

Regoverning Markets

Small-scale producers in modern agrifood markets

Innovative Practice

Philippines

Keys to Inclusion of small-scale organic rice producers in supermarkets: the case of Upland Marketing Foundation Inc

Sylvia Concepción, Larry Digal, Rene A Guarin and Luis Hualda

School of Management, University of the Philippines
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The case of Upland
Marketing Foundation Inc.**

**Sylvia Concepcion
Larry Digal
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Luis Hualda**

2007

Regoverning Markets

Regoverning Markets is a multi-partner collaborative research programme analysing the growing concentration in the processing and retail sectors of national and regional agrifood systems and its impacts on rural livelihoods and communities in middle- and low-income countries. The aim of the programme is to provide strategic advice and guidance to the public sector, agrifood chain actors, civil society organizations and development agencies on approaches that can anticipate and manage the impacts of the dynamic changes in local and regional markets.

Innovative Practice series

Innovative Practice is a series of country case studies from the Regoverning Markets programme providing examples of specific innovation in connecting small-scale producers with dynamic markets at local or regional level. Based on significant fieldwork activities, the studies focus on four drivers of innovation: public policy principles, private business models, collective action strategies by small-scale farmers, and intervention strategies and methods of development agencies. The studies highlight policy lessons and working methods to guide public and private actors.

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Country studies

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Acknowledgments

Funding for this work was provided by:
UK Department for International Development (DFID)
International Development Research Centre (IDRC), Ottawa, Canada
ICCO, Netherlands
Cordaid, Netherlands
Canadian International Development Agency (CIDA)
US Agency for International Development (USAID).

The views expressed in this paper are not necessarily those of the funding agencies.

Citation: Concepcion, Sylvia, Larry Digal, René Guarin, and Luis Hualda (2007), *Keys to Inclusion of Small-Scale Organic Rice Producers in Supermarkets: The Case of Upland Marketing Foundation Inc.*, Regoverning Markets Innovative Practice series, IIED, London.

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Published by:

Sustainable Markets Group
International Institute for Environment and Development (IIED)
3 Endsleigh Street
London WC1H 0DD
www.iied.org
Tel: +44(0)20 7388 2117, email: sustainablemarkets@iied.org

Cover design: smith+bell

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1 Executive summary

This study examines a case of successful linkage between small organic rice farmers and supermarkets. These small scale farmers have seized opportunities brought about by the changing markets in the Philippines, where supermarkets continue to improve patronage from consumers who demand convenience as incomes improve and lifestyles change. This was possible through the innovations and strategies made by Upland Marketing Foundation, Incorporated (UMFI) who act as a marketing consolidator for supermarkets buying from organized groups of organic rice farmers such as the Pecuaría Development Cooperative, Incorporated (PDCI).

A distinct innovation is that a development or non-profit institution (UMFI) acts as a marketing division to enhance market access for small scale producers to mainstream supermarkets. This was made possible by carrying out an effective marketing role, at least at par with private marketing corporations. The main difference is that the mission of this organization is to promote development, particularly for small scale producers and enterprises. In addition, being a development entity, trust with small scale producers is enhancing supply chain collaboration. Funds from development agencies help cover the high cost of dealing with small scale producers, particularly in linking them to high value markets.

Key strategies that worked include establishing a house brand to allow as many suppliers as possible to supply the product if the market picks up. They also adopted a niche consolidator strategy, which combines champion and rider products. They achieve economies of scale for champion products and provide opportunities for rider products to pick up and, at the same time, meeting requirements of supermarkets for variety. They continue to strategically position their product by assessing trends in the markets and deciding which product features to highlight. These strategies are augmented by providing market requirement information to producers, who in turn deliver commodities that meet market demands.

By providing opportunities to small scale producers to access supermarkets, farmers have improved their income. A survey of 18 farmers showed that while yield declined under organic rice farming, compared to the conventional/inorganic farming, and production costs has not changed significantly, net income of farmers increased by 119 per cent. This is mainly due to better prices with a difference of 46 per cent. The price premium can be attributed both to the quality attributes of the brand and the product as well as to the type of market outlet. Supermarkets generally provide higher prices compared to traditional markets due to convenience provided to consumers.

Moreover, based on sales records of 36 farmers before 2000 and after 2006; volume sold per farmer and price paid per kilo of rice increased by 64 per cent and 16 per cent respectively. These translate to an 89 per cent increase on the average gross sale from PHP 27,069.75 or USD 563.95 to PHP 51,202.85 or USD 1066.72.¹

¹ 1 USD = 48 PHP

2 Background and rationale

In the Philippines, the number of supermarkets has been growing as Filipinos increase in number and purchasing power. However, many small scale producers of agricultural and non-agricultural products find it difficult to access these supermarkets. They are challenged to meet their requirements on quality, volume, reliability and consistency in supply. This study highlights a case of innovation to link small scale organic rice producers to supermarkets.

The UMFI ventured into an approach of taking the role of a marketing consolidator for small scale producers who have difficulty accessing supermarkets. Small scale producers are inherently at a disadvantage when supplying to supermarkets. Notwithstanding requirements on quality and price, supermarkets demand volume and consistency of supply of a variety of products. Small scale producers do not have the volume but when consolidated, especially across products, economies of scale and scope may be achieved. This case study shows that it is possible for small scale producers to access high value markets such as supermarkets through the innovation made by UMFI. The elements of this innovation are discussed in this case study with a focus on organic rice.

The framework of analysis, objectives and data collection methods employed in this study is discussed in section 3. To contextualize the innovation being examined the environment external to the organizations being studied and internal within the organizations is discussed in sections 4 and 5 respectively. The innovation or set of innovations is then discussed in section 6. Finally, lessons learned and conclusions are presented in sections 7 and 8 respectively.

3 Framework of analysis, objectives and data collection

3.1 Framework of analysis

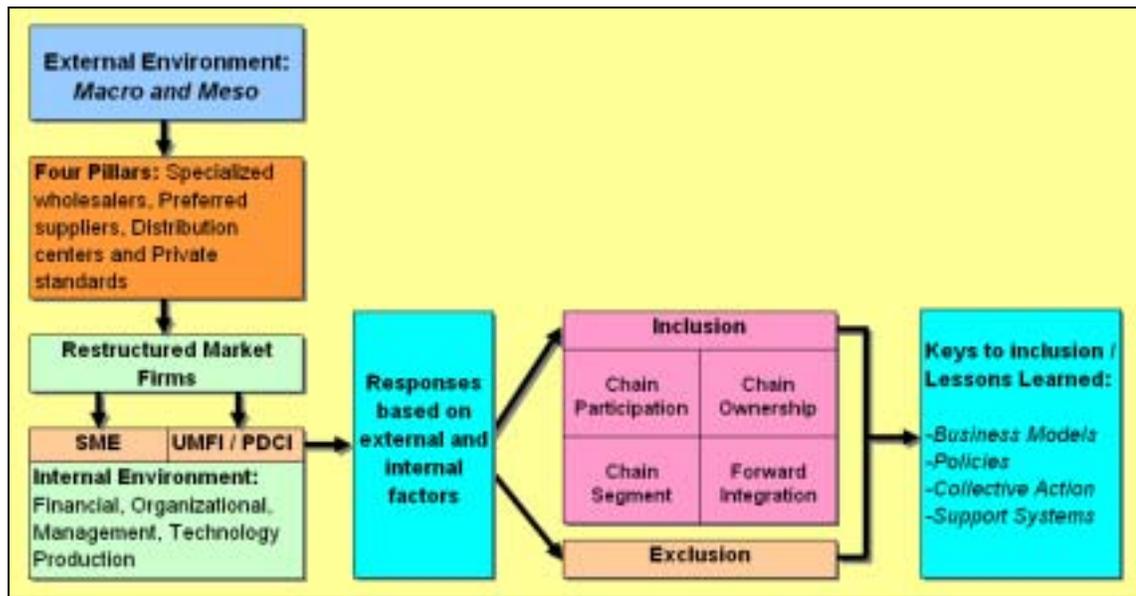
In order to address the aforementioned objectives, it is important to use a framework to understand the keys to inclusion of small scale producers in dynamic markets. In this study, we use the framework of Berdegúe, J.A. and Peppelenbos, L. (2005) from the regoverning markets programme (See Figure 3.1).

