Regoverning Markets

Small-scale producers in modern agrifood markets

Innovative practice in connecting small-scale producers with dynamic markets

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Keys to inclusion of small-scale producers in dynamic markets

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[1] No seniority should be attributed.

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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.

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Contents

1 Executive summary

1. Many of the drivers of agrifood system restructuring are inevitable. It is therefore possible for governments, development agencies, and farmers' organizations and their allies, to prepare themselves and to act proactively. However, the adaptations and responses documented in the case studies often were initiated after the changes had occurred. This gave little time to create better conditions to take advantage of new opportunities or to minimize the social costs. Governments and donors need to shift emphasis from compensatory and reactive initiatives, to proactive, anticipatory policies and programmes.

2. Governments have significant scope to introduce pro-poor policies, even within an overall framework of free trade and liberalized markets. This is underutilized. There is a need to acknowledge the legitimacy of 'regoverning' agricultural markets. No country has developed its agriculture on a model of pure private sector development. Up until now public intervention in agriculture has been of paramount importance in Organization for Economic Cooperation and Development (OECD) countries. If we set aside the paraphernalia of subsidies, there are many economically rational and socially valuable market interventions that governments can implement. Public policies favouring inclusion can at the same time be very pro-poor and very pro-market. In fact, if the objective of a policy is inclusion of small-scale farmers in dynamic markets, pro-poor policies that are not also pro-market are most likely to fail.

3. The potential of the private sector in promoting economic growth of the countryside is high as it is very effective in linking smallholders to dynamic markets. This is illustrated by several examples documented in the programme. However the potential of the private sector as 'partner in development' is underutilized. Private sector initiatives can bring along economic benefits for smallholders plus technical capacity-building but they seemingly do not result in lasting economic empowerment of the farmers or their organizations beyond the trade relationship in question. Moreover the programme did not encounter many strong examples where the development impact of the private sector was enhanced through smooth cooperation with the public sectors.

4. Collective action remains an important strategy for increased smallholder participation in dynamic markets. The case studies show that in view of lower transaction costs and greater effective transfer of capacity, private companies often prefer to work with organized farmers rather than individuals, despite the

increased bargaining power that groups enjoy. The case studies also showed that collective action by small-scale producers need not always take the form of a formalized farmers´ organization. Furthermore, some farmers' organizations have developed different forms of memberships (e.g. quasi-memberships, top-up suppliers) enhancing, at least in some cases, both competitiveness and inclusiveness.

5. NGOs and donor agencies often place great importance on building value-chains that are owned by farmer organizations (vertical integration). The case studies encountered show that the net economic benefits for farmers in value-chains owned by farmers' organizations do not seem higher than in private sector initiatives, though impacts are higher in terms of capacity-building. However, we did not encounter a case study where the collective action or the farmers' organization had become independent from external support. The effectiveness of donor support cannot be measured because there is no data due to a lack of monitoring systems. It appears low in many cases, but this disregards the fact that it is about capacity building and experimental learning, therefore trial and error. Moreover there is no benchmark for comparison with private sector initiatives, where 60 to 80 per cent of new business ventures fail. In general, donor interventions seem rather inefficient as they disregard;
   - the fact that value-chains are composed of various specialized companies rather than one company in charge of everything;
   - that the most effective entry point for intervention may not always be at farmers' level;
   - that value-chains cannot be built by outside agents but must be built around private sector initiative.

6. The world of financial services and that of market access/value-chain development is still largely separated. It is crucially important to create links and develop innovative financial products that cater for the needs of small and medium enterprises (SMEs) in value-chain development.

7. To achieve and sustain inclusion of small-scale farmers in restructured markets, different agents need to participate and cooperate. This is a big challenge. The successful case studies share the characteristics: collaborative arrangements between trained and organized farmers, a receptive business sector, and conducive public policies and programmes. Such arrangements are in most cases supported by specialized partnership facilitators. It is important that all elements are in place for inclusion to be successful. Comprehensive strategies and

specialized and skilled players will help to achieve this cooperation. Such strategies and the engagement of skilled players are expensive and demand time to mature.

8. The challenge of connecting smallholders to dynamic markets is still a new field without proven replicable models and methodologies. Our worldwide search for best practice did provide interesting and inspiring material, but we are still far away from the public sector having anticipatory policies, the private sector being a partner for development, support agencies making effective interventions, and farmer organizations being capable of, and empowered for, participation in dynamic markets. The Regoverning Markets case studies show the overarching need for public and private sectors to understand further how they can complement each other.

