Inclusive Business in Agrifood Markets: Evidence and Action

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Farmer innovation - linking with modern agrifood markets

Conference Issues Paper 4

Market restructuring and modernization presents opportunities and threats for farmers and their organizations. Can small-scale producers and their organizations be partners in new business? This Issues Paper looks at evidence of how farmer innovation can achieve successful inclusion of the small- and family-scale farm in modern dynamic agrifood markets at national and regional levels.

Key messages

- **Meeting the needs of modern agrifood markets is within the reach of small-scale farmers. But it requires threshold investments, a receptive business sector, conducive public policies and programmes, and often specialized facilitation. Producers must evaluate their market options carefully.**
- **Collective action remains an important strategy for increased small-scale producer participation in dynamic markets.**
- **Existing producer organizations were found to have a mixed record of providing members with economic benefits in terms of access to dynamic markets**
- **A key factor for successful small-scale producer participation in dynamic markets is the ability to introduce innovative management models such as supplier differentiation and supplier clusters. But these are often challenging to the cooperative ethos**
- **Intermediation is key to bridging the realities of small-scale production and modern organized markets. Innovative models do exist, as alternatives to vertical integration and 'cutting out the middleman'**
- **Producers should use policy influence on business strategy as well as public policy.**

What challenges do producers face in keeping their place in or gaining access to modern markets?

Small-scale farmers and small and medium-sized enterprises (SMEs) form the bedrock of global agrifood supply. This business composition has given farmers great strength and flexibility to innovate and adapt to emerging domestic markets in developing and emerging market economy countries. Compared with large-scale commercial production, small-scale farmers can have a price advantage due to lower opportunity costs for land and labour, and have better farm management because of their status as resident owner-managers.

Small-scale and dispersed agricultural production can, however, also make small-scale farms less able to respond to market restructuring and modernization, because of their weak negotiating position when selling to much larger buyers, and their reduced competitiveness when dealing with supply chains that are becoming increasingly formalized and upgraded. Agrifood markets are in an unprecedented state of flux, and are generating intense policy debate worldwide. The primary drivers are market liberalization, a reduced role of the state including a shift towards market-driven policy, changes in consumer preferences and purchasing power, and the modernization of food processing and retailing.

The International Federation of Agricultural Producers (IFAP) has drawn its members' attention to the challenge of market concentration and market access and has made the subject a top issue for global policy action.

Deregulation and removal of market controls – for example in India and Turkey – mean that producers have more flexibility on where to market. There are new buyers in the countryside. This brings opportunities and threats. A recent *Wall Street Journal* report from India says that **'**For the first time in India's history, modern retailers are offering farmers a choice of a buyer other than the traders at government-controlled Agriculture Produce Market Committee (APMC) markets. But some farmers also say this may be something limiting choice because they could end up selling to the only buyer who comes to them rather than selling through the APMC's open auction system that ensures several buyers bid.'

Over the long term, these opportunities will not benefit small-scale producers if they themselves are not organized to meet market requirements and exercise countervailing market power.

Cooperating to compete?

Private companies often prefer to work with organized farmers rather than individuals despite the increased bargaining power that groups can enjoy. This is to overcome a set of common issues and problems such as dispersion of producers; diseconomies of scale; poor access to information, technology and finance; inconsistent volume and quality; lack of traceability; and management of risk. Farmers are interested in collective action when, as a result of cooperation, they can access new markets or achieve higher market price, in order to stabilize their market position in the longer term and defend their market share.

Research in eight countries (see Issues Paper 1) found that membership of producer organizations was correlated with participation in modern markets in only half of the countries. In the rest the correlation was not significant or negative. This is indicative of the very mixed role of producer organizations, from political lobbying to channels for government subsidies. Marketing cooperatives are rare, and members typically remain oriented towards the traditional commodity markets.

However, benefits of collective action in accessing modern organized markets can be considerable. For instance, in the case study of potato production in Indonesia, a producer group that had organized to trade with a supermarket was found to have produced the highest value added, and farmers received the highest portion of the value added (49 per cent), since the farmers undertake product preparation and sell graded potatoes.