Innovations that enable small scale producers to enter modern markets are actually responses or strategies of organizations such as the UMF I to the challenges and opportunities in the industry given its competencies and resources available. These challenges and opportunities are rapidly changing in these dynamic markets. Procurement strategies of supermarkets change over time for example. Their standards become stricter, and they streamline suppliers to lower transaction costs and improve efficiency. Thus, preferred suppliers, specialized wholesalers and distribution centres emerge.

The quality of responses or innovations made by organizations such as the UMF I and other players in the chain including the organic rice farmers will determine their ability to compete and sustain access to these modern markets. These responses or innovations must be translated into improving their competitiveness in terms of meeting the changing requirements of the market. Otherwise, these farmers will be excluded.

The components or elements of the framework in Figure 3.1 provide a systematic way of understanding the factors that underlie the exclusion or inclusion of small scale producers in modern markets.

Figure 3.1: Framework of analysis



3.2 Objectives

The objectives of this study are to:

- describe the key elements of the innovation and its context at the level of the supply chain and of the relevant meso and macro trends, policies and institutions;
- explain how the innovation emerged over time and how it resulted in greater inclusion of small farmers and/or rural small to medium enterprises (SMEs);
- map the critical stages and the critical success factors in the evolution of the innovation;
- identify evidence of inclusion, the costs and benefits of the innovation, and how are they distributed across different actors in the supply chain particularly if small farmers and/or rural SMEs gain and whether results are sustainable;
- determine the drivers towards a greater degree of inclusion particularly in terms of policy principles, business models, collective action and support systems and to
- explore implications for potential upscaling and/or replication and its

challenges.

3.3 Data collection

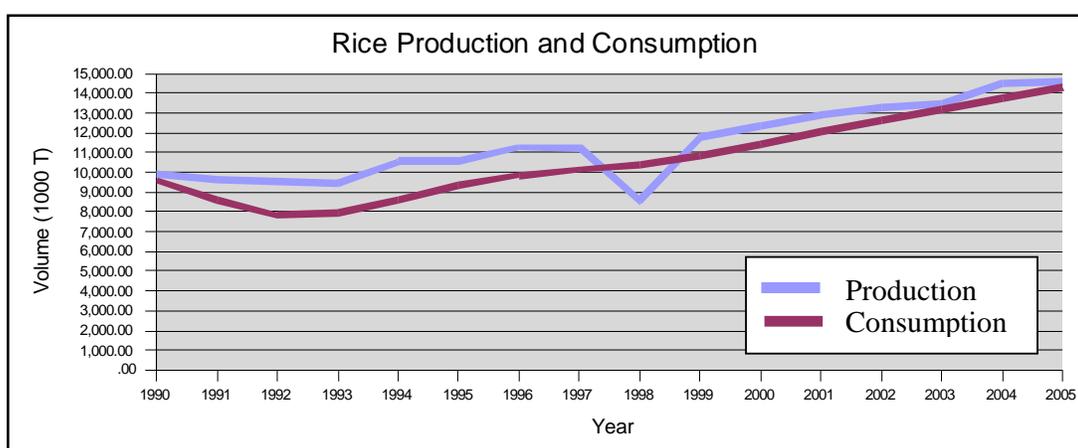
Primary and secondary data were used in the analysis of this case study. Primary data was gathered through interviews conducted with UMFI and PDCI representatives, a focus group discussion with the officers and key members of PDCI, and a survey of 18 PDCI farmers. Secondary data such as records, reports and presentations made about PDCI and UMFI were also used to supplement primary data.

4 The external environment

4.1 The Philippine rice industry

In the period of 1990 to 2005, the population of the Philippines increases at an average of 2.34 per cent annually, while rice consumption increases by 2.84 per cent (see Figure 4.1). Increasing demand puts pressure on production especially when prices of inputs are increasing while the price of *palay* (unmilled rice) remains roughly the same (see Table 4.1). Production cost is placed at USD 191.00 per ton in 2003, with a recorded annual increase of 5.51 per cent. Nominal wage for *palay* production has also gained a significant increase with an average annual increase of 11.36 per cent in 1990 through to 1999. Thus, producers do not have the incentives to meet demand especially when the government allows importation of rice and dampens output prices. Competitiveness of the rice industry is constantly challenged.

Figure 4.1: Rice production and consumption



Source: FAOSTAT, 2006

Table 4.1: Prices of palay in 1996-2001 (PHP per kilo)

	1996	1997	1998	1999	2000	2001
Special	8.74	8.48	8.95	8.61	No data	8.58
Fancy	10.26	9.9	10.68	11.07	No data	10.97
Ordinary	7.54	7.52	8.08	7.67	No data	7.9
Other Variety	8.19	8.03	No data	No data	No data	No data

Source: PIDS

4.2 The Philippine organic rice industry

The organic rice industry is a very small subset of the Philippine rice industry. Out of approximated area of 4 million hectares planted to rice in the country, area devoted to organic rice was estimated at 1,754 hectares in 2001. In this year it was also found that about 15,411 hectares were being planted by 11,052 farmers, who practice low chemical input applications². Assuming that the number of low chemical inputs farms has already converted to full organic production, this will only account for 0.43 per cent of the total 4 million hectares planted with rice. At present, there are only two producer groups that were awarded certification by the Organic Certification Centre of the Philippines (OCCP)³.

The organic rice industry began in 1986. The average yield for irrigated organic rice grew to four tons per hectare compared to the 3.4 tons per hectare of conventionally grown rice. Studies showed that the net profit cost ratio of organic rice production is at 3.78 compared to 1.79 of high-yielding varieties of rice. This came with a production cost per hectare of PHP 13,519.25 (USD 281.65) for high yield varieties (HYV) and PHP 7,148.00 (USD 148.92) for organic rice. On average, HYV produced 120 sacks (38 kg/sack) of rice while organically grown rice produced 105 sacks (44 kg/sack). This translates to 4,560kg and 4,620kg for HYV and organic rice, respectively⁴.

Organic rice reaches the consumers through the efforts made by groups and individuals. The organizations that market producer groups' organic rice are UMFI, the Bukidnon Organic Products Corporation (BOPC)⁵, Gratia Plena and Sunnywood Enterprises. BOPC has outlets in the cities of Cagayan de Oro, Dumaguete and Iloilo. Other distributors are present in the Metro Manila but it could not be established whether their products come direct from organic farmer groups. Figure 4.2 shows the UMFI-PDCI organic rice supply chain.

