RURAL INFRASTRUCTURE AND
AGRO-INDUSTRIES DIVISION

Smallholder business models for agribusiness-led development

Good practice and policy guidance

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1 Africa, Caribbean and Pacific Countries
2 http://www.euacpcommodities.eu/en; http://www.fao.org/economic/EST/AAACP/en/

Acronyms

ACP	Agricultural Commodities Programme
AGS	Rural Infrastructure and Agro-Industries Division (FAO)
CFA franc	Central African CFA franc
CPO	crude processed oil
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FFB	Fresh Fruit Bunches
GDP	gross domestic product
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
HQCF	High Quality Cassava Flour
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
NGO	non-governmental organization
SMAE	small- and medium-sized agro-enterprises
SME	small and medium enterprises
UNIDO	United Nations Industrial Development Organization

Chapter 1
Introduction

Macroeconomic and trade policy tools were common instruments used to defend local economies and livelihoods from the fallout of the post-structural adjustment era. Conceptual and empirical evidence increasingly suggest, however, that interventions aimed at facilitating smallholder organization and market participation require support that is targeted at facilitating and reducing the costs of interactor agribusiness along value chains (FAO 2010a). The onset of the 2008 food crisis has placed smallholder-based import substitution strategies for food commodities and staples at the centre of many agriculture development programmes, making public sector guidance on this topic even more essential.

Even before the 2008 crisis a wide range of programmes were launched with the aim of strengthening smallholder-market linkages, many of which adopted a value-chain approach. The basis of this approach is anchored on an analysis of the interdependence between actors to better understand the formal and informal dynamics of potential chain partnerships and related needs. The success and failures of many of these initiatives have been well documented, but the fact still remains that for most cases, the producer-first buyer point of sale continues to be the most inefficient linkage, impacting on the overall chances of a successful smallholder-based chain.

In an effort to better understand how the public sector can support smallholder integration in value chains, FAO – with the support of the EU – pilot tested a business model approach to identify the critical success factors for improving supplier-buyer trade falling under different contexts and market structures. The approach provides a framework for analysing the inter-organizational linkages between producers and buyers to understand the potential for coordination and partnership, and to identify where value can be added, costs reduced and efficiency improved.

The rationale for this action-research programme of work was based on two key arguments. First, that within a relatively liberal market economy, when a market opportunity exists, the private sector entrepreneurs will work around disabling environment factors to move their local businesses forward, albeit at a slow rate and with higher transactions costs. As such, if both players – suppliers and buyers - believe that the net economic value of the business partnership is worth more than the resources, time and effort invested in dealing with standard transactions costs, complex business registration procedures, local levies, or paying regular bribes, then growth will take place.

Second, that small-scale institutional innovations focused on reducing inefficiencies in supplier to buyer commercial transactions, are more effective than macrotrade and price policy initiatives, which are often far removed from the realities and needs of district level businesses (Barrett, Bachke, Bellemare, Michelson, Narayanan, Walker, 2012). This argument is reinforced by international corporate strategic management thinking that growth and wealth creation do not necessarily transpire at the level of a sector or industry but in the ability of firms to create valuable goods and services using efficient methods (Porter, Ketels, Delgado 2006).

Kenya is a lead example of the potential role that, small-holder linkages to small and medium sized agroenteprises (SMAEs), have in poverty reduction and rural development. Three-quarters of Kenya's population depend on SMAEs and small-scale farming for a living with the sector providing most employment in the country and almost half of the GDP. Between 2003 and 2009 agriculture growth has more than trebled from 2.0 to 6.7 percent annually, and the portion of the rural population living below the poverty line has declined by 5 percent over the same period (GTZ in Schneider, Buehn, Montenegro 2010).

The Kenyan experience coupled with the region's access to huge reserves of arable land and rural labour has contributed to a growing realization in many African countries that, support for local level agribusiness, needs to be a major focus of public policy concern, if agriculture is to be transformed into a competitive sector for development and poverty reduction (UNIDO. 2011).

Drawing on this genesis, FAO piloted a number of microeconomic and firm-level analyses (smallholder supplier to buyer) to identify country-specific, industry-specific, time-specific and mostly institution-specific solutions across local contexts and commodity markets dependent on smallholder supplies. In this regard, in collaboration with local service providers, activities were carried out across 14 countries, linking approximately 42 farmer groups to 30 small, medium and large agroenterprises for a selection of cash and food crops[3] between September 2008 and December 2011.

While policy guidance for broad value chain development encompasses an array of strategic entry points ranging from enhancing agricultural productivity to upgrading national infrastructure and investing in research and development, these activities, as a result of focusing on one core linkage within the value chain (producer-first buyer), have enabled the development of four strategic policy areas. An appraisal of these areas has subsequently led to the identification of a number of success factors and policy guidance for fostering smallholder-buyer business models and their role in value chains for agribusiness-led development. As such, this paper covers:

1. Easing the cost and risk of doing business with smallholders for SMAEs.
2. Supporting smallholder competitive advantage for agribusiness-led development.
3. Smallholder organizational models for improved bargaining power and value-chain governance.
4. Institutional innovations and strategic value addition for sustained value capture.
5. Success factors and policy guidance for strengthening smallholder-buyer business models within value chains.

