Inclusive Business in Agrifood Markets: Evidence and Action

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Business innovations for inclusive agrifood markets

Conference Issues Paper 2

The potential of modern agribusiness to promote broad-based economic growth in the countryside is huge. Food retailers, wholesalers and processors can effectively link small-scale producers to dynamic markets. They can bring technical and managerial capacity-building and investment. This potential of modern agribusiness is, however, underutilized. Indeed, in many countries small-scale producers and small- and medium-scale enterprises are relegated to lower-value markets. Many recent initiatives of modern agribusiness, often working with development partners, do not seem to have resulted in lasting economic empowerment and modern market engagement of small-scale farmers or their organizations. Can the new agrifood business drivers be 'partners in development'? This Issues Paper looks at some of the evidence of how business models can succeed in securing the inclusion of small-scale producers in dynamic markets.

Key messages

- **Agrifood business (retail, processing, procurement, etc.) investment in developing and emerging economy countries requires a strategy of involving the small-scale producer, if business is to be a partner in national development**
- **The current corporate responsibility agenda, and the UN Global Compact, largely miss the point about the position of primary producers**
- **The biggest challenge for large business in working with small-scale farmers and small and medium-sized enterprises (SMEs) is organizing supply: quantity, consistency, quality, safety and traceability**
- **There is a good business case, beyond meeting the Millennium Development Goals (MDGs), to take on these challenges and to trade with the small-scale sector, if a strategy is built on sound business models**
- **Business models can range from relatively simple changes to procurement policy through to joint ventures**
- **Organizing supply through direct linkage to small-scale farmers can be successful, but usually has high transaction costs**
- **Some of the most successful cases of procuring from small-scale producers involve working with specialized intermediaries, who understand both ends of the chain. Reinforcing rather than 'cutting out the middle man' may be the most sustainable strategy**
- **A foundation for success is for multiple actors to work together**

Why 'inclusive business'? Why now?

Agrifood markets are in an unprecedented state of flux, and are generating intense policy debate worldwide. The primary drivers of this are market liberalization, a reduced role of the state and shifts towards market-driven policy, changes in consumer preferences and purchasing power, rising energy and food prices, climate change and its implications, and the modernization of food processing and retail itself.

The modernization of retail has been accompanied in some cases by political turmoil, especially in India, where local traders – but also farmers – feel a threat to their livelihoods. This reflects a perception that the growth benefits from globalization are patchy and are, according to the Indian Finance Minister, Palaniappan Chidambaram, 'not reaching to the bottom of the pyramid'.

Market modernization offers increased economic opportunities for producers and SMEs, consumers, and other actors in the food chain. New buyers in the countryside are competing for farmers' produce. But there are also risks, of domestic businesses being bypassed, and of costly market entry requirements which favour the better-resourced. If the Millennium Development Goals (MDGs) are to even be partially met by 2015, then market modernization and restructuring has to deliver a growth and equity 'win-win'.

Development is not the primary purpose of for-profit business. But transferring a business model from urbanized countries, where less than 2 per cent of the workforce may be engaged in agricultural production, to investments in 'transforming'[1] and 'agriculture-based' economies, overlooks the huge differences in the structure of the economies, and thus the challenge that it poses to the business model. In China and India – the two most populous 'transforming' countries – 43-60 per cent of the workforce is engaged in agriculture, over 640 million people in all. Even in countries such as Thailand, Turkey and Morocco, 40-50 per cent of the workforce is involved in agriculture, and in Romania and Honduras, it still accounts for a third of employment.

So agrifood investors – processors, retailers and intermediaries – in these transforming countries need a strategy of enabling rural people, including the small-scale farmers, to be partners in national development.

[1] Economies in which agriculture contributes less to growth yet poverty remains overwhelmingly rural

Contemporary corporate responsibility (CR), with its emphasis on supplier standards for environment, worker welfare and community relations, has generally been poor at addressing issues of market inclusion of primary producers.