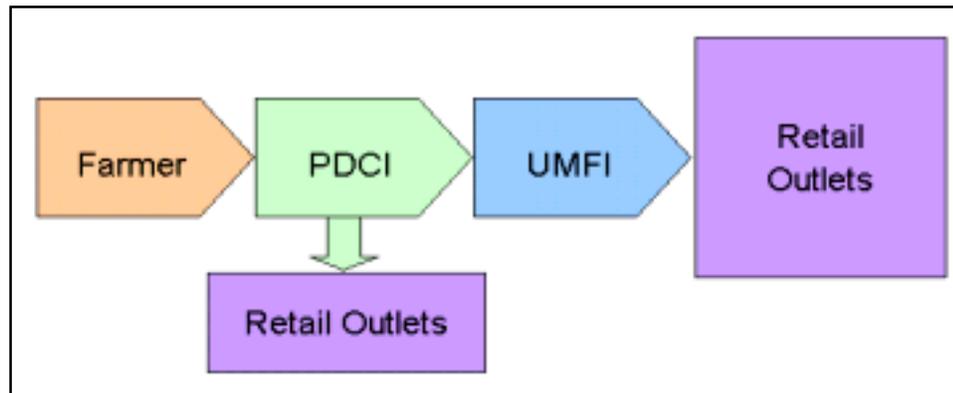
² Organic Rice Industry Orientation Paper commissioned by PDAP.

³ These groups are located in Bukidnon and Camarines Sur. Information was obtained through personal communication.

⁴ Xavier University, 1997

⁵ <http://www.organicrice.org/faqs4.htm>

Figure 4.2: UMFI-PDCI organic rice supply chain



4.3 Expanding modern retail industry

A study by the International Food Policy Research Institute showed that supermarket chains have dramatic impact on the food retailing industry. The study cites that in Brazil, food sales from supermarkets grew from 30 per cent in 1990 to 75 per cent in 2000. In Latin American countries such as Guatemala, the share of supermarket in food sale increased from 30 per cent in 1999 to 35 per cent in 2001. This shift is also true for Asian countries where in urban China and Thailand food share sales of supermarkets have increased from 30 per cent to 48 per cent and 35 per cent to 43 per cent respectively for the period 1999 to 2001. This trend has also driven many large multinational supermarket chains to set up operations in other countries.

In the Philippines, while only two foreign supermarkets/hypermarkets (Makro and PriceSmart) have set up operations since the liberalization of the retail industry in 2001, sales performance of modern grocery distribution is bullish, increasing by 22 per cent from 2005 to 2006 (Table 4.2). In fact, a study showed that from 1997 to 2001, the consumer patronage of supermarkets increased from 14 per cent to 22 per cent while the wet/public market patronage decreased from 85 per cent to 77 per cent⁶. Supporting these findings was a study conducted by AC Nielsen, which showed that 49 per cent of manufactured products were sold through the supermarkets and groceries. The same study also reported that supermarkets and groceries increased by 27 per cent and 35 per cent respectively in one year from 2000 to 2001. Moreover, sales per capita of modern grocery distribution increased by 20 per cent from 2005 to 2006 (Table 4.2). This clearly shows that these channels play a significant part in the distribution and marketing of consumer products.

⁶ Singapore Rice Case Study from Asian Institute of Management

Table 4.2: Retail Market Indicators, 2004-2006

Retail market indicators	Year			Growth rates (%)	
	2004	2005	2006	2004-05	2005-06
Retail sales (USD mn)	38,319	43,718	50,103	14	15
Retail sales / capita (USD)	444	498	560	12	12
Grocery retail sales (USD mn)	24,172	27,284	30,948	13	13
Grocery retail sales / capita (USD)	280	311	346	11	11
Modern grocery distribution, total sales (USD mn)	8,946	9,813	11,520	10	17
Modern grocery distribution, total sales /capita (USD)	104	112	129	8	15
Modern grocery distribution, Grocery sales (USD mn)	7,552	8,382	10,198	11	22
Modern grocery distribution, Grocery sales/capita(USD)	88	95	114	8	20

Source: PlanetRetail, 2006

In terms of trends and movements of consumer preferences, the market for products that were deemed healthy is increasing. To validate this, consumer surveys and market studies were conducted by UMFI. The studies showed that while the consumers do not know what organic products are, with only 0.54 per cent of the Metro Manila population being familiar with the term, the consumers do prefer products that are deemed 'healthy'. Their preference for this 'healthy' product is reflected on the premium price that they are willing to pay. 50 per cent of the survey respondents were willing to pay 35 per cent more than the commercial-conventional counterpart. Supplementing these survey results, focus group discussions obtained information that healthy food products generally pertain to products that are fresh, vegetables, fruits, no preservatives-additives, no chemicals or all natural.

In addition, the structure of the modern retail industry in the country is also changing. The concentration ratio in the retail sector (i.e. supermarkets) as measured by the National Statistics Office appears to be low at 1.1 per cent in 1994. This is based on the sales of the top four individual supermarkets divided by the total sales supermarkets in the country. However, if supermarket chains are treated as one unit, the concentration ratio would be higher. Data from Planet Retail (2005) showed that the market share of 181 stores of the SM group accounts for 12 per cent of total supermarket retail sales (Table 4.3).

Table 4.3: Top five grocery retailers in 2005

Company	No. of Stores	Sales Area (sq.m)	Average Sales Area (sq. m)	Retail Banner Sales 2005 (USD mn)	Market Share (%)
SM Group	181	438,250	2,421	1,163	11.9
Mercury Drug	510	153,000	300	879	9
Robinsons	224	287,600	1,284	562	5.7
Rustan	183	214,348	1,171	449	4.6
SHV Makro	16	134,400	8,400	332	3.4
Sub Total	1,114	1,227,598		3,385	34.5
Other				6,428	65.5
Total				9,813	100

Source: Planet Retail, 2006

4.4 Implications to small rice farmers

The increasing population, concentration in urban areas and rapid increase of supermarkets present an opportunity to earn more income for small rice farmers. However, increasing production cost due to increasing input and labour costs negate the incentives offered by rice farming. On top of these, accessing the markets is also an issue. Supermarkets are more demanding in terms of product quality, volume and stability of supply. These are requirements that most small farmers are not able to comply with due to their size and lack of financial resources for investing in technology.

With a lower cost of production, higher price, and a yield at par with conventionally grown rice, organic rice presents an opportunity for small farmers to increase their income and improve their welfare. However, even given these incentives for organic rice production, there are marketing challenges along the way.

5 Keys to inclusion: the organizations

5.1 Upland Marketing Foundation, Inc. (UMFI)

UMFI is a spin-off entity of the Upland Marketing Program of the Upland NGO Assistance Committee (UNAC) and the Philippine Business for Social Progress. Its Board of Trustees come from the member organizations, which include the Philippine Business for Social Progress, Kalahan Educational Foundation, Philippine Partnership for the Development of Human Resources in Rural Areas, Upland NGO Assistance Committee, and the Federation of People's Sustainable Development Cooperative.