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3 Africa: Kenya, Zambia – Cotton; Zambia, Malawi, Cameroon – Cassava; Senegal, Mali, Burkina Faso – Rice; Cameroon – Coffee, Oil Palm Partners: Farm Concern International, Zambia Agribusiness Technical Assistance Centre ZATAC) Centre, IITA, Groupe de Recherche et d'Echanges Technologiques (GRET), Amassa Afrique Verte.

Pacific: Samoa, Vanuatu, Solomon Islands, Fiji – Fruits and Vegetables Partners: Samoan Crops Corporation Association, Nature Way Cooperative, Farmer Support Association, Kastom Gaden Association.

Caribbean: St. Vincent's and the Grenadines, Guyana, Jamaica, Grenada – Roots and Tubers. Partners: Caribbean Farmers Network

Chapter 2
Easing the cost and risk of doing business with smallholders

A critical role of government in improving the integration of smallholders into value chains is to ensure that policy eases the costs and obstacles of doing business with small farmers. The role of small firms however in rural development and job creation is often not given due credit and recognition. In addition to being overlooked by development agencies, where the focus is primarily on more disadvantaged groups, the regulation of SMAEs tend to receive very little attention from the state as they fall between the policy mandates of the ministries of agriculture, trade, industry and commerce (Baker, 2011).

While SMAEs play a critical role in driving modernization of the agricultural subsectors and rural employment creation, a number of critical constraints still need to be addressed before the full developmental potential can be realized. To better understand the challenges faced and the strategies required to overcome them, FAO organized a number of regional "agribusiness roundtables" with SMAE managers in developing countries, with a number of interesting lessons emerging, described in Box 1.

In addition to guiding investment in local infrastructure development, governments can also support the role of SMAEs in the agribusiness sector by introducing policies that cover a number of institutional, legal and administrative factors to stimulate a general easing of doing business with smallholders. The IFC/World Bank annual review of *Doing Business* provides an overview of govern-

BOX 1
Lessons from FAO-led SMAE Roundtables

1. SMAEs start as family-type businesses, using personal savings and loans, based on a vision and need to generate income and wealth for the family and relatives. Capitalization and access to finance is always an issue with few commercial banking options to choose from and unreasonable high interest rates and loan criteria.
2. Large seasonal variations in employment and pressure from extended family and friends for jobs is a daily stress for owners and managers.
3. The over-regulation and bureaucracy that SMAEs face discourage the formalizing of their businesses.
4. The unreliability and cost of utilities infrastructure (power and water) lead to waste and loss of business effecting long-term competitiveness.
5. Smallholder challenges related to production, planning and collective marketing translate into procurement impediments, resulting in some firms having to divest scarce resources to small farmer organization schemes and on-farm technical assistance to improve supplies.
6. SMAEs often face competition from cheap imports and as such require support with market development in developing local brand differentiation to build up a reliable and loyal customer base.
7. Business is also highly dependent on a minimum standard quality product. Small companies however often do not have the capacity to ensure safe and good quality food or the resources for certification fees charged to large firms. With assistance, however, locally customized quality management schemes can be put in place.
8. Operations and transport can be a company's highest cost factor. Again with support on post-harvest and logistics systems in place a small company can address a lot of waste and in-efficiency transforming this aspect of business into a competitive advantage relative to other local companies.

ments' progress in the area, showing for instance, that Cameroon established a one-stop shop for setting up a business, abolishing requirements for certifying business premises and fees; Cape Verde eliminated the needs for a municipal inspection; Congo Dem. Rep. eliminated for the need of a company seal; and many countries across Africa have introduced online registering of businesses. Box 2 shows the criteria used by the IFC/World Bank appraisal to monitor the *Ease of Doing Business* in different countries, with Rwanda, Zambia and Cape Verde among the top 10 economies for improving the most in the ease of doing business in 2009/2010.

Governments can also promote local institutional strengthening with the establishment of business information centres and support at the municipality level which, presuming a high quality standard, can also be an extremely useful mechanism to help small businesses and farmer organizations, through tedious administrative processes. An example of this type of service is the award-winning work of Entebbe Municipal Council on improving licensing[4] (Bannock Consulting Ltd. 2005).