Cooperation between small-scale farmers may be instigated by producers themselves, such as the case of Rushere in Uganda or Avium in Hungary, by large farmers seeking extra supply volumes, such as Normin in the Philippines, by producers and retailers seeking to assure supply such as Narlidere in Turkey, or by NGOs and other support agencies. Each model creates different dynamics**.**

Case study: Rushere Dairy Farmers' Co-operative Society in Uganda

The dairy market in Uganda was characterized by a low share of the market price for farmers, poor milk marketing facilities, poor quality of milk marketed, and milk traders cheating farmers. The Rushere Dairy Farmers' Co-operative Society Ltd has successfully connected small-scale farmers to markets. In 1981, a group of dairy farmers in Kiruhura district in south western Uganda recognized the need to work together to address common constraints they faced in the production and marketing of milk. The group received technical support from Land O' Lakes in the form of training in hygienic milk production and handling, business skills and milk marketing. Membership has since grown from 120 to 1,700. Milk yield has increased and almost every member sells between 50 and 500 litres of milk daily. Rushere has pursued a successful business model based on forward integration of the dairy value chain. At the start, the group had a cooler with a capacity of 2,300 litres but today they are able to buy over 30,000 litres and sell only 15,000 litres daily. The group is involved in processing dairy products and has an outlet in Kampala City where their products are marketed.

Case study: AVIUM in Hungary

The introduction of a market economy and accession to the EU were seen as a huge market opportunity by a group of poultry farmers in Hungary. The agricultural cooperative AVIUM was established in 1993 in Besnyő village, Hungary after the new cooperative law came into force in the western part of the country. At that time, small and medium-scale poultry processors were not present in the market. To fill this market niche and meet the rising demand in western Europe, a few farmers belonging to an existing cooperative joined forces to establish a poultry processor, which has grown into a successful medium-sized company. AVIUM is a new generation of purchase, processing and marketing cooperative which aims to concentrate the supply of live chickens and to organize the joint procurement of inputs. An essential element of this structure is the strong integration of raw material supply and processing. A processing unit developed new value-added products for domestic and foreign markets.

Challenges in the management of collective marketing organizations

Small-scale farmers' organizations engaged in dynamic markets sooner or later face the dilemma of having to sustain the participation of the organization or to sustain the inclusion of all the members. This can threaten the competitiveness of the organization. One of the key factors for successful small-scale farmer participation in dynamic markets is the ability to introduce new management models, such as supplier differentiation and supplier clusters. Some of these arrangements accept differentiation within the organization based on assets, and are a significant departure from the original co-operative ethos of equal treatment for all members.

Case study: Aj Ticonel in Guatemala

The successful Aj Ticonel in Guatemala has had to establish different categories of suppliers among its small-scale, indigenous farmer base: those who supply year-round, and those who supply only in certain seasons; those in whom the organization invests to have them certified in Good Agricultural Practices, and those who are not certified; those with whom the organization contracts a fixed based price, and those who are paid according to the market price on the day of delivery. Aj Ticonel correctly identifies this differentiation as one of the sources of its competitiveness and its success, even while recognizing the social consequences of such a strategy.

The same differentiated membership status is used by farmers' organizations marketing watermelons in China, in order to ensure that new members comply with business standards.

There are mechanisms that can be used by farmers' organizations to create opportunity for poorer farmers, while not damaging the flexibility of the organization or its competitiveness in the market in which it participates. These include quasi-membership arrangements and top-up suppliers. An example of this is the decision by the TACA cooperative in Jordan to collect sheep milk not only from its organized members, but also from small private producers, which resulted in greater inclusion of a greater diversity of small producers. The successful Morakert cooperative in Hungary accepts a significant amount of produce from non-members - sometimes more than half of the total production supplied.