Initial capitalization for the operations came from UNAC during the early years. UMFI received donor support for the salaries of some of its personnel, development of its business systems, training of personnel, and the purchase of office equipment. However most of its working capital came from loans and the amount of subsidies were smaller than the amount of loans UMFI acquired to support its operations.

The vision of UMFI is to make;

'Community-Based Enterprises as mechanisms for local economic development in marginalized communities through the generation of income and employment opportunities that are anchored on the processing/value addition and marketing of local raw materials into high value and marketable products to local and mainstream markets.'

Its mission, on the other hand, is to be a:

*'provider of affordable access to appropriate technology, financial resources, and growing markets to community based enterprise;
provider of high quality – healthy products to the consumers and an
-advocate of fair trade in the mainstream market.'*

UMFI's assistance to small scale organic rice to supply modern supermarket chains is a strategy that will contribute significantly to the realization of its vision and mission.

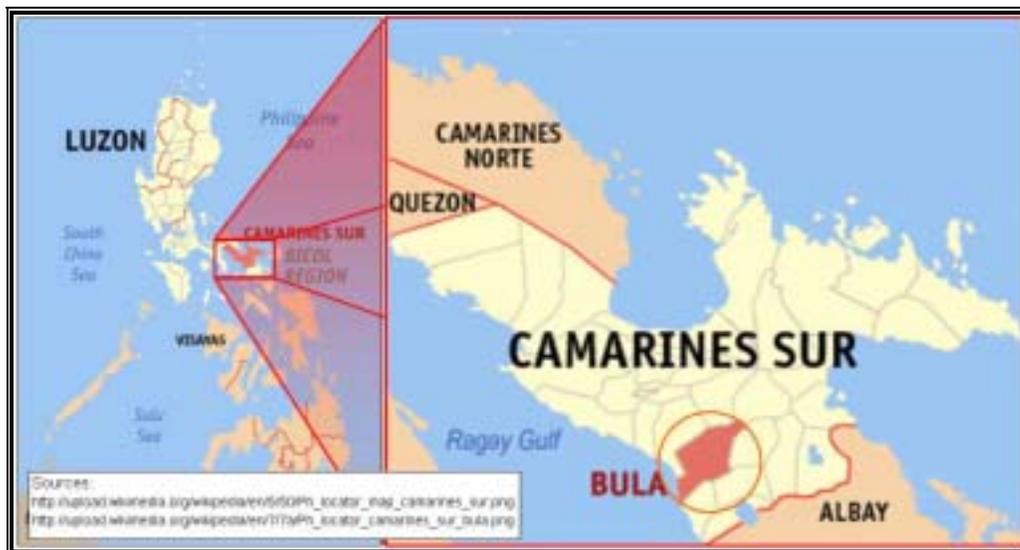
5.2 Pecuaría Development Cooperative, Inc. (PDCI)

The Pecuaría Development Cooperative Inc. (PDCI) is an organization of agrarian reform beneficiaries composed of 426 members based in the municipality of Bula, Camarines Sur. As beneficiary of the Comprehensive Agrarian Reform Program the group was awarded with 817 hectares of land for farming, housing, and educational facilities. Rice is planted on 130.87

hectares of irrigated and non-irrigated land. The cooperative was registered with the Cooperative Development Authority on September 31, 1991.

PDCI is the major supplier of UMFI with a total traded volume of 487 metric tons from 2002 to 2005, a volume that is worth approximately PHP 12.9 million (USD 302,390). The organization started with 14.2 metric tons in 2002 and reached a volume of 254 metric tons in 2005.

Figure 4.3: Location map of Bula, Camarines Sur



Source: www.wikipedia.org, 2006

PDCI;

'envisioning a progressive and united agrarian reform community with deep respect for ecology and gender equality and governed through a participatory and democratic process rooted in positive Bicolano and Filipino values, culture and with strong Christian Faith.'

Its mission is;

'as an autonomous rural organization is committed on building the capability of the organization and its member families towards a productive and sustainable community through a principled partnership and efficient and effective organization and farm resources management.'

It can be gleaned that the vision and mission of both UMFI and PDCI are not incongruent. They want to pursue economic upliftment of their clients through sustainable or appropriate technology. Hence, strategic partnership makes sense and can be sustained.

6 The innovations

6.1 History of the innovation

Inclusion or exclusion of small producers happens through a series of events across time that changes the landscape of the market and the economic structures. In the Philippines, most agricultural products are sold through a traditional supply chain where the producer sells the commodity to a buyer who in turn delivers to the wet market. The producer has very little involvement either in processing or in the analysis of the final markets. Often, the buyer who takes the products off the producers' hands acts as the financier of the farmer in terms of the provision of inputs for the production of the commodity. In the emergence of new market structures and modern chains like supermarkets, the small farmers are sometimes unable to respond to the market changes because traditional structures prohibit them from engaging the market intermediaries in ways that allow them to learn how to respond to changes in market needs.

Government programmes on agrarian reform, forest stewardship, or ancestral domain brought about opportunities for farmers and their organizations to acquire land tenure. These efforts were then followed by programmes by both government and non-government development agencies, to increase farm productivity and therefore farm incomes.

6.1.1 Selling through traditional supply chains

In the case of the UMFI partner communities, the farmers' and people's organizations were either given assistance on organic farming or value addition technologies that utilized locally available resources. These interventions lead to an increase in farm productivity, as farmers begin to realize an increase in harvest while communities engaged in food processing started producing finished products using local fruits and crops.

Despite these efforts, the income objectives of the communities were still not addressed. The farmers' and people's organizations were having difficulties selling their organic rice and processed food products as a premium product. In both cases tapping the right market was the main problem and without access to proper markets, the efforts on increasing productivity did not lead to an increase in household income.

In the case of the PDCI, the organic rice was sold at the local market in Bicol but since the local market did not have a trade channel for organic rice, the product was classified as regular rice. Since the organic rice did not come from certified seeds its maximum retail price was only PHP 20.00 (USD 0.42) per kilogram. While PDCI was able to sell organic rice at PHP 25.00 (USD

0.52), this was mostly through trade fairs in Metro Manila and to direct buyers also based in Manila and the volume was minimal. Most of the rice was sold between PHP 18-20/ per kilogram.

Table 6.1: Average price of rice

Rice Classification	Physical Characteristics	Other Requirements	Prevailing Retail Price (per kg)	
			PHP	USD
Premium	Purity, Whole/Long Grains	Certified Seeds	21-25	0.44-0.52
Well Milled	Purity, Whole Grains		19-20	0.40-0.42
Regular Milled	Broken Grains		16-18	0.33-0.38
Fancy/Aromatic/ Glutinous	Purity, Whole Grains		25-30	0.52-0.63

Source: NFA

From a review of the business operations, the cost of producing organic rice was higher than the wholesale price. As a strategy to entice farmers to engage in organic rice production, the cooperative PDCI provided a premium fixed price for palay produced using organic farming practices. This was a common practice and strategy among communities engaged in organic farming. In the case of PDCI, the cooperative decided to peg palay prices at PHP 10.00 (USD 0.21) per kilogram. Between 1997-8, market price for palay would range from PHP 8.00 (USD 0.17) to PHP 9.00 (USD 0.18) per kilogram. Although the strategy worked as farmers shifted to organic farming, the subsidy made their rice trading operations unprofitable. The data in Table 6.2 shows the cost of organic rice based on the review of the cooperative's business operations. The review revealed the cost to be PHP 19.35.