This type of proactive state support to the private sector is commendable and is a definite step forward from a macroeconomic management approach to poverty. The challenge however for policy-makers is to design policies that reach, fix and stimulate market access at the district level where business takes place between farmers and processors, traders, transporters, retailers etc., and reinforce this upgrading with industry policy frameworks that address value-chain collaboration and guide competitiveness. National commodity value-chain strategies and platforms are, to a certain extent, a response to this need and have become popular over the past few years as instruments responsible for ongoing analyses, interactor dialogue, priority setting and channeling public funding. Some donors such as the EU, will often not lend support to a commodity, without these types of strategic mechanisms being in place.

FAO's experience under the EU-funded All ACP Agricultural Commodities Programme[5] (3ACP), which was designed around the establishment or support to existing value-chain platforms and strategies, noted that, while these initiatives provide an excellent platform for information sharing and collaboration among actors, there is the risk that dialogue agendas can be captured and dictated by individual personalities or groups. For newly commercializing food commodities for instance, such as rice and cassava, micro and small-scale enterprises, the bulk of firms in the sector, rarely had a significant voice in value-chain dialogues because of an absence of strong associations representing their interests.

It was also found that value-chain platforms can be over-participatory, addressing all of the main actors' agendas without due consideration placed on strategic prioritization with the result that the most essential constraints and priorities for improved competitiveness do not receive the required attention from follow-up funding opportunities and support interventions.

Cases under the 3ACP also showed that macroeconomic policies, in an effort to protect disadvantaged groups, can hamper the efforts of resource poor farmers from taking advantage of market opportunities. For instance, in 2008, support for strengthening rice producers buyer linkages in West Africa was considered timely with the onset of the food crisis, when price spikes for crops such as wheat doubled and for rice tripled in a matter of weeks. Smallholders and SMAEs, set to benefit from these market conditions, were unable to do so, however, as some governments quickly set minimum prices and lowered import duties in an effort to protect consumers. Ultimately the well-intentioned policy changes offered little respite and were mostly counterproductive for the other domestic groups who otherwise could have benefited from the price movement.

BOX 2
Ease of Doing Business

1. Starting a business
2. Dealing with construction permits
3. Registering property
4. Getting credit
5. Protecting investors
6. Paying taxes
7. Trading across borders
8. Enforcing contracts
9. Closing a business

Source: World Bank/FC, 2011

4 The Entebbe initiative won the Africa Investor 2004 award for "Smart Regulation" presented in Dakar, Senegal.

5 http://www.euacpcommodities.eu/en

Experience has also shown that commodity specific policy support to value-chain development should be carefully designed and based on reliable market, policy analysis and public-private sector dialogue. Targeted interventions also need to be acutely aware of the impact, not only on chain actors and long-term competitiveness, but also on the potential for adverse effects on substitute and competing crops. These types of policy challenge became evident during support provided to the commercialization of cassava in Zambia, where SMAE's efforts to break into the animal feed sector face a major barrier in the form of government subsidies for maize. Conversely in Nigeria, the government over the years has introduced a series of policy changes to make High Quality Cassava Flour (HQCF) more economically viable to the baking industry than wheat flour. Despite the obvious debilitating effects for actors dependent on wheat flour production, the government's enforcement of the policy changes has in the past translated into savings of US$14.8 million *per annum* in foreign exchange; net returns to processors from this saving has been estimated at US$12.7, and cassava farmers have received in the region a gross benefit of US$4.2 million (FAO, IFAD, 2004). Using Nigeria as a benchmark example, a key policy request emerging from FAO-3ACP support to the producer-buyer linkages in the cassava sector in both Cameroon and Zambia has been a call for similar policy initiatives to stimulate the use of cassava products, such as flour and chips for the bakery and animal feed industries.

In Kenya, commodity and stakeholder specific policy interventions for the cotton sector in the form of a minimum farmgate price for cotton were introduced in an effort to protect smallholder exploitation and improve the quality of cotton. Stakeholders argue, however, that with so many factors determining price, it is difficult for the government to monitor or predict how a fixed price is facilitating or adversely damaging the industry. The strategy in Kenya has led to industry factions, with the ginneries boycotting cotton board meetings in protest at the minimum prices, arguing that the policy is squeezing the ginning industry out of business, promoting cross-border black-market trade, and in most cases does not protect smallholders from price volatility because of a lack of enforcement at the local level.

Ultimately, public policy and support is critical for fostering competitive producer-buyer business models, by ensuring that policies covering a number of institutional, legal and administrative factors ease the general costs and obstacles of doing business within the agricultural sector and with smallholders. FAO support to smallholder integration in value chains has shown, that more care needs to be taken by policy-makers to ensure that chain specific support does not result in interventions that unduly subsidize or distort market conditions. Most importantly interventions need to be based on reliable analysis and public-private dialogue which have impartially identified critical factors for improved competitiveness, rather than on agendas developed by pandering to the needs of politically influential actors.