The same can be observed at Normin in the Philippines. A medium-scale farmer, Green Haven Farm, was producing lettuce for Blue Dairy, a vegetable processor supplying McDonald's fast food chain. Blue Dairy extended production and post-harvest technical advice to Green Haven Farm. It asked for quantities that Green Haven Farm could not supply alone, forcing it to coordinate with other farmers. Small-scale farmers showed interest in this opportunity; the fast food market was judged to be more stable and more profitable than local wet markets if one could deliver quality produce. Green Haven Farm thus organized the small-scale farmers in a 'marketing cluster' sharing production technologies and market information, and gradually involving other farmers interested in growing lettuce.

The NorminVeggies farmers' organization was then formed with the support of the government and a development agency (USAID). This resulted in targeted support, in particular from government (reefer trucks, chillers, pre-cooling facilities), that allowed NorminVeggies to improve its marketing capacity. With NorminVeggies becoming known within the dynamic markets, other marketing clusters have been set up with the support of the association. They are characterized by a common marketing plan for identified markets, and they involve a core of financially independent farmers and small-scale farmers who also benefit from NGO support, where financially independent growers are creating market opportunities for small-scale farmers. They produce the capital-intensive crops while the small-scale farmers produce the less capital-intensive ones. They also facilitate sharing of knowledge inside the clusters. To sustain their inclusion in dynamic markets, the clusters put the stress on their ability to consistently deliver as a group.

Shared equity

Models of investment by producers in vertical integration**,** to becoming co-owners of the supply chain or one of its segments in pursuit of value-added, can make sense when built on a business mentality. But this downstream ownership route may not always compare well to a network of specialized actors.

Case study: ESOP in Togo

In Togo, the soybean organization ESOP (*Entreprise de Services et Organisations de Producteurs*) exemplifies an innovative shareholding structure with participation from a farmer organization, a private entrepreneur and a support agency. NGO support is focused on the development of innovative multi-agent organizational arrangements which are organized around the set up of a processing enterprise producing innovative niche products and developing specific relationships with buyers. Financial, technical and organizational support is provided for the creation and the functioning of the enterprise. This enterprise links up with groups of farmers organized under the scheme of the 'tontine' with solidarity among the members regarding agreed deliveries and reimbursement of seeds. The best performing farmers are allowed to progressively become shareholders of the company, which increases their participation in the supply chain. This seems to be a promising way forward, though there are questions concerning the governance capacity of the farmer organization and the exit strategy for the support agency.

Contract farming

Contract farming can be successfully used to link small-scale producers to modern markets where capital, technology and market access constitute key limiting factors. But contract farming can be an intermediate step. In northern Thailand, innovation by small-scale potato farmers – in terms of seed saving and early sowing to exploit a gap in the market – enabled them to move out of a contract farming system. Their technical innovation allowed them to reconnect with more traditional network of brokers, but on their own terms.

Technical support

Technical upgrading is a core priority for producer organizations and SMEs. Many donor programmes fail to invest in better quality and increased yields, and move onto marketing immediately. For many smallholders and SMEs, service provision between commercial actors – termed 'embedded services' – holds promise in that these services depend on commercial incentives rather than public or development subsidies. This is the case in the Narlidere-Migros relationship in Turkey, where heavy constraints to producers 'co-operating to compete' was the justification to access technical and administrative support from a supermarket partner.

Case study: Win-win relationship between producers' unions and supermarket chains: Case study of Narlidere Agricultural Development Cooperative in Turkey

The marketing of fresh produce in Turkey is highly regulated. Both supermarkets and producers in Turkey are interested in contracting with each other through producers' unions, because they reduce marketing costs related to transaction fees. Supermarket chains appear to be looking for this kind of direct linkage. Most of the difficulties come from the producers who cannot organize themselves around producer unions. The Narlidere Village Development Cooperative became a producers' union in 1995, and at the instigation of the Migros Türk supermarket, refocused its activities on fresh vegetable marketing for Migros as well as for other clients, bypassing the wholesale commissioner. Migros's investment in capacity building for co-op staff and production management by acting inside the cooperatives is justified by the reduced transaction costs of dealing with only one contract, and receiving sufficient volume and quality at fixed price.