Table 5: Organic rice production cost

Activities	PHP / kg	USD / kg
Palay (14% MC, 65% Milling Recovery) Buying at P10/ kg	18.31	0.3815
Drying Cost per Kilogram	0.47	0.0098
Milling Cost per Kilogram	0.21	0.0044
Sack Cost per Kilogram	0.10	0.0021
Hauling Cost per Kilogram	0.18	0.0038
Delivery Cost per Kilogram	0.08	0.0017
Total Cost of Organic Rice	19.35	0.4031
Average Selling Price per Kilogram	19.00	0.3958
Net Loss/ Kilogram	0.35	0.0073

Source: UMP-PDAP Study

6.1.2 Entering dynamic markets

Wet markets failed to recognize the product differentiation offered by PDCI when organic rice was sold through the traditional chains. Lessons learned by other community based enterprises was that supermarkets provide an attractive option because the shoppers in supermarkets have a better appreciation of the premium product, although volume plays an important role to cover costs.

Dealing with supermarkets also involved other costs. It is a common practice for supermarkets to ask for 'listing fees' a specific amount to be paid by a supplier before a product is accepted by the store. This would range from a low of PHP 50.00 (USD 1.04) per sku⁷ to a high of PHP 85,000 (USD 1,770.83) per outlet. After the listing fees come the varied array of discounts on top of the regular discounts. There is an introductory discount which would be during the first three months, an anniversary discount, and special promotional discount.

Finally, the suppliers also have to contend with the cost of promoting and advertising their products in the store or area they are available. Product

⁷ Stock Keeping Unit

sampling, which is the most common and effective way to introduce the new product to the shoppers, would have a cost of PHP 500 (USD 10.42) per day to PHP 3,500 (USD 72.92) per weekend/store. Promotional materials like flyers, posters, and brochures help increase consumer awareness but also entail additional costs.

The two situations are typical of most of the businesses or enterprise initiatives of the farmers' and people's organization that UMFI worked with. The community could not tap into better markets for their products, or for those that were able to, could not maintain the markets due to costs considerations. In the case of organic rice, selling to the local market in Bicol was not the right market for their product.

The main criteria of UMFI for choosing a supplier is that the supplier must be a community-based enterprise (CBE) – a business that is owned and managed by a poor community or people's organization. The supplier must be legally registered and has the capacity to maintain the quality of the product they produce. The product must pass the industry standards set by the government and should be deemed saleable by UMFI (based on market information). In cases where UMFI has to sell products from the private sector, the product must not compete with existing products coming from the CBEs and would help pave the way for a new market for products that CBEs could produce in the future.

6.1.3 Hiring the right people

Supermarkets were a demanding set of buyers that required a manner of approaches that personnel of development agencies and NGOs do not usually have. Supermarkets required sales personnel who knew how to deal with them, dressed in business attire, were willing to wait long hours just to give a product demonstration, spoke the language of the supermarkets, and had knowledge of the consumer markets they were targeting. Initially, UMFI sale force was knowledgeable in dealing with producer groups but did not have the patience for the bureaucracy of supermarkets. They dressed in rugged and very casual garments, much like the clothes they would wear when dealing with the producer communities, which the supermarkets thought looked unprofessional and unclean.

Hiring of people from the business sector was uncommon within the NGO community. Organizations would rather convert an organizer or a technician into a marketing-sales person than hire a real sales person. The cause for this includes a combination of mistrust, cost, and attitude of doing everything on

their own. The organization says this because UMFI did the same initially and it got the organization nowhere.

Sales people from private companies have knowledge and understanding of the intricate policies and procedures that govern the supermarkets. For an NGO to learn these from scratch would take a lot of time without guaranteed access or efficient and effective operations. Industry sales people have the contacts with retail and supermarket chains, buyers or people managing these channels that remain in their positions or move only from store to store. They have good rapport and would have wider access and could facilitate easier entry of products to more stores.

UMFI decided to hire sales people with private company experience and assign them in Manila to manage the accounts and perform the task of booking orders, delivering the products, product merchandising and sales collections. These activities also had to follow fixed schedules that vary from store to store.

UMFI does not provide higher compensation but the incentives (commissions) are comparable to the offer of big companies. UMFI also provides continuous training and skills upgrade for its personnel. For the top manager that came from a multinational company, the rate is lower than what was received previously but the pressure and load of work is less in UMFI. Finally the people have also developed a need to be of service for others.

6.1.4 Responding to consumer preference

Trends in the consumer market continue to reveal that there is increasing interest in safe and healthy products that promote a healthier lifestyle. At this stage of the development of the innovation used by UMFI, the attributes of products that they marketed had to be redefined. For example, the packaging of one of the jams had to be redesigned because one of the supermarket buyers commented that the label should not say 'made by indigenous people'. This label gave the impression that the jam was made by indigenous people who may not know how to prepare food in a manner that complies with sanitary standards. Although this perception may be completely unsubstantiated, UMFI decided to delete the label which may give the false impression that the jam does not conform to sanitary standards.

UMFI therefore had to learn to satisfy the needs of the supermarket buyers, whether real or perceptual. For the organic rice, UMFI used the brand label 'Pecuaría Healthy Rice' and not organic rice because they did not have

organic certification⁸ and the preferences of the consumer was for healthy products and not necessarily organic products.

6.1.5 Using house brands

Using house brands emerged as a response to the risks posed of relying on one supplier. In 2006, PDCI was beset by typhoons that affected their organic rice production. Due to this, UMFI had to constantly renegotiate and reschedule delivery dates due to delays in supply delivery. They need to find other suppliers that can co-supply the market requirements to stabilize supply. UMFI however had already established contacts with other suppliers in the early years, thus allowing the foundation to maintain the volume requirement for the market. This averted the possibility of losing the foothold in the supermarket that UMFI had gained if they failed to deliver to the supermarkets the volume and frequency that was agreed upon. If UMFI loses the market, PDCI and the other CBEs will also lose the access to supermarkets.

With the move to also source from different producer organizations, UMFI was persuaded to use 'Healthy Rice' rather than 'Pecuaría's Healthy Rice'. This gave UMFI the strategy of using a house brand rather than a producer's brand. This helped spread the cost and the benefits derived from the brand. The supermarkets accepted the new label because trust with UMFI has already been established.

6.1.6 Tactical partnership with small and medium enterprises

The strategic or tactical partnership with the SMEs was a critical stage of the innovation. During the initial years, there was very limited volume of products to be sold coming from the communities. The products from the SMEs gave UMFI the volume of trade it needed to partly cover its costs of sales and distribution. The partnership with the private sector allowed the innovation to work and maintain its hold on the markets while the farmer groups improved their capacities and volume of production. In 2004, UMFI's volume of organic rice increased and in 2005 the foundation limited the marketing of products from private SMEs to provide focus on CBE products. (Table 6.3 shows the percentage sales contribution of products between private SMEs and CBEs)

⁸ Organic certification was acquired from the OCCP last January 2007.

