policy to allow smallholders to benefit from the cooperative structure but not to be tied to one model of cumbersome decision-making (e.g. “new generation cooperatives” in Indonesia, Chile and Canada).

### **Pros and cons, opportunities and challenges**

The chief advantage of cooperatives and farmer-owned businesses is that they are controlled by the farmers, and at the same time provide a single entity that is easier for agribusinesses and governments to work with. More specific pros and cons are described below.

Pros:

- Pooling of resources allows access to markets and value-added activities (e.g. purchase of processing or distribution facilities), efficiency gains and much stronger bargaining power for members.
- Incorporation enables smallholders to work on equal legal terms with agribusinesses, an advantage for both sides in terms of creating a predictable, regulated business environment.
- Companies offer considerable financial flexibility, particularly in share-based models, as shareholders can raise equity finance as well as loan finance, and re-invest earnings in a number of ways that can protect against financial risks and reduce tax burdens.

Cons:

- While formal structures allow smallholders greater access to economic and legal options, they can be exclusionary of those who do not meet entry requirements (e.g. on grounds of product quality and delivery, land ownership, gender).
- Working within a company structure opens smallholders to a range of new risks associated with unfamiliar and complex governance and legal frameworks, such as unscrupulous accountancy, and opportunities for elite capture.
- High capital costs remain a limitation in most countries: farmer-owned businesses are unlikely to afford top-end investments, such as multi-million dollar biorefineries, state-of-the-art abattoirs or cold storage chains.

- Decision-making can be cumbersome, and collective trust and motivation may be difficult to maintain, especially if membership is diverse and divided.

Opportunities and challenges going forward:

- Depending on contexts, company structures and formal procedures may have to be simplified for smallholders and community groups to be able to make the most of them, and smallholders may need tailored support to maximise the benefits and minimise the risks associated with formalisation and associated issues of banking, taxation and reporting.
- Farmer-owned businesses are well placed to access Fairtrade and other socially differentiated markets.

### **Future potential and options for scaling up**

Cooperatives have a healthy and economically important future in the world's leading economies such as India and the US (USDA 2002). Farmer-owned companies are likely to increase in future, as drivers towards vertical coordination in food, fuel and fibre supplies continue to favour contract production and those farmers most able to deliver according to clear business plans. Both governments and development agencies are actively promoting farmer-owned businesses as means for smallholders to achieve higher returns from their produce and to access opportunities for value-addition. Coupled with appropriate support from governments, there is tremendous scope for scaling up these types of businesses. Notable too are emerging innovations, such as consumer shares in farmer-owned businesses, as seen for example in the organic horticulture sector in France and Canada, where urban residents are taking up equity shares in organic farms not on a for-profit basis but to keep these operations in production with preferential supplies to the shareholders.

## 4.6. UPSTREAM AND DOWNSTREAM BUSINESS LINKS

### Brief description

“Upstream and downstream business links” is an umbrella expression for the set of business opportunities beyond direct agricultural production that exist both for agribusinesses and for smallholders and small local enterprises. These business activities may supplement agricultural production, for example provision of services to smallholders, such as training (e.g. Farmer Field Schools), which are a common feature of contract farming schemes.

Some agribusinesses offer these types of services separately from contract farming. They may work with government or NGOs on a non-profit basis, with the long-term business objective of building the sector in the country. In other cases, agribusinesses seek business opportunities to work with smallholders in the upstream or downstream end of the agricultural supply chain, without direct involvement in agricultural production. Upstream examples include supply of inputs and business services (seeds, fertilisers, pesticides, micro-credit, insurance, advisory), while downstream examples include specialised wholesale and retail.

Upstream and downstream opportunities also exist for smallholders and other local small enterprises. At the upstream end, local enterprises may enter into agreements to supply inputs or services to agribusinesses operating in the area. These initiatives may be encouraged by government policy (through local content requirements). At the downstream end, local enterprises, including farmer-owned businesses, may operate processing, storage, transport and wholesale facilities. These are very much sector-dependent and country-dependent; for example, ownership by farmers of dairy processing facilities is

### Summary profile of ownership, voice, risk, reward

<b>Ownership</b>	Co-ownership is not a feature of these schemes; assets remain separate.
<b>Voice</b>	These models do not offer specific opportunities for shared decision-making, but do provide a much wider range of working relationships between agribusinesses and local enterprises or smallholders.
<b>Risk</b>	Distribution of risk is very much dependent on the purpose of the scheme. Group certification, for example, depends on all members meeting standards on a continuous basis – the market risk is shared across the group.
<b>Reward</b>	For most group support schemes, delivery of longer-term financial benefits is more important than immediate returns. Joining fees and other upfront costs are likely.



common in India but not in Brazil. For biofuel production, the high capital costs of establishing mills and refineries to supply fuel at a national or international scale puts these options beyond the reach of current farmers' organisations.