Chapter 3
Supporting smallholder competitive advantage for agribusiness-led development

Public support for promoting smallholder-based value chains must be anchored on the premise that a business case exists for supporting smallholders supply to the market. A business case is generally based on the existence of a smallholder comparative advantage in supplying a product that satisfies the buyers' needs, better or more effectively than other types of suppliers (Johnson and Scholes, 2002).

Firms, which can also include smallholder-based enterprises and SMAE's, when compared to competing suppliers and enterprises, can possess a competitive advantage from a number of circumstances particular to their local context (Porter, 1985), from access to suitable local agro-ecological land and knowledge; basic agroclimatic and hydrological conditions; proximity to appropriate infrastructure, such as market feeder roads, warehouses, processing facilities; access to cheap labour and subsidized inputs; good organization of smallholder supply; and no alternative sources of supply (Bennett et al 2012).

By capitalizing on a given competitive advantage, smallholders can better compete with other larger suppliers by offering a differentiated product to the market, which can be characterized by a higher quality grade; a lower price; or a niche market product destined for fair trade, organic or boutique premium markets.

Provided that there is a business case, the public sector should contribute to fostering private sector service provision that reinforces the collective core competencies of suppliers through a variety of actions related to improved production, product assembly and better access to market-oriented services, with due care taken not to oversubsidize or unduly distort market conditions.

Drawing on this principle, a fundamental entry point for FAO's support to smallholder-based value-chain development has been the existence of a smallholder competitive advantage in supplying the market. The 2008 food crisis, and the ensuing price spikes, provided a competitive advantage across a range of smallholder commodities and impetus to FAO's programme of work, but, as discussed above, was short-lived because of policies put in place to protect consumers. The strength of the competitive advantage varies according to the commodity, local market structure and local business enabling environment.

For the case of the smallholder-industrial buyer linkage model in support of the oil-palm sector in Cameroon, smallholders' competitive advantage lay in their access to land in the face of forest protection laws prohibiting industry from expanding plantation farming, as well as no alternative local sources of supply and elevated market prices of crude oil-palm because of competition from the biofuel market. For support lent to labour-intensive hand-picked cash crops, such as coffee and cotton, abundant and low cost labour is the main smallholder advantage, as well as local agro-ecological and product knowledge, particularly in arid areas and for drought resistant crops such as cassava.

Before investing in a smallholder-based value chain the public sector needs to appraise if downstream actors are also convinced of a smallholder competitive advantage in supplying a product. In other words, buyers need to believe that the risks of doing business with smallholders will be covered by net value of the final transaction. Risks can include: not meeting quality standards specified by the market; inconsistent supply of agreed quantities; contract hold-up because of side-selling; and reputational risk based on public perception of exploitation of smallholders by buyers. It can be conceded, therefore, that the more willing the buyer is to assume the risks of dealing with smallholders and withstanding initial trials and errors of supply, the stronger the smallholder competitive advantage.

A key lesson to emerge from FAO programme of support to smallholder-based value-chain development has been the need to better understand and manage buyers' risks in order to increase procurement from smallholders, with the realization that more focus needs to be on the sourcing decisions of buyers rather than the market opportunities of smallholders. During FAO consultations with agro-enterprises in various ACP countries, it was noted that buyers evaluate the associated risks of doing business with smallholders according to various factors, including: land tenure; agro-ecological knowledge and skills relative to the crops' characteristics; proximity to markets; membership of a functioning farmer organization; local infrastructure and transport; and local and national business enabling environments.

Companies also noted that because of a high probability of some level of side-selling on inputs and contracted produce, a decisive factor in doing business with smallholders was the level of credit, inputs and technical assistance required by suppliers, and the impact of this diversification of resources away from potential buyers' core business.

Access constraints to finance, inputs and technical assistance is nonetheless endemic across all smallholder-based agriculture commodities in developing countries, and without improved access it is difficult for small farmers to compete in modern markets. Obstacles, however, are not just confined to credit and finance but form part of the overall malfunctioning of smallholder- based value chains, interrelated with problems regarding confidence of commercial banks in financing smallholders and guaranteed collateral; absence of reliable and functioning agricultural inputs and services markets; collective bargaining power of smallholders; feasible diversification strategies; appropriate targeting of markets; sound business plans; and the ability of producer organizations to manage business and financial operations of their members.

In short, the issues of access to finance need to be tackled from a value-chain position, with a view to long-term sustainability, rather than being resolved through punctual and isolated subsidies in the form of agriculture inputs, equipment, revolving funds, grants, etc. National and local government can promote this message and approach, promoting the good practice that non-financial alternatives are considered before direct financial support is provided to any actor along a value chain.

As described in Box 3 practical public support can include brokering linkages with microfinance institutes and other commercial banking and investor groups; neutrally facilitated dialogue spaces that bring together financial providers and potential value-chain clients; technical assistance to farmer organizations or SME's in compliance with bank criteria; facilitating linkages with exporters; and sound market outlets providing financiers with more lending confidence (Miller, Jones 2011).