Table 6.3: Percentage sales contribution from SMEs and CBEs

	2001	2002	2003	2004	2005	2006
CBE Products	31%	37%	44%	85%	99%	99%
Private SMEs	69%	63%	56%	15%	1%	1%
Total	100%	100%	100%	100%	100%	100%

Source: UMFI Sales and Marketing

The other critical stage was when expansion of operations grew faster than the capacity of UMFI to generate resources to support operations. Supermarkets paid UMFI from 30 to 120 days after delivery while UMFI pays the farmers anywhere from cash on delivery to 45 days after delivery. The gap of the receivables period meant that UMFI had to have the reserve cash to support the orders of the supermarkets. In 2004 sales dipped because of cash-flow problems as the trade volume increased. Partner-producers found it hard to maintain the flow of supply if UMFI does not pay cash. The delay in the infusion of capital made partner-producers stop deliveries until payments has been made. The arrival of loans saved the business operations from collapsing.

6.2 Elements of innovation: Its key strategies

The UMFI saw the need to access the supermarkets outlets for the communities as the major hurdle. Learning from its previous efforts, UMFI saw that providing market information, conducting trainings and linking communities to buyers did not always result to tangible or sustainable trade. While UMFI saw the potential of the mainstream supermarkets as markets for many of its partner communities, it also saw the limitations of the communities to directly access these markets. Experience and data show that communities cannot be linked directly to these markets. Communities from the provinces do not have the resources and expertise to tap and maintain these markets although their products need these markets in order to generate the income they need, and the markets need the products that the communities offer.

6.2.1 The development agency as marketing division

UMFI decided that instead of just providing information and training and trying to link these communities to the market, the foundation will engage in the actual trading of community products to the mainstream supermarkets. This decision was greatly supported by the farmers' and people's

organization as UMFI became their official marketing division – distributor in Metro Manila markets.

As UMFI engaged the market, key changes were made within the structure and operations of UMFI and its partner suppliers. The first thing that UMFI did was to hire new set of personnel who were from the retail trade as these people had the knowledge, experience, expertise and contacts within the industry. This was followed by an upgrade on its logistic capacity by acquiring needed equipment, facilities and business-operational systems, including the increase of operational working capital.

As a marketing division-distributor, UMFI is tasked to open and maintain outlets/ distribution channels like supermarkets. UMFI to a certain extent also conduct below the line promotional activities. In return for these services, UMFI gets a discount ranging from 15 per cent to 20 per cent to cover its costs of operations. For the other costs like the conduct of promotional activities, payment of special discounts, reproduction and distribution of marketing materials, UMFI charge the suppliers at cost plus cost of time spent by UMFI personnel. Since UMFI is also located at Manila, the supply requirements of its partner suppliers (like sacks, glass bottles, labels, boxes) are bought and sold by UMFI to its partner suppliers. These items carry a markup ranging from 10 per cent-15 per cent.

6.2.2 Niche consolidator and champion rider product strategy

The niche consolidator strategy was to market a combination of champion and rider products. By marketing several CBE products, the combined volume of these groups was to contribute to the volume needed to sustain distribution operations in Metro Manila. However, UMFI saw that even with the combined volume of many CBEs, the amount of business generated was still too small to make operations viable. This was then supported by the ‘champion vs. rider product’ strategy employed by UMFI.

With the champion-rider product approach, UMFI had to look for a champion product – a product that had good market potential and that can also be produced in bulk once the market picks up the product. Products such as rice and muscavado sugar are considered champion products. These are the products that by their big volume of trade, allow UMFI to generate the income to cover its costs. The champion products are thus the major source of UMFI income from marketing. The rider products are specialty products that have smaller market demand – low turnover product. These are products with niche or specialty markets that are produced or supplied in small volume or quantities by a CBE. The innovation will move on to a stable

position if the number of champion products are increased and would have a maximum sales contribution of not more than 20 per cent of total sales.

As a consolidator of service back to the CBEs, UMFI was able to provide product development services like improvement on packaging and product quality to address the main concern of the supermarket against CBE products. UMFI provided services that ensured products are of the expected quality and appearance and always available.

6.2.3 Branding and product positioning

As against many organic products at the onset, UMFI was keen in determining how it would position its product in the market. Using market data and assessing trends and even products in the market, UMFI would choose what specific product feature to highlight. With organic rice, marketing the 'health' dimension of the product than the 'organic' features seemed to have worked as other new products have copied this brand name (new competing products also call their rice Healthy Rice). UMFI registered the phrase 'Healthy Rice' as a brand name and not as a claim, as such it was not covered by the regulations of the Bureau of Food and Drugs (BFAD).

With muscovado sugar, UMFI also did not choose the 'organic' label as the positioning as strongly suggested with other groups. UMFI rather positioned the product as the perfect partner for coffee. In its packaging, this is more highlighted than the organic.

6.2.4 Cash flow management

The other critical stage was when expansion of operations grew faster than the capacity of UMFI to generate resources to support operations. Supermarkets paid UMFI from 30 to 120 days after delivery while UMFI pays the farmers anywhere from cash on delivery to 45 days after delivery. The gap of the receivables period meant that UMFI had to have the reserve cash to support the orders of the supermarkets. In 2004, sales dipped because of cash flow problems as the trade volume increased. Partner-producers found it hard to maintain the flow of supply if UMFI did not pay cash. The delay in the infusion of capital made partner-producers stop deliveries until payments has been made. The arrival of loans saved the business operations from collapsing.

All of the loans of UMFI were obtained from development organizations engaged in the business (Oikocredit, Federation of People's Sustainable Development Cooperative) of financing social enterprises. The interest rates

are market rates and while some are collateralized, others get guarantee support from donor organizations like the Interchurch Organization for Development Co-operation (ICCO). The grants and subsidies UMFI currently receives are not used for the business operations but for the development work that UMFI also conducts like developing new products, assisting communities establish their enterprises.

7 Keys to inclusion: Lessons learned

7.1 Critical success factors for inclusion

7.1.1 Constant monitoring and assessment of the environment

UMFI has been monitoring the changes in the market and in the industry to prepare it for changes/shocks or adjust its strategies to tap new and emerging opportunities. In the initial stage when the organic rice was launched, UMFI opted to position the rice as 'Premium Rice' and highlighted the term 'chemical and pesticide free' as against the common strategy of others to highlight 'organic' in the packaging and promotion of the rice. As a result, new entrants are copying and using the term 'healthy rice' on their products. The same was done for muscovado sugar, the 2nd champion product of UMFI. The muscovado was positioned as sugar for coffee instead of 'organic' sugar. The current packaging of UMFI Muscovado sugar does not contain any word organic but highlights 'best for coffee'.

The packaging of the 'Healthy Rice' and launching of a new product line of rice is also the result of this constant monitoring of the industry and market. The latest offshoot of this is the planned re-launching of 'Healthy Rice' under a new label design (Figure 7.1) and the launching of 'High Fiber Rice' as a result of the observation of the market that many people purchase rice and other health food products because of their fibre content. This was also validated through interviews and encounters with key customers and informants.

Figure 7.1: New label design for 2007



The monitoring of the environment also helps with benchmarking efforts of the organization, where efforts to identify best practices and industry standards are done and incorporated in the regular business operations. Among the changes within the organization that were conducted due to this

are monitoring of the cost to sales ratios of major expenses like transportation (3 per cent) merchandising (3 per cent) product returns (1.5 per cent), outsourcing of non core business functions like merchandising, and trucking.