Market facilitation: Working with intermediaries

Intermediation between small-scale producers and modern markets is a key to success in order to bridge the very different worlds of smallholder production and modern organized food markets. Rather than invest in vertical integration and 'cutting out middle man', there are very promising models whereby producers help set up or work with a new generation of 'doubly specialized' intermediaries. These may be informal alliances with existing intermediaries, as with the example of truckers in the Astrakhan region of Russia.

Case study: Normincorp in Mindanao, Philippines

Farmers of NorminVeggies can successfully participate in dynamic vegetable chains primarily because of the organizational structures they chose by which to respond: a corporation – Normincorp – enabled them to deal with each development in the supply chain. Normincorp's formation signified a new development in marketing set-up for small farmers. While established as a stock corporation, it functions more like a cooperative and has a social enterprise character. It was a set up and operated with keen business sense but also with full empathy for the small farmers. As market facilitator, Normincorp saw to it that production was programmed by the clusters with their respective cluster leaders according to marketing plans. It enabled quality farm and post-harvest management to be done by each farmer in the cluster, and coordination of the sequence of activities that include order taking, outshipment logistics, billing/charging, collection and remittance to the farmers. For these services, Normincorp earns a market facilitation fee based on the value of the sale and uses the income to cover the marketing management overhead. Normincorp is not a trading company. Rather, it is a market facilitator linking the farmer through the cluster direct to the buyer. The farmer is given the buyer's price, and s/he is therefore accountable for the product and retains ownership of the product up to the institutional market's end. This encourages the farmer to supply the best quality since the price is given to him/her and all sales are remitted directly to him/her after deducting the market facilitation fee based on accepted vegetables. Conversely, all rejects are individually charged to the farmer concerned. Labelling of products according to farm or farmer provides this traceability.

Case study: Coordination of long-distance transport for small-scale tomato producers in the Astrakhan region of Russia

The most appropriate production for traditional varieties of fresh tomatoes preferred by Russian consumers are those produced by smallholders. The major tomato-producing areas are remote from the major consumption centres such as Moscow and St Petersburg. Astrakhan producers were excluded from Russian market for a long time, despite their advantage of an early ripening period which gives them a price premium. Quick and efficient delivery to Russia's major centres is a necessity. In response to this need, the local truck drivers organized in a type of cabstand with a common dispatcher system. The dispatchers collect the requests from the smallholder producers for deliveries of their produce to other regions and allocate these requests to the drivers. The drivers pick up the products at pre-agreed venues and times. They receive advance payment and go to the markets. The representative of the contractor (producer) meets the truck at the market and conducts the final financial settlement. The system works quite efficiently and provides a good net return both for the smallholder producers and the drivers. It also meets the needs of the urban consumers in major national metropolitan areas.

Finance

Financial services are crucial for farmers to access dynamic markets and sustain their participation in them. As supermarkets and processors tend to pay only after a certain period, a mechanism to bring liquidity into the supply chain is required. In addition to working capital, other financial services like investment capital, alternative collaterals, and risk management can have a strong impact on the success of smallholder inclusion.

In the case study of indigenous vegetables in Kenya, the presence of a Saving and Credit Cooperative (SACCO) as a sub-committee of the farmers' group allows the farmer organization to pay the farmers upon delivery despite the supermarkets' delayed payment. The SACCO is based on farmers' contributions but also benefits from NGO (Family Concern) support in case of accumulated delays.

Working with development agencies

Case study research reveals few, if any, examples of successful small-scale producer/SME linkage to modern markets where there has not been external support of some kind, either from an NGO, support agency, or from trade partner or government. How these external agents position themselves in the chain makes a substantial impact on the long-term sustainability of an initiative.