The big question, then, is how to make inclusive market development work for mainstream business, as well as meeting the MDGs.

What are the business challenges in linking small-scale producers and SMEs to modern markets?

The biggest challenge for modern agrifood business to work with small-scale farmers and SMEs is organizing supply. There are perceived to be high transaction costs and higher risks with purchasing from large numbers of fragmented small-scale farmers and SMEs.

Modern food processing and retail is positioned in the market with high standards for safety. Assuring standards of quality and food safety is built on principles of traceability and bookkeeping. Demands for consistent quantity and continuity of supply, packaging and bar coding are all elements of meeting modern agrifood requirements. Standards may extend to labour and environment, with certification costs proportionately much higher for small-scale producers. Such farmers are also perceived to be less reliable in honouring trading agreements.

Case study: Carrefour's quality line in China
Of the supermarkets in China, Carrefour is characterized by marketing fresh foods. With the rising consumer awareness of food safety issues, the demand for high quality and safe food has increased. In 1999, Carrefour started to sell a 'green' food supply line under its own brand with the 'Quality Food Carrefour' logo. This line represents an innovation in the purchasing system within the China context, where Carrefour carries out integrated management on the entire supply chain, with full traceability. Other retailers are following suit. To date, participants in the Carrefour quality line are all larger-scale, rather than small-scale, farmers. The latter account for more than 90 per cent of the agricultural population in China, demonstrating the challenge of connecting small-scale farmers with demanding 'safe food' markets.

Given these demands, it is not surprising that buyers seek out large suppliers and also seek out areas that are already favoured by agribusiness. For example, those already engaged in export production. This is easier in countries with a dualistic farm structure such as South Africa and Zambia.

Case study: From wholesale to preferred supplier: Shoprite
In 1992, Shoprite, a leading South African retailer, relied on wholesale markets for 70 per cent of its sourcing. In 1992, Freshmark, their now wholly-owned specialized and dedicated wholesaler, started to form 'preferred supplier' relationships with large commercial farmers (from whom it sources the majority of its produce), as well as some large wholesalers and some medium- and smaller-scale farmers. By 2006, it had 700 such preferred suppliers (a few for each main product), from whom it sourced 90 per cent of its produce, with only 10 per cent sourced from the wholesale markets. A decade ago that share was 50 per cent. The shift to using preferred suppliers, away from the wholesale markets, was facilitated in South Africa by the sharply dualistic farm sector structure. Freshmark 'follows' Shoprite into other African countries, still sourcing much of its produce from South Africa.

Producers and SMEs also face competition from the high-quality low-price imports, ushered in by structural adjustment and demands of WTO membership. There is a close link between chain modernization and liberalization; supermarket chains, in particular the multinationals, are important importers of foods.

Why should business – procurement, wholesale, processing, retail – be interested in inclusive procurement?

The business case

The role of business as a 'partner in development' has been actively debated, especially as a result of the World Summit on Sustainable Development in 2002. This has since been taken up by the World Business Council for Sustainable Development (WBCSD) and by a number of UN agencies. The Sustainable Agriculture Initiative, with is broad membership of global agribusiness seeks within a limited set of key commodities to address some of the key social and environmental issues facing agriculture globally.

The World Food Business Summit 2008 will, for example, focus on 'Growth and Sustainability' and on how to build profit responsibly recognizing the many current issues of the day including energy supplies, the 'global plight of farmers', aggressive supermarket pricing agendas, global sourcing, corporate responsibility and the multiple issues facing the consumer.

But amongst such conferences and reports, the business case for corporate engagement in rural development can get lost, outside a small set of frequently quoted case studies. Yet the business case for working with small-scale producers is convincing.

Small-scale producers can have a comparative advantage in terms of quality, innovation, costs and farm management. There can be an even stronger business case for linking with small-scale producers and SMEs where there is a scarcity of alternative suppliers, either due to the characteristics of the product (seasonality, labour requirements, locality), a shortage of land for large-scale domestic or own-business production, a lack of a medium/large-scale supply base (for example the dairy sector in India or Poland), or where demand is called for in more remote areas away from main distribution channels.