2 Background - Regoverning Markets

Rapid changes are taking place in the structure and governance of national and regional agrifood markets in developing countries, affecting the ability of agriculture to contribute to economic growth and sustainable development. Small-scale agriculture that supports the livelihoods of the majority of rural poor is poorly prepared for these changes.

In recognition of this challenge, research organizations from around the world set up Regoverning Markets, a two-year programme from 2005 to 2007 of collaborative research and policy support. Regoverning Markets focuses on the keys to inclusion of small-scale farmers into dynamic national and regional markets. It aims to further the research on implications and opportunities for small-scale producers and SMEs, to understand what is best practice in connecting small-scale producers with dynamic markets, and to bring these findings into the wider policy arena.

This paper synthesizes Component 2 of the Regoverning Markets Programme. It is based on 38 empirical case studies where small-scale farmers and businesses connected successfully to dynamic markets, doing business with agri-processors and supermarkets. The studies aimed to derive models, strategies and policy principles to guide public and private sector actors in promoting greater participation of small-scale producers in dynamic markets. The analytical framework of the case studies is described in box 2.1.

Box 2.1 : Analytical framework (see Berdegué et al. (2006))

1. Strategies of agriprocessors and food retailers operating in restructured markets result in new procurement chains characterized by the specialization of wholesalers, centralization of distribution, consolidation of preferred suppliers, more stringent private grades and standards, and in certain cases internationalization of procurement.
2. The emergence and continuous restructuring of these markets provides incentives to suppliers, including small-scale farmers and rural SMEs, to undertake successive and never-ending changes in the areas of technology, management and inter-firm organization, all of which have significant financial implications.
3. The capacity of small-scale farmers and rural SMEs to keep up with this continuous stream of changes defines their inclusion or exclusion in the evolving supply-chain and, thus, the restructured market.
4. Public policy, private business models, collective action by smallholders and/or intervention by development agencies can change the set of incentives facing the small-scale farmers and/or strengthen the farmers' capacities in facing these incentives.
5. Inclusion can take different forms, including participation as individual suppliers of raw material, collective action with other suppliers to meet basic demands for volume and consistency of supply, becoming a specialized supplier on the basis of value-adding activities, or becoming co-owner of a supply-chain or one of its segments.

Each case study analyzed one specific 'innovation'. These innovations are specific arrangements built on public policies, business initiative, and collective action by small-scale farmers. Support from development agencies appears to have played a positive role in supporting greater inclusion. We term these 'innovations' because they counteract the tendency that small-scale farmers and rural SMEs become excluded from markets as supply-chains evolve in complexity. They represent a departure from the context-specific *status quo*, i.e., the conventional way of thinking and/or acting in relation to the participation of small-scale farmers and rural SMEs in dynamic markets.

Inclusion or exclusion is not defined in terms of the farmers' situation at a single point in time, but rather in terms of the capacity of small-scale producers and rural SMEs to sustain their participation in a given supply-chain as it evolves and becomes ever more challenging and competitive. Hence, it is necessary to analyze the problem from an evolutionary or 'innovation history' perspective. In addition, inclusion or exclusion does not indicate any differences in welfare outcomes as such. It is not given that a group of small-scale producers who are 'included' will be better off than those who are excluded, in terms of net income or net assets, exposure to risk, or autonomy in decision-making. That inclusion leads to significant welfare gains is a hypothesis critically examined by the case studies.

The case studies sought to answer six sets of questions:

1. The context: What is the level of restructuring of the market, and to what extent does it trigger exclusion of small-scale farmers? What are the incentives given to small-scale farmers? What are their major needs, risks and opportunities?
2. The innovation: What are the main characteristics of the innovation? Who are the actors driving the innovation and what are their strategies? What are the relationships among included farmers, and with farmers not participating?
3. Evolution: How was the innovation triggered and how did it emerge over time? What were the critical stages and the critical factors? How did the strategies of the different stakeholders evolve? How did the relationships among farmers evolve?
4. Evidence of inclusion: What are the costs and benefits of the innovation, and how are they distributed across different actors in the supply-chain? What did the small-scale farmers and/or rural SMEs gain or lose? Are these results sustainable?
5. Drivers: What explains the greater degree of inclusion? What were the key drivers in terms of policy principles, business models, collective action and support systems? Did the drivers for inclusion change over time?
6. What is the potential for upscaling and/or replication? What are the key challenges?

The case studies that are the basis of this report were selected in two rounds of global competitions, one in 2005 and one in 2006. A total of 131 case studies were submitted to the competition, from which a total of 35 were selected. Additional studies were selected through an independent mechanism with the International Federation of Agricultural Producers (IFAP). In the end, 38 studies were completed successfully for inclusion in this report.