Assuming the existence of a business case for fostering and supporting smallholder-based value chains, a top priority for the public sector subsequently needs to be a combination of institutional strengthening and the creation of conditions so that local communities, local governments, non-governmental organizations (NGOs) and the private sector (including producers) mobilize their own resources to invest in agribusiness so that public support can be applauded for "crowding-in" rather than impeding potential private investment (Staatz in Yumkella *et al.* 2011).

BOX 3

Strengthening linkages between smallholders and financial service providers

Business model appraisals were commissioned to identify constraints, but most importantly the critical success factors required to strengthen the producer-buyer relationship. In anticipation of the identification of access to finance and inputs as a constraint, initial support for all cases immediately commissioned a local financial landscape appraisal and implementation plan for linking smallholder groups to existing local financial products and services. The objective of the review was to dissuade the provision of subsidized inputs that contravene a business approach to smallholder-based agriculture, and promote a strategy whereby representatives of smallholders engage in dialogue with financial service providers to design bankable products.

Chapter 4
Institutional innovations and strategic value addition for sustained value capture

Interest in value-added commodities has grown over recent years with farmers, traders and small agroprocessors working towards the adoption of mechanized technologies in an effort to earn higher returns that are typically captured by upstream actors (FAO. 2007b.). Value addition is also often synonymous with investments in high-value processing, however significant value can be added to raw produce without changing the physical form of the product by introducing activities including for instance, cleaning, grading or labeling. Value can also be added by putting in place logistical, marketing and quality control systems that mostly involve strategic planning and cooperation with value-chain partners.

Value subtraction rather than value addition can occur however when the end buyer is not willing to pay a higher price for the product that more than compensates for the cost of the investments in value addition. This can often be the case when subsidized investments are made in mechanization, tractors or processing equipment, which encourage firms to adopt capital-intensive, labour displacing technologies where labour is abundant and cheap, relative to capital scarcity and high interest rates (Staatz in Yumkella et al, 2011).

During consultation processes carried out by FAO with farmer groups and supporting local NGO's to prioritize interventions for improving producer-buyer linkages, numerous calls were voiced for support on investments in agroprocessing technologies. Motives were noted to be, however, supply-push rather than market-led, with little background carried out on feasibility studies or comparative advantage appraisals for diversifying into a new business and market. Ultimately, many of the proposed additional income-generating and value-addition activities added very little in terms of competitiveness and mostly resulted in the diversion of the groups' resources and attention away from improving their core business of production and marketing.

In the case of support to the palm-oil sector in Cameroon, for the most part, participating farmer groups were struggling to compete on the basis of their core business, that is, their ability to grow and supply Fresh Fruit Bunches (FFB) to the market. Farmer groups and supporting local NGOs were, nonetheless, particularly keen to take on medium-scale processing units to capitalize on the high price per litre of crude processed oil (CPO) during the food crisis 2007–2008. A feasibility analysis revealed, however, that returns on investments were, per kilo harvested, higher if they sold their raw product directly to industry for processing. Table 1 shows a comparative return on investments across three smallholder cooperatives, which clearly demonstrated to the groups with direct sales to industry without value addition (MAIIF Coop) had a higher return on investment compared with neighbouring coops (SOCOMAK, SOCOAP) which focus their activities on processing crude palm oil for the local wholesale market.

Experiences have also shown that the transformation of agricultural raw materials into higher value products does not only depend on investments in new agrofood technologies but also on value-chain systems and capacities that are put in place to reduce transaction costs (UNIDO. 2011). Under the aegis of the 3ACP, the World Bank identified three sites for the location of technologically appropriate Coffee Washing Stations with initial training provided in the running and maintenance of the stations. After some months FAO, in collaboration with the World Bank, Café Africa and the Coffee and Cocoa Board of Cameroon, developed a capacity building programme, after it became evident that the stations were at risk of failure because of the need for additional and reiterative trainings, not only in the running and management of the new technology, but also in agribusiness and marketing skills, required to enable the group to survive and interact within a new value chain. To ensure that high cost capital investments in agroprocessing are capitalized on, the support provided demonstrated the importance of delivering complementary and reiterative capacity building in a range of skills, that not only match the new technology acquisition, but also the new target market and value chain.

Based on the cases outlined above and the type of support delivered, two key messages have emerged from FAO support to smallholder integration into value chains. First, before public support is provided to farmer groups or SMEs to move up the value chain, care needs to be taken to ensure that groups excel at their core function and as such are considered reliable chain partners. Second, that low capital intensive value-addition strategies and organizational innovations can be more effective in the medium term, than high cost technologies, as products can be marketed to local, national and regional markets with similar consumer preferences, and where fewer requirements are needed to conform to standards demanded by consumers in developed countries.