### **Prevalence and practice**

Upstream and downstream business links are very widespread and extremely diverse. By way of example, the following models and case studies can help illustrate the nature of these business links.

***Global standards, certification and Fairtrade:*** Private voluntary food standards, such as GLOBALGAP, and other voluntary certification schemes for sustainably produced commodities (e.g. palm oil, soy, cotton, timber, pulp) or fairly traded products (coffee, tea, wine, flowers, bananas, cotton) are taking a growing share of some markets and provide preferential opportunities for smallholders. There may be advantages to agribusinesses in these sectors to support farmers' groups to achieve and maintain standards. For example, the chocolate company Green & Blacks has helped smallholder cocoa producers in this way, while a number of agencies are working to support and reduce the cost of compliance to international food standards for small-scale horticultural producers in East Africa (Borot de Battisti *et al.* 2009).

***Specialised intermediaries:*** Much emphasis has been put in the past on "cutting out the middleman". Today, however, promising new business models are emerging that specialise in procurement from large numbers of smallholder farmers and onward sales to large-scale retailers (Vorley *et al.* 2008). These "upgraded intermediaries" or "specialist wholesalers" are experimenting successfully with options for overcoming the transaction costs of dealing with large numbers of farmers while meeting stringent standards for quality and hygiene, including through lead farmers and combining input sales with output purchase (see case studies).

***Small-scale contractors:*** Agribusinesses involved in agricultural production and processing may provide opportunities for local enterprises to offer a range of services, for example harvesting, transport or catering. These may have very positive benefits of keeping economic value within the local community. However, the increasing trend away from full-time employees towards out-contracting in agriculture and forestry is associated with more vulnerable and poorly paid job opportunities for those who work as labour for either the contractor or the agribusiness (Clarke and Isaacs 2005).

### **CASE 11: HORTIFRUTI AND LEAD FARMERS, HONDURAS**

Hortifruti is the specialised wholesaler for fresh fruit and vegetable for Wal-Mart in Central America. The company works with a variety of suppliers for vegetables in Honduras and Nicaragua, often purchasing product from existing farmer cooperatives. However, it has experienced significant difficulties with these farmer organisations in terms of lengthy decision-making processes. As a result, Hortifruti Honduras has developed and promoted a “lead farmer” model of organisation through which it identifies and builds the capacity of farmers who can meet its quality needs in a consistent fashion. After demonstrating such capacity, lead farmers receive larger and larger orders for product or new products and are invited to work with neighbouring farmers to meet this demand. Lead farmers provide access to technology, technical assistance and market access to their network of neighbours as part of a bundle of production and marketing services. The cost of these services is recouped via the sales margin to Hortifruti. The expansion of this model depends on the identification of new lead farmers. Early results indicate that it is low-cost, scalable and sustainable.

#### ***Critical data:***

Population density of Honduras: 46 people per sq km

Size of investment and landholding: unknown

Date of establishment: 1989 (international headquarters in Brazil)

Source: Vorley *et al.* (2008).

### **CASE 12: HARIYALI KISAAN BAZAARS, INDIA**

Hariyali Kisaan Bazaars are a chain of one-stop-shops for Indian farmers. Established in 2002 as a subsidiary of DCSL (Delhi Cloth and General Mills Shiriam Consolidated Ltd), by 2007 the company had opened 75 outlets across Andhra Pradesh, Madhya Pradesh, Rajasthan, Uttar Pradesh, Haryana, Uttarakhand and Punjab States.