Although it was also primarily the monitoring and assessment of the industry and the markets that the major bottlenecks within the business chain were identified and correspondingly addressed. The role of UMFI as a consolidator-distributor was addressing the major bottleneck of farmers in accessing the markets.

7.1.2 Transparency with partner communities

The transparency with the partner communities is another important element. This allows UMFI to tailor-fit services, identify potential problem areas and work out or maintain strategies to keep the business competitive in the market. The danger of non transparency is the building of mistrust between the supplier and the consolidator-distributor. The lack of knowledge and understanding of how the business operations could erode trust and confidence between and on each party, which would lead to deadlock situations or no win solutions.

The transparency will also anchor a more effective supply chain management initiative as decisions, strategies or interventions that will impact on margins and costs could be easily or openly discussed. The communities' increased understanding of the total business chain would also allow them to rethink or abandon short-sighted or unrealistic views and demands on the business. This allows the farmers groups to mature in their perspective. UMFI discuss the pricing with the suppliers regularly. UMFI discloses to the supplier the cost, expenses and even the margins UMFI makes.

7.2 Benefits and costs of inclusion

With UMFI performing product consolidation, sales and distribution of products and the farmer groups upgrading their capacities many products were introduced to the supermarket outlets. In 2001 when UMFI started its commercial operations as a product distributor-marketing arm of the farmers, supermarket outlets did not reach 100 stores all located in Metro Manila. The total sales for the year reached only PHP 1.8 million (USD 38,944). As of December 2006, UMFI serves 223 supermarket outlets all over the country (not counting the convenience stores of 7-11 and Mini-stops). The total sales for the year was PHP 25.7 million (USD 535,416.67) or an average of PHP 2.14 million (USD 44,583.33) per month. The sales performance for the first quarter of 2007 is PHP 9.2 million (USD 191,666.67) or a monthly average of PHP 3.06

million per month (USD 63,750). For the 1st champion product, organic rice sales reached almost PHP 13 million (USD 270,833.33) in 2006 or 469 metric tons.

Table 7.1: Traded volume of organic rice 2002-2006

Years	Volume	Estimated Value (PHP in million)	Estimated Value (USD)
2002	285 sacks 14.2 MT	PHP 0.35	7,291.67
2003	1,254 sacks 62.7 MT	PHP 1.60	33,333.33
2004	3,128 sacks 156.4 MT	PHP 4.20	87,500.00
2005	5,082 sacks 254.1 MT	PHP 6.80	141,666.67
2006	9,110 sacks 469.3 MT	PHP 12.99	270,625.00
Total	9,749 sacks 956.7 MT	PHP 25.94	540,416.67

Source: UMFI, 2006

7.2.1 Benefits for PDCI and farmers

Inclusion in the organic rice supply chain has brought significant increase in the income of the farmers. This increase is attributed to the reduction of production expenses and the higher buying price of the produce. Table 7.2 shows the comparison of the performance of 36 farmers in the years 2000 and 2006. The figures shown were derived from the records of PDCI, which documents the volume of palay sold to the cooperative and the buying prices. Palay sold in year 2000 were composed of HYVs, chemical free or a combination of both. It was in this year that farmers underwent the transition from conventional to organic production. On the average, there was an increase from 3,065.18 to 5,014.18 kilograms (64 per cent) in the volume sold per farmer and an average increase from PHP 8.83 (USD 0.18) to PHP 10.21 (USD 0.21) (16 per cent) for the price paid per kilo of rice. The percentages translate to an average gross sale from PHP 27,069.75 (USD 563.95) to PHP 51,202.85 (USD 1,066.73) or an 89 per cent increase.

Table 7.2: Volume and sales difference (2000 and 2006)

	2000	2006	Percent Increase
Average Volume (Kg)	3,065.18	5,014.18	64
Average Gross Sales (PHP)	27,069.75	51,202.85	89
Average Price (PHP)	8.83	10.21	16

Source: PDCI records

Benefits in terms of reduction of production costs were also obtained by the farmers when they shifted to organic rice production. A survey of 18 farmers showed while yield declined under organic rice farming compared to the conventional/inorganic farming and production costs have not changed significantly, net income of farmers increased by 119 per cent (Table 7.3 and 7.4). This is mainly due to better prices with a price difference of 46 per cent. The price premium can be attributed both to the quality attributes of the brand and the product as well as to the type of market outlet. Supermarkets generally provide higher prices compared to traditional markets due to convenience provided to consumers.

Table 7.3: Average costs of production per hectare

Production Activities	Conventional			Organic			Difference	
	PHP	In USD	%	PHP	In USD	%	PHP	%
Land Preparation	5,995.10	124.9	28.89	6,942.59	144.64	31.72	-947.49	-15.8
Planting	302.63	6.3	1.36	205.26	4.28	0.94	97.37	32.2
Seeds	1,262.18	26.3	5.68	1,609.79	33.54	7.35	-347.61	-27.5
Irrigation	10,047.89	209.33	45.21	10,713.16	223.19	48.94	-665.27	-6.6
Fertilizers	3,108.48	64.76	13.99	2,419.23	50.4	11.05	689.25	22.2
Herbicides	757.75	15.79	3.41	--	--	--	--	--
Pesticides	750	15.63	3.37	--	--	--	--	--
Total	22,224.03	463	100	21,890.03	456.04	100	334	1.5

Source: Survey of PDCI farmers, 2007

Table 7.4: Comparative sales, income and yield performance: conventional vs. organic

Item	Conventional	Organic	Difference	
			Value	Percent
Yield (bags/hectare)	83.06	73.78	-9.28	-11.17
Price per kilo (PHP)	7.26	10.63	3.37	46.42
Gross sales (PHP)	30,150.78	39,214.07	9,063.29	30.06
Net income (PHP)	7,926.75	17,324.04	9,397.29	118.55

Source: Survey of PDCI farmers, 2007

7.2.2 PDCI adaptation to innovations

The increasing demand for organic rice in the market is an opportunity presented to PDCI that must be acted upon. In order to meet with the increasing demand, PDCI is required to encourage more farmers to engage in organic rice farming to boost their production levels.

To encourage more farmers to convert to organic rice production, their initial strategy was to peg the buying price of palay at PHP 1.00 higher than those given by traditional buyers. In order to maintain the farmers who were

already into organic rice production, they provide input assistance for seeds and organic fertilizers that are payable after the harvests have been made.

UMFI conducted studies in a) local rice trading dynamics, which identified the current players in the industry and their practices; b) business operations review, which focused on how cooperatives conduct their business operations; and c) consumer surveys to see how the market behaves.

7.3 Distribution of benefits

As discussed, there is a significant difference in the price of organic and non-organic rice or unbranded rice. But how are these distributed across players in the chain?

One way to answer this question is to look at the share of each player in the chain to total margins (i.e. retail less farm price). Table 7.5 shows that PDCI accounts for more than 50 per cent of margins. This is followed by UMFI with 33 per cent and about 14 per cent for supermarkets. This does not mean however that PDCI gets most of the benefits since this indicator does not include costs incurred. PDCI does the milling, hauling and trucking of rice to Manila (Table 7.6). UMFI provides the storage, packing and transporting of rice from warehouse (Manila) to supermarket outlets. Supermarkets incur costs of selling the product to final consumers. Unless we get detailed costs of various players in the chain for performing marketing and other functions, we cannot ascertain exactly who benefits most in the chain. It is clear, however, that farmers increase their income by selling to high value markets such as supermarkets through PDCI and UMFI.