TABLE 1
A comparative cost/returns analysis of profit from 1 hectare (ha) of oil-palm (in CFA francs)

	Activity/Item	MAIIFA COOP	SOCAMAK	SOCOAP LH
A.	Tree felling (4 rounds per year)	60 000	60 000	40 000
B.	Clearing (twice a year)	30 000	30 000	30 000
C.	Pruning and other maintenance activities	30 000	30 000	30 000
D.	Fertilizer (150 kg)	0	0	0
E.	Farm tools	15 000	15 000	15 000
F.	Road maintenance	5 000	5 000	5 000
G.	Harvesting	30 000	30 000	30 000
H.	Maintenance fees	30 000	38 000	38 000
I.	Depreciation	25 000	25 000	25 000
J.	Return on investment (450.000X5%)	22 500	22 500	22 500
K.	Total production cost (per hectare)	247 500	255 500	235 500
L.	Average yield per hectare	8 tonnes	7 tonnes	6 tonnes
M.	Cost of production per tonne	30 938	36 500	39 250
N.	Purchase price of 1 tonne	40 000		
O.	Cost of transportation to mill		21 000	10 000
P.	Cost of processing (10 000/tonne)		70 000	70 000
Q.	Total processing cost per hectare (O+P)		91 000	80 000
R.	TOTAL COST (K+Q)	247 500	346 500	315 500
S.	CPO obtained per ha (12% extraction rate)		840 litres	720 litres
T.	Price per litre CPO		450	500
U.	Total revenue (LxN for others)	320 000	378 000	360 000
V.	Total profit per hectare (U-R)	73 500	31 500	44 500

Chapter 5
Smallholder organizational models for improved bargaining power and value-chain governance

Under the aegis of FAO's programme of work on smallholder integration in value chains, the term value chain implies a focus on market-oriented smallholder farmers, where impact and sustainability are most likely to be maximized. As a result of observing the welfare-enhancing effects of market participation from others, small-scale farmers will transition to more commercially oriented farming. Within the context of value-chain development literature, the more recent adoption of the term "inclusive" does not imply "no farmer left behind" or "a focus on the poorest of the poor" but instead refers to scale and outreach to a large number of smallholder farmers (Neven, 2012).

If smallholders are expected to participate in, and benefit from a well coordinated chain, any type of public support must take into consideration the relevance of farmer organizational models, starting from a situation where farmers participate in some form of informal or formal organized structure.

Depending on the local context, commodity and market structure, there are a number of smallholder organizational models that can be applied, including traditional marketing cooperatives that are vertically integrated into value chains; farmer associations mandated to bargain on behalf of members; registered producers groups; informal farmer groups. In the absence of effective farmer groups, external actors may seek to organize individual farmers through, for instance, outgrower schemes or local traders[6].

The ways in which farmer organizations can be linked to the market can, as described in Table 2, be labeled "driver models", which are namely producer-driven, buyer-driven, or intermediary-driven[7]. Producer-driven models are motivated and owned by small-scale producers based on collective action for increased small-farmer participation in markets. Buyer-driven models involve larger businesses organizing farmers into suppliers, which can also include the provision of inputs

TABLE 2
Organizational models for smallholders

Model	Driver	Motivation
Producer-driven	Smallholder groups, associations, cooperatives	Access to new markets, increased bargaining power, access to inputs, technical assistance, secure market position, farmer empowerment
Buyer-driven	Processors, retailers, exporters, traders, wholesalers	Access to land, supplies, increase volumes, supply niche markets
Intermediary-driven	NGOs, development agencies, governments	Local and national economic development, farmer empowerment

6 See Chapter 2 of Mangus, de Steenhuijen Piters, 2010, Dealing with Smallscale Producers – Linking buyers and producers, Kit publishers for a detailed overview of various forms of smallholder-market organizational models.
7 This concept was developed in FAO 2008a. *Business Models for Small Farmers and SMEs.* Rome.

and technical advice based on the buyers' needs, also known as contract farming. In conclusion, intermediary models that are commonly led by local NGOs involve the provision of technical assistance and support to identify and improve smallholder market linkages.

As such, traditional farmer organizations are only one of a number of ways for organizing the supply of smallholders' products through a value chain to the market, and to varying contextual degrees offer farmers the space to collectively face the demands of modern agriculture, with the coordination of activities, such as bulk buying of inputs, collective marketing, negotiating credit and contracts, and lobbying policy makers.

If successful, collective action can address key constraints related to high transaction costs, entry to higher value markets, and access to business development services and finance, and more importantly, can enable a renegotiation of power relations in the chain.

Porter's Five Forces Theory explained in Box 4, enables a better understanding of how power is established and maintained in a chain, and is useful to gauge and measure bargaining power. However, for smallholder-market integration, there are a series of dysfunctional market characteristics that generally prevent upstream players from benefiting from apparent strengths. The cases supported by FAO show that, while it is unrealistic and unviable to expect a level-playing field, an overtly skewed lack of relative bargaining power for any player in the chain, not only impedes the progress of the given actor, but also adversely impacts on partners on either side of its trading base, effecting the overall functioning of the entire chain.