Case study: Access to high-value markets by smallholder farmers of African indigenous vegetables in Kenya

With Kenyan consumers becoming more conscious of food safety, the high-value markets for indigenous vegetables impose stringent conditions on quality of the produce they purchase. Considering these stringent conditions, farmers acting collectively developed a partnership with an NGO, Family Concern. The partnership has promoted well-coordinated linkages among farmers, support agencies, government extension staff and supermarkets in promotion of a viable enterprise.

Modern or traditional markets?

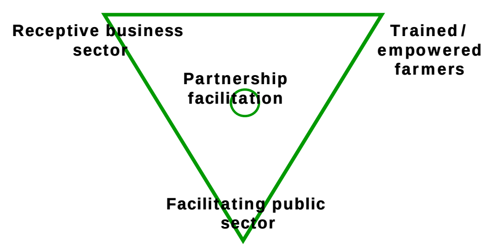
Traditional markets are resilient and can co-exist for significant periods of time within restructured markets. Small-scale farmers usually operate in different market channels, both new and traditional. They diversify marketing strategies in order to meet different economic needs (such as access to credit or improved cash flow and controlled risk levels) or social needs (such as inclusion in the social networks that are interlinked with the marketing networks). Despite perceived advantages of integrating into formal supply chains, the informal supply chains can be more beneficial for small-scale farmers. Their prices are more flexible and reflective of demand and supply dynamics, where formal supply chains, such as supermarkets, have stringent quality requirements with which even the well-established commercial farmers are failing to comply.

In South Africa, for example, there are questions as to whether it is viable and necessary for small-scale farmers to be worried about integration into formal food supply chains.

Some emerging modern markets are extremely small, niche and donor-influenced, and a distraction from the priorities of broad-based rural development. And even very progressive modern procurement systems can be exclusionary. Producers, intermediaries, buyers and support agencies must evaluate their options very carefully.

Chain-wide learning and collaboration

A key pattern in successful linkages between small-scale farmers and dynamic markets is the importance of collaborative arrangements between (a) trained and organized farmers, (b) a receptive business sector, and (c) conducive public policies and programmes. Such arrangements are in most cases supported by (d) specialized partnership facilitation. These multi-actor collaborative arrangements are subject to evolution with the changes that are 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.



National multi-stakeholder task groups build understanding between stakeholders and support chain-wide learning for effective policy (see Issues Paper 5). Typically, success depends on constant innovation and change on all sides.

It is through these collaborations that farmer organizations can adopt a chain vision, engage in multi-agent cooperation and acquire new "mainstream" business expertise, and build trust between agents in the chain. There is much scope for progress. Very few case studies showed any evidence that small-scale farmers have any significant role in supply chain governance. Even in cases in which the small-scale farmers had an important role in the governance of the supply chain, like in the case of Aj Ticonel in Guatemala, both sides continually face issues of loyalty and fulfillment of commitments.

Lobbying for inclusive markets

Producers and their organizations have an opportunity to redirect their considerable influence in support of public policy and donor priorities (see Policy Brief 3) that underpin successful market linkage. These include the enabling environment of infrastructure and land tenure; policies that support (or at least do not inhibit) group marketing and collective bargaining; policies that are supportive of equitable trading relationships; policies to upgrade traditional and wholesale markets; and policies to maintain a competitive marketplace. Support to appropriate technology generation and the provision of technical and business advisory services is pre-requisite. The private sector, however, is also an appropriate target for producer lobbying, in support of the development and uptake of inclusive and pro-poor business models.

A call to action

- Producers can meet the needs of modern markets, in partnership with other chain actors.
- Overcoming resistance to collective marketing is a key first step.
- For an organization to grow while providing opportunity for all members but maintaining the flexibility and competitiveness of the organization, new management models are required.
- Intermediation is a key to bridge the realities of small-scale production and of modern organized markets. Innovative models do exist, as alternatives to vertical integration and 'cutting out the middleman'.
- Producers should use policy influence on business strategy as well as public policy. Without a receptive business sector and facilitating policies, there will be no fundamental shift towards inclusive agrifood markets.

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