The business model is to provide farmers with a reliable one-stop-shop where they can both purchase inputs and sell outputs. For sale are fertilisers, seed, pesticides, agricultural implements, tractor parts and animal feed, with more than one brand per category. All managers and salespeople are trained agronomists and provide a free advisory service, though it is unclear whether this is linked with marketing of particular products. Hariyali has also partnered with ICICI bank to provide an on-site bank at each outlet, offering insurance (crop, life, general) and credit, including an “agricultural credit card” to help farmers deal with seasonal cashflow issues. Another partner is Bharat Petroleum, which supplies a range of fuels at each outlet.

Hariyali has three methods of purchasing farmers’ outputs: contract farming arrangements for producers of certified “private label” seed for rice, wheat, soy and mustard (a known brand with a premium price); purchase contracts for particular vegetables (e.g. potatoes for the fast-food industry); and spot purchase of other produce such as wheat.

A typical outlet has annual revenues of INR 50 million (USD 1.2 million) with year-on-year growth of 40% in the first year and 25% in subsequent years. Each one services around 15-20,000 households. The outlets are proving popular with farmers, but do have a downside in that they are displacing traditional locally owned retail outlets.

***Critical data:***

Population density of India: highly variable, with an average of 324 people per sq km  
Size of investment and landholding: INR 20-30 million (USD 0.5-0.75 million) and 2 ha per outlet

Date of establishment: 2002

Source: Bell *et al.* (2007).

### **Roles of third parties and of policy support**

Many group support schemes to train and certify smallholders against international criteria are currently driven by private standards and initiatives rather than by government. However, third parties, particularly NGOs and development agencies, play major roles in kick-starting such schemes, often including covering the transaction costs during early stages of development.

Upstream and downstream business links cover a wide variety of initiatives and, as such, specific types of government support are less appropriate, though policy to enforce local-level economic participation may be relevant. For example, local content provisions require the company to employ and train local staff and contractors, and/or to procure local goods and services during the implementation of the investment project. These provisions may be included in a contract between the company and the host government (for example, a long-term land lease), or in national policy and legislation. In this context, “local” refers to employees and suppliers that are nationals of the host state, even if they have no direct link with the locality where the investment project is implemented.

With regard to the supply of goods and services, local content provisions may require the company to give priority to local goods and services if the cost, quality and/or time of delivery are comparable internationally. They may also require that priority be given to local suppliers even if doing so increases project costs – but cost increases are within a specified percentage from alternative suppliers available internationally (no more than 10% above the cost of comparable, internationally available suppliers, for instance). Finally, depending on local business capacity, it is also possible to include specific

percentage targets that the investment project must meet, and related reporting requirements. These targets may be based on sliding scales, whereby the local content percentage targets increase over project duration.

### **EXAMPLES OF LOCAL CONTENT PROVISIONS**

#### **“Section 12 Use of Liberian Products and Services**

When purchasing goods and services related to Firestone Activities, Firestone Liberia shall give preference to goods produced in Liberia by Liberian citizens, and services provided by Liberian citizens, who are resident in Liberia [...] which are equal to or better than comparable goods and services obtainable from other Persons taking into account price, quality, delivery schedules, availability and other terms. In addition, Firestone Liberia agrees to include in each contract or work order with its major contractors and other Associates a provision requiring them to adhere to the requirements of this Section, and to require their sub-contractors to do so, with respect to any activities undertaken in Liberia by such Associates and major contractors (and their sub-contractors), on behalf of Firestone Liberia. Subject to the foregoing, Firestone Liberia may freely contract with any Person.”

Source: Amended and Restated Concession Agreement between the Republic of Liberia and Firestone Liberia Inc, 22 February 2008 (government-allocated land lease for a rubber plantation), available at <http://www.revenuewatch.org/news/publications/getting-a-better-deal-app.php>

### **Pros and cons, opportunities and challenges**

#### **Pros:**

- Business links upstream and downstream provide opportunities to enter new markets, particularly high-value niche markets, for both smallholders and agribusinesses.
- They also provide opportunities for local non-farm small-scale enterprises, for example in provision of a variety of services such as transport, laundry and catering, thereby diversifying the local economy and providing particular opportunities for women.
- Finally, they may provide opportunities for agribusinesses to contribute to local economic development through participation and reinvestment throughout the value chain.

#### **Cons:**

- At the same time, the entry of agribusinesses into local retail, service provision and related sectors may displace locally owned small-scale enterprises.