This was seen in the case of the rice sector in West Africa, where the circumstances showed that the skewed bargaining power of one actor, the women parboilers in this case, can impede the overall progress and competitiveness of the entire chain. In Burkina Faso, for instance, women parboilers are, similar to other countries in the region, an important actor in the rice value chain and a major buyer for rice producers. Despite the groups having secured a market for large volumes of parboiled rice, they lacked access to credit to augment their orders from smallholder producers because of significantly less bargaining power than the rice producers' association. As a solution to the issue, facilitated seller-buyer meetings were organized where it was agreed that the producers associations would supply rice at 50 percent credit, with the balance being paid after the parboiled rice had been sold, resulting not only in a simple win-win solution for the buyers and sellers, but also an improvement in bargaining power for the parboliers group and a realignment in the chain.

BOX 4

Criteria for assessing smallholder bargaining power

Smallholder bargaining power is adversely weak if:

- there is collusion among buyers, particularly if the volumes of purchases are high;
- there is a lack of collusion among suppliers due to high number of fragmented smallholders;
- there is a local functional farmer organization to support smallholder collection action;
- there are alternative supplies, for instance, from more commercial farmers, or through cheaper imports;
- the cost of switching suppliers for the buyer is relatively easy, for instance, if there are no long-term contracts;
- the product being supplied is undifferentiated, with many supply sources; such as products with little value addition – e.g. seed cotton.

Source: Porter's Five Forces Theory (1980) (in Johnson and Scholes 2002)

For value chains that are made up of fragmented actors, either buyers or sellers, collective action is crucial, not only for improving relative bargaining power, but also for overall chain alignment and efficiency. Collective action is most often thought of in terms of smallholder organizational models, but FAO support to smallholder-buyer linkage initiatives has shown that addressing the fragmentation and collective capacity of buyers is as important for the overall effectiveness of the chain and smallholder inclusion.

Support to a cassava smallholder-SMAE linkage case in Malawi demonstrated the smallholder benefits that can be accrued from trading with processors that are collectively organized around an association which provides services for market linkages, product promotion and lobbying. By working together as an association of small-agro-processors, the group was better able to inform small suppliers of the sub-sector's requirements as well as arranging collection points. The collective action of the buyers resulted in improved smallholder confidence in a market outlet which led to improved production planning, and overall considerably offset the diseconomies of scale from unorganized smallholders.

Support to smallholder collective action for the cotton sector in Kenya is another good example of how groups can work around institutional obstacles by promoting smallholder group set-ups based on the members' needs, and the local marketing requirements of cotton, which contributed significantly to an improvement in smallholder-ginnery relations. Support provided to cotton cooperative-ginnery linkages in Kenya found that cooperatives were often non-functional because of some type of internal conflict and political strife. Appraisals also noted that a lack of success in membership recruitment was also because of the political stigma associated with the cooperative movement from the pre-structural adjustment era, a common trait across a number of African countries. To work around this institutional obstacle, in consultation with local cooperative management and the Ministry of Cooperatives, smallholder cotton marketing groups were organized outside of these structures, to avoid association with politically aligned groups. The group designed rules of membership suitable to their needs, and the marketing requirements of cotton, contributing significantly to an improvement in smallholder-ginnery relations.

These cases have shown that institutional innovations that are grounded in the realities of the local context can add considerable value to the role of smallholder groups in value chains. To support this process there are a number of ways in which the state can indirectly enable collective action by, first, not creating or dismantling over bureaucratic legal rules of institutional organization, bearing in mind that "*the organizational form that minimizes ownership costs has the greatest probability of survival.*" (Cook, Burress, 2011). Ultimately, as much room as possible should be allowed for groups to design membership and organizational rules locally to ensure coherence with the local cultural context and marketing needs of the targeted commodities (Markelova, Meinzen-Dick, 2009).

Chapter 6
Success factors and policy guidance for strengthening smallholder-buyer business models within value chains

Based on an appraisal of the strategic areas outlined above, the below covers, (a) a review of key success factors for strengthening farmer-based organizational models[8], and (b) a number of policy guidance principles for promoting locally-led market linkage innovations for fostering smallholder-buyers business models and their role in contributing to competitive value chains.

6.1 SUCCESS FACTORS FOR STRENGTHENING SMALLHOLDER ORGANIZATIONAL MODELS:

The following factors have been identified as key for strengthening the role of smallholder organizational models and their overall position in the value chain:

Non-politically aligned organizations: There is a lingering political stigma associated with farmer organizations and cooperative terminology in Africa, with groups preferring to disassociate themselves from past connotations of politically aligned organizations in order to be viewed as practical and market oriented service providers for their members.