Case study: Securing supply in remote regions
Tanzania: Given the remoteness of the hotels, local supply from small-scale farmers is much less costly, especially during the rainy season when road transportation from outside the area is not always possible. Furthermore, the local supply has a promotional value within the tourist trade as a support to local communities coupled with the encouragement of environmentally sound production.

South Africa: In contrast to the centralized fresh produce procurement systems of South African retailers relying on preferred commercial suppliers, there are also innovative procurement schemes. Two rural-based supermarket chain stores in the Limpopo Province source fresh vegetables locally from small-scale farmers. By 2004, the Thohoyandou SPAR was procuring approximately 30 per cent of its vegetables from about 27 small-scale farmers. These farmers are supported by interest-free loans for selected farmers, a guaranteed market, farm visits, and training on required quality standards. The drivers for supporting the development of this local procurement scheme from small-scale farmers are the remoteness of the supermarkets from the central distribution centres, the stores' operation in rural areas, reduced transportation costs, and meeting freshness requirements and contributing to community development.

Securing supply is especially important in the current tightness in global supply which is shifting markets from a buyer's to a seller's market. Retail buyers and processors may also seek to work around markets where large traders have a hold. This was the situation in Pakistan where a milk processor, Haleeb Foods Limited, worked around the large and well established milk traders by securing a small-farmer supply base.

Small-scale producers are themselves a new business opportunity. In India, now that retailers can buy direct from farmers rather than operate through the government-controlled Agricultural Produce Marketing Committee (APMC) markets, new models of rural retail are emerging. One such example is the Hariyali Kisaan Bazaar, which combines a 'bottom of the pyramid' approach to both the input and output sides of the farm-to-consumer value chain. This is an extension of the approach advocated by Prahalad and Hart (2002) which argues that corporations can make considerable profits by designing new business models and products to target the four billion poorest people who make up the base of the economic pyramid.

Small-scale and artisanal producers are also sources of produce for niche markets for alternative trade.

Community goodwill
Working with small-scale farmers is also a means to build community goodwill. The political importance of supporting national development goals cannot be understated within the context of a company's 'licence to operate', and not just the debates such as that currently raging around liberalization of retail foreign direct investment (FDI) in India, or in the quest for black economic empowerment in South Africa. A policy backlash against organized or foreign-owned retail is possible anywhere, and can translate into restrictive legislation.

What are the practical options for companies to go for inclusion?

The traditional way that downstream agrifood companies have demonstrated a commitment to development has been through codes and standards for their suppliers. These codes, such as the Ethical Trading Initiative, focus on worker welfare and are felt as costs by suppliers. Attention to the welfare of wage labour is of utmost importance to poverty reduction, but does not address the issue of small-scale farmer and SME exclusion. In fact, these standards are another barrier to market entry.

In general, whilst attention to the welfare of wage labour is of utmost importance to poverty reduction, it does not necessarily address the issues of small-scale farmer and SME exclusion. Codes and standards can indeed be seen as a cost to supplies and a barrier to market entry of producers.

Business model innovations
Extension of business model thinking can create value for small-scale suppliers in mainstream markets. Much can be achieved without any major redesign of business operations, and within existing trading practices.

Upgrading mainstream procurement
A lot can be done by business to ensure that their procurement practices work to the benefit rather than detriment of small-scale producers. Points of focus are coherence between corporate policies including CR and procurement practices, and through related adjustment of reward systems and senior management buy-in. Where modern retail operates through preferred supplier schemes, understanding and benching marking of these suppliers on key aspects of their business operation can help to identify hot spots. Market information and technology can be shared with producers and SMEs. Standards and certification systems should be adapted to the reality of small-scale producers. Payment practices are of critical importance – especially prompt and transparent payment (see the Madzarov case study). Attention can be given to the upstream impacts of chain-wide business practice including 'back margins', slotting fees, retrospective discounts, and avoiding playing one supplier off against another.