- The growing replacement of in-house employment with out-contracting can lead to greater economic instability at the local level, as small-scale contractors are vulnerable to bankruptcy, and employment conditions are likely to be worse paid and shorter-term.
- High-value markets carry higher risks of market exclusion and financial losses; smallholders may not be able to keep up with rapid changes in demand from international markets.

Opportunities and challenges going forward:

- There is a need to continue supporting smallholders in group certification and adherence to international market standards.
- There are growing roles for specialised wholesalers, traders and service providers that work with (rather than displace) local businesses.

### **Future potential and options for scaling up**

As food markets continue to progress towards greater concentration, specialisation and vertical coordination, the opportunities for specialised businesses and service providers will be considerable. For example, an increasing trend is for agribusinesses in countries such as Brazil, Israel and India to move away from plantation management and into agricultural technology, e.g. R&D and supply of irrigation equipment, improved seed (particularly genetically modified or organic) or processing facilities. The other major area for innovation and expansion is among specialised intermediaries, particularly vertically coordinated wholesalers.

There is huge potential for governments to step up efforts to promote and support initiatives that provide a wider set of opportunities for smallholders to participate in modern markets. Appropriate roles for government agencies and policy may be to improve information flows, encourage technological innovation, provide training and broker relationships. Variations on supply quotas and local content requirements are an emerging policy trend in agriculture – as seen in Brazil’s Social Fuel Seal and South Africa’s BBBEE scorecards. These have value in providing a secure market space for smallholders, but require high levels of oversight and fine-tuning by government.

**V. CONCLUSIONS**





## **5.1. OVERVIEW: THE VALUE AND LIMITS OF INCLUSIVE MODELS FOR AGRICULTURAL INVESTMENT**

This report has reviewed the great diversity of business models that can be used to structure agricultural investments in lower- and middle-income countries in a way that shares value and retains land with smallholders and local communities. Some of the models involve collaborations in agricultural production between agribusiness and smallholders (contract farming, for example), while others mainly share value through the distribution of rewards, such as leases and management contracts. Some models have been used for a very long time and are documented by a vast literature (contract farming is again a case in point). Others have come into use in lower- and middle-income countries only much more recently, and are yet to be properly documented and assessed.

It is important to stress the limitations of the analysis presented in this report. Drawn from the literature, it presents a cherry-picked selection of examples to illustrate the key features of broad categories of business models and as such gives only superficial treatment to a complex set of issues. A more thorough assessment of inclusive business models would require analysis of a large number of in-depth case studies, and sharing of experience among practitioners involved with the design and implementation of these models. Such in-depth analysis would need to recognise the importance of local contexts in affecting the suitability of different models. For example, contract farming may be difficult in contexts with very low population densities and low levels of local capacity for agricultural production.

Recognising these limitations, this section draws some broad conclusions about the value of more inclusive business models compared against agricultural production based on highly concentrated land ownership. In very general terms, large-scale land-based investments (plantations) take away land and replace land-based livelihoods with (usually a smaller number of more highly paid) employment opportunities. While for some income will increase, this kind of monetarisation of local economies may also be associated with a net loss of livelihoods, particularly due to losses in traditional forms of non-monetary income. It can be also associated with greater local income inequality, giving rise to the “precariat”, a class of people with precarious entitlements from the state and other sources (Standing 2009).



Business models that include smallholders would seem to provide more effective local livelihood options that (a) do not preclude traditional non-monetary income sources and (b) spread the benefits more widely among the population, rather than just the “lucky few” who get more skilled jobs. As the case studies attest, there is positive experience with more inclusive business models in providing new, reliable sources of income to participants. But in practice, “inclusive” business models like contract farming can also be exclusionary, as better-resourced farmers tend to capture the contracts, while poorer farmers work as labour on the contracted farms (Poulton *et al.* 2008). Also, business models that avoid direct takings of land may nonetheless trigger changes in land access in the longer term. The literature on contract farming (see section 4.1) suggests that land access may shift from women, who cultivate subsistence crops, to men, who are more likely to sign contracts for cash crops with agribusiness. Shifts in land access may also favour local elites that are better positioned to make the most of the new market opportunities created by contract farming.