High quality service provision: In order to retain and recruit farmers, members must value their membership based on the provision of paid high quality services, some of which may be outsourced, such as: the identification of market outlets, product assembly, training, technical assistance and advice.

Social and enterprise strategies: In the absence of local social services, farmer organizations are often compelled to address the priorities of the community. These activities should be managed separately from agribusiness related activities, which should take precedence as they are directly linked to poverty reduction and the financial sustainability of the organization.

Network membership: Primary level organizations need to be part of a wider network that links members to information on new technical ideas, markets and funding opportunities outside of their community.

Focus on core business: Farmer organizations need to, first, excel on their core function of supporting members to improve productivity, production planning and marketing; and, second, have acquired the appropriate marketing and management capacities, before diversifying activities and resources into additional enterprises such as capital intensive value adding agroprocessing technologies.

Low cost value addition through organizational innovations: If compatible with their core business, farmer organizations can play an important role in adding value to their members produce through organizational innovations and support with activities, such as sorting, grading, production planning and logistics, which do not require high cost capital investments.

There is no "one-size-fits-all": Farmer organization models can range from traditional marketing cooperatives and farmer bargaining associations to informal groups. The models identified as the most likely to succeed are those that are formed on the basis of local cultural contexts and the marketing needs of members.

Understanding the needs and risks of agribusiness companies: There are a number of risks that agro-enterprises face when buying from smallholders – from inconsistent quality and quantity of supply to side-selling and reputational risk based on public perception of smallholder exploitation. To minimize these risks an important role of farmer organizations is to remain in constant dialogue with buyers and guide smallholders in responding to market requirements.

8 This list is not intended to be a comprehensive list of all necessary requirements for linking farmers to markets, as the prioritization of factors will vary according to local institutions, markets and commodities.

6.2 POLICY GUIDANCE PRINCIPLES FOR SUPPORTING SMALLHOLDER-BUYER BUSINESS MODELS

The following principles have been identified as key for guiding policy support that strengthens producer-SMAE business models and overall position in the value chain:

Formalization of the shadow economy: The vast majority of agro-enterprises operating in the informal sector seldom grow sustainably, making informality a major obstacle to economic growth and major focus of public policy concern if agriculture is to be transformed into a legitimate and competitive sector for development and poverty reduction.

Good governance and management systems: A departure from farmer organizations that are dogged by nepotistic and paternalistic behaviour patterns is needed with more support for structures that promote transparency good leadership with knowledge about target commodity markets, combined with transparent financial and management systems capable of delegating tasks to experienced staff.

Easing the costs of doing business locally: SMAEs can provide smallholder groups with reliable market outlets. As such their role in rural development is often not given due credit and recognition. To this end, a general easing of doing business locally for SMAEs can significantly contribute to the role of farmer organizations in linking smallholders to markets.

Coherence with local cultural and market contexts: Support should focus on dismantling superfluous rules and regulations and not create over-bureaucratic legal rules for voluntary organizations; promoting the design of membership and organizational rules that are coherent with the local cultural and market contexts.

Due care in not creating dependency syndrome: Any direct support to SMAEs or farmer organizations in the form of subsidies, equipment or credit funds should not unduly subsidize activities that can create a dependency syndrome on public support and threaten the long-term sustainability of a business.

Creating an enabling environment for private sector investment: Targeted support should not distort local market condition or crowd out potential private sector investment, with conditions created that allow farmer organizations and SME's to mobilize their own resources to invest in agribusiness.

Long-term public commitment with short-term interventions: Farmer-based organizations learn and grow, sometimes fail and in many cases take a long time to mature. Organizations need to know that they have the long-term commitment of the public sector, which is based on, when required, short-term sustainable interventions with clear exit strategies embedded.

Support to broad-based innovation: Institutional strengthening of agriculture and business service providers, and location of industrial technology and innovation centres as close as possible to SMAEs.

Local government support for SMAEs: Local government officials, if given the mandate, capacity and resources, can monitor the provision of service provision, identifying capacity and services gaps, and establishing linkages with national fora, technical training institutes and potential investors.

Conclusions

This paper advocates agribusiness-led development based on increased public support for small-scale, locally-led institutional innovations and private sector investment that foster business between local farmers and buyers. As these types of innovations are generally carried out under context specific settings, involving an array of local institutions, markets structures and commodities, they are however, often difficult to upscale, constituting a common argument against this type of public support.

Rather than gauging the success of support based on the possibility for replication, success stories emerging from these cases should be more widely publicized and disseminated for adaptation, customization, and primarily for stimulating ideas on organizational and institutional innovations at the district level based on good business practice. The role of policy in promoting these innovations is critical, but needs to be anchored on the existence of a smallholder competitive advantage and a private sector willing to do business with small farmers. This paper, based on practical field-based initiatives, provides some practical guidance on how public policy can support this trend.

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