Learning from alternative trade models
Some businesses may want to push further toward adopting practices from alternative trade models such as Fairtrade. These include an emphasis on long-term trading relationships built on trust, transparency and accountability, enhanced producer and SME voice in supply chain management decisions, capacity building of producers and SMEs including strengthening producer organizations and support for diversification, while avoiding dependency and ensuring equal access for women and men to contracts and leadership positions.

Inclusive procurement
There are also models of inclusive procurement, built on preferential sourcing from small-scale producers and family farmers and their organizations, and SMEs. For example, Carrefour Indonesia has established a dialogue with SME suppliers of fresh food (vegetables and fish), household equipment and textiles, to improve product quality and packaging and improve their shelf access, in part by waiving the listing fee. Included in the scheme is a 'best supplier' prize and a 'most promising supplier' prize, and SMEs are a theme of its 2006 advertising campaign. Similarly, Wal-Mart, Honduras has established the 'Una Mano para Crecer' ('Help to Grow') programme for SMEs.

Organizing own supply base.
Both producer and buyer ends of the value chain usually want to 'cut out the middle man' and shift from a dependency on traditional wholesale markets in pursuit of value, improved quality, and product assurance. Direct procurement is often presented as a win-win-win for customers, business and producers. It improves information flow among the supply chain segments while reducing the marketing risk faced by both the company and farmers. Another area for business to organize their own supply base is where there is a lack of collective producer action, often because of suspicion of cooperatives or laws that insulate producers from the market.

Case study: Dimitar Madzarov in Bulgaria
The private dairy processing firm Dimitar Madzarov Ltd in Bulgaria has increased its daily processing of milk by a factor of 20. The milk is sourced from over 1,000 small farms, half of which have fewer than five cows. The firm has successfully met all the requirements to continue selling its dairy products in the demanding and highly competitive European market. Part of the success of Madzarov in building a reliable milk procurement system has to do with the regularity with which it pays its small-scale farmer suppliers. In the case of the smallest farmers, the firm goes as far as advancing payment. Access to this source of timely and reliable financing is considered by the small-scale farmers to be of greater importance than the price received for their milk. The link to Madzarov has opened new and very rewarding markets to small-scale producers, but it has not empowered them in the value chain.

But organizing direct procurement can have high transaction costs for private players and with mixed outcomes. In Mexico, Wal-Mart recently tried to buy strawberries direct from the farmers, but withdrew due to high costs. Given the difficulties faced by producers in Turkey to organize themselves, the few cases of successful direct relations between supermarkets and producers' unions are largely implemented and promoted by supermarkets. For example, Migros Türk achieved direct sourcing with the Narlıdere Village Development Cooperative in the Bursa region where others failed, only because of its historical background and its anchoring within the Turkish agrifood chain. Migros invests in capacity building of its supply cooperatives' staff and supports production management, thus going far beyond the incentives offered by formal contracts.

Buyer-organized direct sourcing can also be highly paternalistic and create dependence rather than empowerment among producers in the chain. Producers will accept paternalism when, as in case of Hortifruti in Honduras, it is compensated for by the certainty of the sales, rapid and guaranteed payment, and technical and financial support. But processors or retailers can encourage their suppliers to organize into more autonomous groups, and thus construct a partnership rather than an exclusive buyer-driven supply network.

Working with intermediaries
Chain intermediaries are often vital in linking small-scale producers to dynamic markets. They are particularly important to small-scale producers and to those located further away from the markets and the main roads. The existence of these intermediaries often makes the difference between successful and sustainable small-scale farmer inclusion, and failure. Their legitimate and useful roles in the value chain need to be acknowledged and they need to be supported in order to streamline the value chain. When the market is dominated by smaller traders, there is also a great challenge in meeting demands for food safety. Business has to work with the new generation of intermediaries to ensure traceability and due diligence.

In fact, some of the successful 'doubly-specialized' intermediaries, which are both business-oriented and development-motivated that we have documented are fully private-sector-driven and are independent of any support from government or NGOs.