Among the different types of more inclusive business models reviewed here, there is no single model that emerges as the best possible option for smallholders in all circumstances. For a start, the models discussed separately in this report are often used in conjunction in the real world, and a wide range of hybrids are possible. For example, in the same investment project, the agribusiness company and smallholders may set up a joint venture, in which the company contributes capital and smallholders land or other assets; smallholders may be organised in a cooperative or a company to hold their equity participation in the joint venture; the joint-venture company may enter into contract farming arrangements with individual smallholders for undertaking agriculture production; and management services may be contracted out to a specialised provider. In other words, rather than being necessarily alternative options, the models reviewed may be viewed as “building blocks” that can be combined into hugely diverse real-life hybrids.

In addition, the review of available evidence suggests that no single one of these building blocks is inherently more advantageous to smallholders or local communities. Contract farming and tenant farming are likely to be particularly relevant for labour-intensive crops and for management of environmental services. But where economies of scale are significant, these models are likely to struggle in a competitive market. In these cases, leases

and management contracts concluded directly with local communities may provide an avenue for exploiting economies of scale while still enabling local groups to participate in project benefits.

What works best locally while still being attractive to investors is very much context-specific, and is contingent on tenure, policy, culture, history as well as on biophysical and demographic considerations. Also, the devil is often in the detail: in defining the extent to which an investment shares value and risk with local smallholders, the detailed arrangements of the scheme may be more important than the abstract model. For example, depending on its specific terms, contract farming may be a vehicle for providing support and improving market access for smallholders, or an exploitative relationship where smallholders are effectively cheap providers of labour who continue to carry production risks. Similarly, joint ventures can in principle offer a vehicle for enabling greater local control over business activities, and for granting local communities a regular stream of income in the form of dividends. But, if inappropriately structured, they can deliver very low dividends, as operating costs can be structured to absorb profits, and local influence over the decisions may in practice be nominal.

The negotiating power of smallholders in their relations with government and agribusiness is key to determining terms and outcomes of business models. Power to negotiate depends on modes of organisation – importantly, the representativeness and effectiveness of community-based organisations – and the asset base on which negotiating positions are predicated – including secure land rights, access to information and political credibility. Collective action through representative organisations is the means for smallholders to present a cohesive position and to reduce the transaction costs of dealing with a large number of individuals at the community level. Strong organisational structures can provide a sound basis for encouraging investments preferred by communities, as well as working with government to develop better incentives for such investments.

Where smallholders are engaged in agriculture production directly, secure rights over land are crucial for providing them with an asset in negotiations with agribusiness, and with incentives to invest, particularly in the case of long-term crops. Where agricultural production is carried out by agribusiness on the basis of leases or management contracts, secure land rights are a

necessary condition for local landholders to be able to contract the agribusiness company and allocate land rights for an agreed period of time. The type of rights that local communities have on their land can have profound implications for the business models they may be able to develop. For example, at the heart of land-lease schemes in South Africa and Papua New Guinea is the ability of the local community to rent out its land – an ability that is missing under national legislation in several jurisdictions, particularly where land is largely state-owned. Where communities improve their position within business models over time, this is often due to factors promoting social organisation and empowerment, such as the involvement of cooperatives, trade unions or NGOs (Vermeulen *et al.* 2008b).

Access to information, to the law, to policy makers and to public services is highly material to the structure and outcome of business models. Asymmetry of information, coupled with differential access to institutions (banks, insurers, law firms, courts), has proven to be a main constraint to the establishment of genuine business partnerships “of equals”. Smallholders and local communities are typically under-informed on market trends, how product prices, royalties and dividends are calculated, the level of risk involved, how much debt they are taking on, or what legal protection and remedy they would have. Where levels of education, media and support are higher, as in Canada, there is growing experience with long-term joint ventures between agribusinesses and companies belonging to indigenous people.

Inclusive models that are developed out of necessity, as a genuine economic component of an investor’s business model rather than as a corporate responsibility project, are likely to be more successful and sustainable in the longer term. This necessity is likely to be as much policy-driven as market-driven. Notably, the growing experience with joint ventures and other collaborative models in South Africa has emerged in close connection with land reform and Black Economic Empowerment policies. Land tenure policy has been a dominant underlying driver of contract models in many other countries, including China, India, Malaysia, Ethiopia and Ghana. Other important policy drivers are incentives for inclusion of social groups marginalised by earlier exclusionary policies (e.g. Canada and South Africa) and regulations limiting foreign equity shares in national business enterprises (e.g. the Philippines and Vietnam). The fact that these models arise in response to policy rather than market drivers does not diminish their value to

investors in terms of coordinating supply, opening up new markets and managing risks, particularly production and political risks.