Table 7.6: Distribution across players in the chain: red vs. brown rice (2007)

Price	Red	Brown	Margins		% Share to Total Margins	
			Red	Brown	Red	Brown
Farm Price	12.50	12.50				
PDCI Selling Price (FOB Manila)	31.00	26.00	18.5	13.5	56.32	51.92
UMFI Selling Price Supermarket	40.82	34.65	9.82	8.65	29.89	33.27
Supermarket Suggested Retail Price	45.35	38.50	4.53	3.85	13.79	14.81
Total			32.85	26.00	100.00	100.00

Table 7.6 Price, Margins and Costs, Brown vs. Organic Rice

		Brown	Red
Organic Rice	SRP	38.5	45.35
Supermarket Margins	Discount	3.85	4.54
Supermarket	Margins %	10.00%	10.00%
	UMFI Selling	34.65	40.82
UMFI Packaging/Return	Packaging	2.55	2.55
Costs	5% Returns	1.3	1.5
	UMFI Net	30.8	36.77
FOB Manila	Buying	26	31
UMFI	Margins	4.8	5.77
UMFI	Margins %	15.88%	15.68%
PDCI	Selling	26	31
PDCI	Margins %	15.46%	29.09%
PDCI	Margins	4.02	8.02
Total	Cost Rice	21.98	21.98
Estimate	Trucking	1.25	1.25
Direct Costs	Palay-Rice	1.5	1.5
Estimate	Cost Rice	19.23	19.23
Buying	Palay	12.5	12.5

Naga to	Manila	Transport
Drying	Milling	Hauling
65%		
recovery	14% MC	

7.4 Participation in chain management

Chain management is a shared role between UMFI and its suppliers. UMFI serves as the official marketing division-distributor of the products of the CBEs in Metro Manila and selected provinces in the Philippines. While the CBEs, like PDCI, are responsible for the production side, the suppliers are not yet shareholders of UMFI although there are plans to increase their stakes in the business of UMFI. At present, the suppliers are being consulted on plans and directions of UMFI and will soon be formed into a committee that UMFI will consult and discuss with regarding the foundations plans and future direction. In terms of the basic price determination, UMFI has always consulted the final price of the product with the partner suppliers.

To ensure that suppliers meet the quality standards set by and between UMFI and its partner supplier, any shipment that falls below the agreed standards is rejected by UMFI. UMFI has an internal quality control officer that inspects all shipments made to UMFI. If a community or supplier suffer shipment rejection, UMFI will help the supplier determine the cause and the community to address the problem. All transactions with the suppliers are sealed by a purchase order from UMFI.

7.5 Sustainability and replicability

7.5.1 Sustainability

The keys to the success of the innovations are its strategies and the competence of the persons involved with the organization. With the existing

system, they were able to maintain an operation that is profitable, with funding support from donor agencies. It is important to note, however, that funding support played an important part during the initial years of the organization and in product and personnel development. At present, all the costs of operations are sourced from the income of the business, while the current sources of funds and financing for the marketing operations come from loans.

Implementation of the strategies and continuous employment of the innovations needs to be maintained in order to achieve sustainability. The responsive characteristics that UMFI has will play an important role in its foothold on the market. Likewise, support to producer organizations must be continuously extended in order to sustain supply.

7.5.2 Replicability

The innovations that were introduced by UMFI are well documented and can be used as a model for other organizations who would want to engage into development of a similar venture. However, central to these strategies are the capabilities of the individuals involved in the implementation of the innovations. The commitment, dedication and business acumen possessed by the personnel of the organization fuels the success of the strategies of the innovations.

The other value of the innovation is that its application is not limited to smallholder producers but can also be used to develop SMEs and other backyard industries.

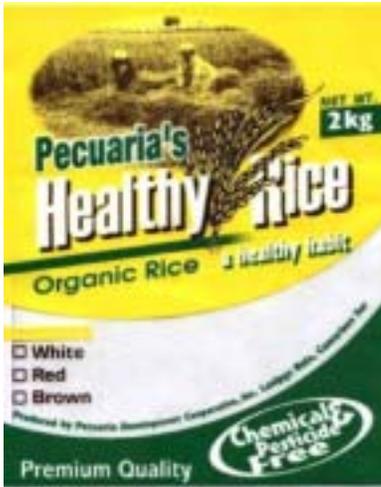
8 Conclusion and recommendations

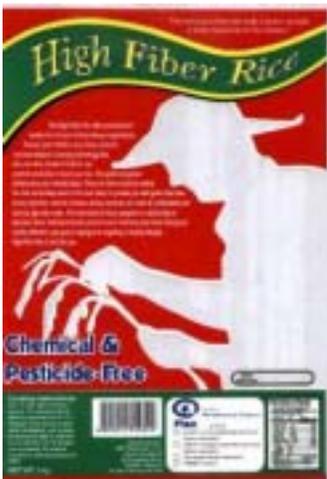
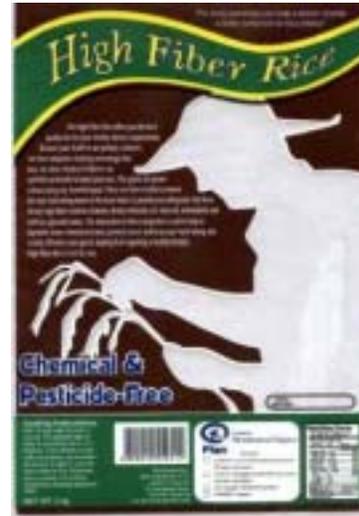
The main lesson derived from this case study is that smallholder producers can be successfully linked with dynamic markets but will require extensive knowledge of both market and production environment. This also requires significant amount of investment and efforts for business incubation. Strengthening of organizations is also highlighted in order for them to meet deliveries and quality requirements.

Collaborative management and involvement of producer organizations in the management of the chain is also important. Through the feedback mechanisms developed by UMFI, producer organizations are able to fine tune production in order to meet market requirements.

9 Appendix

Healthy rice packaging and labels





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Regoverning Markets

Regoverning Markets is a multi-partner collaborative research programme analysing the growing concentration in the processing and retail sectors of national and regional agrifood systems and its impacts on rural livelihoods and communities in middle- and low-income countries. The aim of the programme is to provide strategic advice and guidance to the public sector, agrifood chain actors, civil society organizations and development agencies on approaches that can anticipate and manage the impacts of the dynamic changes in local and regional markets. The programme is funded by the UK Department for International Development (DFID), the International Development Research Centre (IDRC), ICCO, Cordaid, the Canadian International Development Agency (CIDA), and the US Agency for International Development (USAID).

Innovative Practice

Innovative Practice is a series of case studies from the Regoverning Markets programme providing examples of specific innovation in connecting small-scale producers with dynamic markets at local or regional level. Based on significant fieldwork activities, the studies focus on four drivers of innovation: public policy principles, private business models, collective action strategies by small-scale farmers, and intervention strategies and methods of development agencies. The studies highlight policy lessons and suggest working methods to guide public and private actors.

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