Case study: Partnership between farmers and supermarket via a specialized wholesaler
Carrefour Indonesia procures fresh mangoes through a specialized wholesaler rather than directly from farmers. This specialized wholesaler guarantees the product quality and continuity that Carrefour requires. But the wholesaler also provides services to the mango farmer group such as technical assistance and capital. There is no product transaction; the intermediary receives a transparent 5 per cent commission on the sales made between the farmers and Carrefour. The benefits for the farmers are manifold. The intermediary has encouraged the farmers from working individually to work in a group and transformed their relation with the market from spot-market-based to contract-based negotiation. The farmers gain higher prices, faster payment, better access to market information, and, above all, inclusion in a dynamic market.

Case study: NGO as intermediary in India
The Himalayan Action Research Centre (HARC) played a major role in linking small-scale tomato producers in Uttarakhand to a major retailer. First, it identified the potential buyer and negotiated with them to convince them to try sourcing from the Naugaon area. Then, it made use of its good name among the farmers to convince them they could work with this large corporate player, gradually building trust. This included acting as the commercial agent of Mother Dairy during the initial years. Once the business relationship was established NARC continued to provide technical and financial services to the farmers and their federations.

Strategic public sector support to intermediaries, such as the Tongzhou Agricultural Broker Association in China is an area that appears to offer the potential for enhanced market participation by small-scale producers in some cases. The Tongzhou Agricultural Broker Association was organized in 2001 with the support of Administration for Industry and Commerce. The administration issued special policies for the association, such as subsidy and taxation release. It provided the association with initial funds for operation and a working office, technical instruction and printed materials. The outcome has been better skilled and regulated intermediaries able to service many hundreds of small-scale farmers.

Finance
Supermarkets and processors tend to pay only after a long period, which is very significant constraint. A mechanism to bring liquidity into the supply chain is required. An example is cash flow finance in which the commercial relationship rather than traditional assets act as guarantee – three-way agreements between buyer, producer and a finance institution.

Shared equity
Enabling small-scale producers to acquire a share in the business provides a business model for inclusive development. Two examples serve to illustrate this. The Thandi winery combines co-ownership of vineyards by workers (land redistribution beneficiaries) with the economies of scale and managerial and business skills needed in export-oriented markets. The Entreprise de Services et Organisations de Producteurs (ESOP), Togo, is an innovative shareholding structure with participation from a farmer organization, a private entrepreneur and a support agency. Best performing farmers within the organization can progressively become shareholders of the company.

Self-regulation
Cross-industry codes of conduct established by the business sector and regulated by them, for example in Argentina, can provide much-needed oversight of trading relationships at the domestic level.

Case study: Best Commercial Practices Code in Argentina
Rapid investment by global and regional retail players in Argentina in the late 1990s created fierce competition between players. Local retail investors created a trading environment unsuitable for small companies, with a poor bargaining position for most players and complaints at all levels. The choices faced by the sector were either to develop a private code or submit to government legislation. Informed by evidence and experience from across the globe, the Food and Beverages Manufacturing Association (COPAL) and the Argentine Supermarkets Chamber (CAS) worked to develop a private code of practice which was signed in June 2000. Since then supplementary rules have been added and the approach has been shared with many countries in the region and indeed worldwide. Similar private sector codes have been developed and adopted in Colombia and Mexico. Seven years on, there has been significant improvement in both free and fair practice and thus competitiveness. The culture and way of doing business has changed with a dramatic reduction in cases submitted for mediation or arbitration.

Partnering with development agencies
Businesses can develop effective initiatives in partnership with governments, donors and NGOs. It can learn as much from the successes and failures of development agencies and NGOs as the latter can learn from business. This is also a way to gain access to subsidized inputs and technical and financial resources. For example, a link between Shoprite in Mozambique and small-scale growers of fresh fruit and vegetables in Boane is being supported by an IFAD grant of US$23.6 million, to the extent that Shoprite now buys 25 per cent of its fresh fruit and vegetables locally.