Ultimately, none of the arrangements reviewed here can be said to be perfectly fair, nor a holistic solution to rural development at local or national levels. By their very nature, these arrangements link two sets of players – agribusiness and smallholders – with very different asset bases, negotiating power and long-term priorities. The challenge is in providing the right set of incentives and level of capacity that can make it possible for agricultural investments to be structured in ways that deliver value, and minimise risk exposure, for smallholders and local communities, without compromising market competitiveness.

## **5.2. MOVING FORWARD**

### **Improving understanding of more inclusive business models**

A first key next step concerns getting a more thorough understanding of the range of more inclusive business models: what form they take, how they work, and what makes them possible. A better understanding of what works where and under what conditions can provide useful insights not only for smallholders, their support groups and host governments willing to promote more inclusive business models, but also for investors aware of the commercial, political and reputational risks involved in large-scale land acquisitions.

A full assessment of concrete experiences would require much more detailed data than is available in the literature, particularly in three areas:

- the detailed structure of individual business models, particularly their exact contractual arrangements and economic and financial structure;
- issues of process: how a particular business model came to be chosen compared with alternative options, what conditions made the operation of that business model possible, what factors constrained it and how they were addressed by the company and smallholders;
- socio-economic performance and outcomes, including economic performance and the actual impacts on local livelihoods, incomes and empowerment.

Generating solid evidence in these areas can help consolidate a robust business case for choosing more inclusive business models over large-scale land acquisitions. It requires in-depth case studies, and lesson-sharing among practitioners. Case studies can help where enough time has passed since the implementation of an investment project and where appropriate research methods allow access to the necessary data (commercial confidentiality concerns may constrain access to information). Where investment projects are too recent to conduct socio-economic assessments, or where access to data for outside researchers is limited, sharing of experience among practitioners directly involved with the design and implementation of more inclusive business models (whether on the agribusiness or smallholder side) and wider dissemination of that experience can still go a long way to generate insights on what works where and under what conditions.

The ownership, voice, risk and reward framework provides a useful way for assessing and comparing concrete experiences with implementing more inclusive business models. In moving forward, that framework can be further developed, for instance to explore possible trade-offs among its constituent elements (e.g. how to weigh risks with benefits of ownership, voice and reward?). Further improvements to this framework would include consideration of the full value chain, including large-scale retailers, which are often the lead firm in the chain, driving many of the business model choices made upstream by agribusinesses involved in crop production and land acquisition. The framework could also be improved by better consideration of the dynamic nature of agriculture, as markets, technologies and production constraints evolve rapidly.

Development agencies can play an important role both in supporting case studies and in facilitating exchange of experience. An international lesson-sharing workshop convened by IIED, SDC, IFAD and Maputo-based Centro Terra Viva, in partnership with the government of Mozambique's National Directorate for the Promotion of Rural Development (DNPDR), just before the publication of this report (Maputo, 17-18 March 2010) brought together about 30 participants, mainly from Africa but also from South Asia, involved with inclusive business models. Participants included practitioners from local and national support groups assisting local farmers in their negotiations with agribusiness; private sector operators; and observers with first-hand analysis of land deals and business models. The workshop provided a forum for participants to share



Frederic Courbet/Panos Pictures

*Moving forward. A farmer tills his field in Ethiopia*

analysis about their respective contexts and enabling environments, the business models they are involved with – their strengths, weaknesses and early impacts – and issues of scalability and replicability. A publication capturing lessons learned at the workshop is forthcoming. Following this literature review and the lesson-sharing workshop, more in-depth case studies are now being undertaken to improve understanding of what models work best, where, and under what conditions.

### **National and local policies and programmes**

Ultimately the structure and outcomes of business arrangements between agribusinesses and local farmers or communities are in the hands of the partners themselves. But policies and programmes can be put in place locally and nationally to promote and support more inclusive business models. Governments, international donor agencies, intergovernmental bodies, NGOs, community-based organisations and support groups can all make a difference to whether a more inclusive business model is chosen, its specific design, the way it works in practice, and its socio-economic outcomes. The countries that present significant experience with joint ventures, for example, are also countries where governments have more actively promoted these

arrangements, through programmes (see the Konsep Baru programme in Malaysia) or policy change (through land reform in South Africa, for instance). Several experiences analysed in this report were proactively led by the host country government, for example by brokering negotiations or even contributing financial resources, sometimes with involvement of the government of the investor's home country (e.g. the Mali Biocarburant case) or an NGO (e.g. the Asoproban Banana Cooperative case).

Government policies that set conditionalities or targets for all schemes to follow (e.g. a general requirement that all agricultural investments include a fixed percentage of contract farming, as with Brazil's Social Fuel Seal or Benin's agricultural investment programme) may be a powerful force for sector-wide change, bringing good practice to scale. However, targeting has to be very careful to avoid perverse incentives, and incentives for meaningful compliance must be strong. In the absence of these, government policy may amount to little more than box-ticking: token schemes that are neither material to the investor's business model nor beneficial to local livelihoods. A different type of danger is that governments view inclusive business models as holistic solutions to rural development, expecting the private sector to replace broader government responsibilities in terms of providing access to basic services and utilities, and greater economic opportunities and infrastructure.

Government policy is perhaps more realistic and effective when it pushes for the progressive improvement of more equitable models that bring real economic benefits locally and accord some degree of shared power to the smallholder partners. This may involve providing strong safeguards and remedies for local people, for example with regard to security of local land rights; increasing the set of choices open to agribusiness and smallholders; providing more detailed regulation for available arrangements, and flexible model contracts where relevant, particularly for the more complex ones such as joint ventures and management contracts; and providing support to smallholders to negotiate a better set of benefits from investors in terms of infrastructure (above and beyond governmental responsibilities, e.g. irrigation), non-tangible assets (e.g. market information), legal assistance and business support. Governments may also play an important role in promoting individual deals, for instance by facilitating contact and brokering dialogue between investors and communities.



For development agencies, inclusive models involving the private sector may offer a valuable opportunity to leverage greater investment in the agriculture sector. The idea is not for donor agencies to “fund” commercial partners, but rather to reduce risk or lift other barriers that prevent businesses from investing, thereby leveraging investment from a commercial partner that would otherwise not be possible. Development agencies may help finance equity participation by local communities, for instance, and more generally provide grants and bank guarantees to business ventures that embody more inclusive models. In these cases, well thought-out intervention strategies are critical: clearly demonstrable poverty impacts, additionality (would the private investment happen without donor involvement?), leverage (what level of private investment would a given donor intervention trigger?), commercial viability and replicability (can the model be scaled up?). Ultimately, for more inclusive business models to persist they must be financially and managerially viable. Market-distorting support from development agencies can be provided for specified periods of time, but needs to be phased out in the longer term. The experience of Kuapa Kokoo in Ghana illustrates how initial support from development agencies can help establish a commercially viable, dynamic and growing business that is now self-sustaining.

Development agencies and other groups supporting smallholders (e.g. NGOs, advocacy groups, public interest lawyers) can also play other important roles in promoting more inclusive business models. For example, development agencies may strengthen the capacity of local organisations to negotiate and develop fair partnerships with the private sector. There are many examples of success in this arena, for example among the international NGOs SNV, WWF and the Rainforest Alliance, which have combined business acumen with development expertise to broker robust inclusive business models. Another key success factor in these experiences is to support rather than dictate local modes of organisation. Farmers’ associations can make a real difference through collective bargaining with the private sector over issues like pricing of inputs and produce in contract farming. But community-based organisations and associations need to emerge locally to be legitimate and sustainable.