The cash and carry operator Metro is working with the Vietnam Ministry of Trade and GTZ to support the development of Vietnam's distribution network.

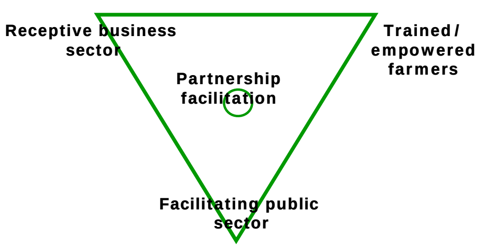
A number of donors have in place business challenge funds, for example the Africa Enterprise Challenge Fund, the Financial Deepening Challenge Fund, and the USAID Global Development Alliance. These offer the opportunity for innovative business models within inclusive agrifood markets to be explored and developed. It is important that donor funding be used for leveraging long-term change rather than distorting subsidies that lead to boom-and-bust projects

Open dialogue between business and public policy
There is much to be done to build cooperation with the public sector. Public policy can play a key role in shaping the structure of farming and of trade through a range of instruments from taxation policy, market regulation, science and technology to FDI arrangements. In general, the public sector has very limited understanding the dynamics of change within agribusiness and opportunities for public intervention. For example, support of agriculture and investment in relevant infrastructure can be greatly aided by constructive dialogue with the agrifood business community. This can be achieved through the work of agrifood trade associations, commodity associations, chambers of commerce, or the formalization of joint structures such as the commodity committees in Mexico.

Joint learning as a foundation for success

Innovation in building inclusive markets is greatly enhanced when business actors within the market chain – from production to retail – engage along the whole chain together with indirect businesses (input suppliers etc) and with relevant public institutions (see Issues Paper 5 *Linking market chain actors for effective policy*).

A key pattern in successful linkages between small-scale farmers and dynamic markets is the collaboration between (a) trained and organized farmers, (b) a receptive business sector, and (c) conducive public policies and programmes. Such arrangements may benefit from specialized partnership facilitation. These multi-actor collaborative arrangements are subject to evolution, with changes occurring within each actor group, in their relationships, and in their market and policy environments. Getting these arrangements right is one key to the inclusion of small-scale farmers in restructured and dynamic markets.



A call to action

The entire development agenda cannot be loaded on the shoulders of modern agribusiness. Nor can modern agribusinesses behave as non-profit entities. There is, however, a good business case for securing and enhancing small-scale producers' inclusion, which can bring both economic and wider development gains. This can be achieved only if the right business models are applied, and where applicable, when this is done in partnership with producers, public sector, intermediaries, and development agencies. The prerequisites for this are:

- Re-thinking corporate responsibility. Pro-poor and inclusive procurement is an emerging agenda. Look beyond good but largely boutique CR stories, to mainstreaming inclusive procurement
- Reversing existing exclusion and innovating with different business models when investing and expanding in developing and emerging economies. Seek to meet organized producers half way
- Fostering agribusiness associations at national level that can dialogue with farmer associations, public policy and related trade associations (e.g. transport and logistics) for more coherent domestic and regional agrifood market development
- Encouraging business self regulation and codes of good commercial practice, including benchmarking
- Working with and fostering the new generation of intermediaries to ensure traceability and due diligence and to broaden the supply base
- Working with the public sector and development funds on ways that can generate new and innovative partnerships and business models, thus also allowing development funds to be better used for pro-poor inclusive market development

References

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Regoverning Markets is a multi-partner collaborative research programme analyzing 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), the Canadian International Development Agency (CIDA), ICCO, Cordaid, and the US Agency for International Development (USAID). The Beijing conference was further supported by DFID, IDRC, CIDA, and the Dutch Ministry of Foreign Affairs/Development Cooperation (DGIS). The views expressed are not necessarily those of the funding agencies. For further information see www.regoverningmarkets.org or contact RegoverningMarkets@iied.org