Likewise, involvement of small-scale producers in modern supply chains needs a real business case and economic realism; it cannot be forced. An international econometric study (Reardon *et al.* 2009) showed that, in countries where there is a highly unequal land distribution, smallholders tend



to be excluded from selling into modern markets. On the other hand, in countries where smallholders are included in modern supply chains, land access is a necessary but not sufficient condition: the key criterion for inclusion is usually a threshold level of a key non-land asset, such as irrigation infrastructure for tomatoes, or a cold tank for milk, or access to nearby roads. This suggests that, to achieve real gains for the resource-poor rural majority, governments and development agencies may do better to concentrate on helping small-scale farmers to raise their basic asset levels rather than on promoting particular types of arrangements with the private sector. However this is moving into a larger debate – beyond the scope of this report – about the future of farming and rural livelihoods in a world of growing populations, changing consumption patterns and increasing environmental constraints.

### **Action at the international level**

The findings of this report have implications for ongoing discussions about international guidance on agricultural investments. Much attention has so far focused on investments that involve large-scale land acquisitions, and on minimising the possible negative impacts that these acquisitions may have on local livelihoods. But international guidance should go beyond setting minimum standards that agricultural investments should comply with to avoid the most harmful impacts. Guidance can be framed so as to provide pointers for promoting models of agricultural investment that maximise opportunities for local smallholders. In that context, the range of business models discussed in this report would be very relevant. For instance, the UN Special Rapporteur on the Right to Adequate Food has issued guidance on how to structure agricultural investments in ways that are consistent with international human rights obligations (De Schutter 2009). More inclusive business models provide an avenue to ensure that local people participate in the benefits generated by the investments, a theme that recurs in the principles defined by the UN Special Rapporteur.

In addition, given the major power asymmetries in the negotiation of agricultural investments, international development agencies can further help by strengthening the capacity of host governments to scrutinise investment proposals and to negotiate and manage contracts with agribusiness. The recent renegotiation of a land lease for a large rubber plantation in Liberia shows the difference that determined political leadership, a strong government negotiating team and world-class legal assistance can make to

these negotiations. For Liberia the result has been fiscal regimes that generate greater and more reliable public revenues, local content requirements that create enforceable commitments on employment and business opportunities for local groups, and explicit contractual arrangements requiring local processing of a specified share of the produce (Kaul *et al.* 2009). Robust capacity of civil society, parliamentarians and the media to scrutinise government-led contract negotiation and management is also likely to make a difference, as is greater capacity of local land users to defend their rights and negotiate more favourable outcomes with government and incoming investors.

These capacity challenges can be addressed through establishing international mechanisms for the provision of legal and other expertise during contract negotiation and implementation, and through sustained investment in training at national and local levels. Besides improving transparency in individual deals and increasing pressure for better deals, public disclosure of contracts would also be a valuable route to progressive improvement of inclusive business models – as over time a growing pool of contracts would be publicly accessible to governments, landholder communities and investors negotiating new and better deals.



**VI. REFERENCES AND  
RECOMMENDED FURTHER  
RESOURCES**





## **Key websites with extensive links to case studies and guidance**

FAO Contract Farming Resource Centre

<http://www.fao.org/ag/ags/contract-farming/index-cf/en/>

Regoverning Markets Resources

<http://www.regoverningmarkets.org/en/og/view/74/resourcebyterm>

WBCSD-SNV Inclusive Business Alliance

<http://www.inclusivebusiness.org/>

Royal Tropical Institute Value Chains for Development Portal

<http://portals.kit.nl>

Wageningen Expertise Centre for Chain and Network Studies

<http://www.wageningencns.wur.nl>

Hivos Knowledge Programme on Small Producer Agency

<http://www.hivos.net/Hivos-Knowledge-Programme/Themes/Small-Producer-Agency>

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# Making the most of agricultural investment:

## A survey of business models that provide opportunities for smallholders

Sonja Vermeulen and Lorenzo Cotula

Recent years have witnessed a renewed interest in agricultural investment. In many cases, this has translated into large-scale acquisitions of farmland in lower- and middle-income countries. Partly as a result of sustained media attention, these acquisitions have triggered lively if polarised debates about “land grabbing”. Less attention has been paid, however, to alternative ways of structuring agricultural investments that do not involve large-scale land acquisitions. These include a wide range of more collaborative arrangements between investors and local smallholders and communities, such as diverse types of contract farming schemes, joint ventures, management contracts and new supply chain relationships. Drawing on a literature review, this report explores the range of business models that can be used to structure agricultural investments in lower- and middle-income countries, and that provide an alternative to large-scale land acquisitions.

ISBN: 978-1-84369-774-9



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