The reader should be well aware that the case studies that have been documented cannot in any way be said to be representative of the full set of innovations taking place around the world or even in the countries covered by the programme. Strictly speaking the findings and conclusions do not apply beyond the case studies covered in the analysis. However we hope that the issues we have drawn out will inspire others to test them in other contexts to advance our understanding through research. Ultimately we hope to improve our collective practice in support of a more sustainable participation of small-scale farmers in national restructured markets in the developing countries and transitional economies.

3 Changes in markets - Opportunities for smallholders

Food markets in developing regions are undergoing big changes. The market changes can be extremely rapid once they take off, challenging the response capacity of governments, businesses, farmers, and donors (see box 3.1).

Box 3.1: Scope of market changes in developing regions

Uganda: The majority of the population buys cheap, low quality dairy products on the informal markets. However, the growth of the urban population and average purchasing power has boosted the demand for high quality milk and dairy products. Liberalization of the dairy market has allowed the industry sector to respond to this opportunity. Since the 1960s the installed dairy processing capacity had remained at 130,000 litres per day. However since liberalization private investments have added an additional 200,000 litres per day, hence trebling the market for the small-scale dairy farmers.

The Philippines: Since the 1990s the population grows over 2.3 per cent per annum, and the consumption of rice has grown by 2.84 per cent per year. The growing middle class in Metro Manila is increasingly conscious of the links between food and health. However, the prevailing systems for quality grading and product standardization that are in use in the traditional wholesale and retail markets fail to distinguish rice on the basis of this type of consumer preference. Supermarket chains are willing to pay price premiums to source quality-assured rice for their clients.

Tanzania: Vegetable growers in the Mara region produced a limited number of farm products, as demanded by traditional local markets. Quality and hygiene were not important parameters in a market dominated by price considerations. However, the rapid increase in tourism since the 1990s created a whole new market. The numbers of tourists grew six fold between 1997 and 2005 to a total of 624,000 tourists each year. Hoteliers and lodge managers were sourcing their fresh fruits and vegetables from as far away as Kenya and even South Africa, paying high costs due mainly to transportation through an inadequate road network or by airfreight. They did not look at the local farmers as a source of supply because of the notorious quality and hygiene gap.

The drivers of market change include;

- urbanization and population growth;
- growing per capita incomes;
- market liberalization;
- foreign direct investment (FDI);
- greater participation of women in the labour market;
- changes in consumer requirements including increased concerns for food safety and quality; and
- improvements in transport and communication infrastructure.

Particularly public policies have been found to be important catalysts of change (see box 3.2).

Box 3.2: Public policies triggering market restructuring

Argentina: Political stability, a favourable currency exchange regime, and liberalization of FDI were major drivers of a rapid supermarket expansion. The number of stores grew from 235 in 1994 to 1167 ten years later. This opened up a whole new market for producers in the country.

Bulgaria: The demise of communism and the increased access to the EU created a new policy environment that provided incentives for a radical change in the structure and nature of the dairy industry. In less than two decades quality, hygiene and efficiency became paramount considerations. Later, environmental and animal welfare issues also became part of the agenda of the Bulgarian dairy industry.

Jordan: Economic reforms have been introduced since the 1990s under an Agricultural Sector Adjustment Programme and the demands of World Trade Organization (WTO) membership. Agricultural markets were opened to foreign competition. Among other things, subsidies such as those for irrigation water and animal feed were reduced or eliminated, and the government stopped purchasing basic grains at pre-established prices. At the same time, food retail in the urban centres has been stimulated by the rapid growth of the supermarket sector, including multinationals like Carrefour and Safeway. About 35 supermarket stores are operating in Amman, Irbid and other cities. Supermarket chains, in particular the multinationals, are important importers of foods.

Many of the market changes are positive signs of development. Their immediate impact may not always be positive in situations where they make old ways of working unviable or too costly, thereby catalyzing painful adaptation processes. However overall, market changes offer increased economic opportunities for producers, consumers, and other actors in the food chain. Box 3.3 shows examples of how changes in the market are perceived as opportunities and therefore trigger innovations by farmers and their supporting organizations.

Box 3.3: Innovations by farmers and service providers

India: An NGO in Uttarakhand was providing agronomic support to small-scale farmers to promote vegetable production. On the advice of a state government official, the NGO contacted a supermarket chain to find new market outlets for the increased production. This newly identified market opportunity catalyzed a series of actions on the part of the farmers' organization and their allies.

Hungary: The introduction of market economy and increased access to the EU was seen as a huge market opportunity by a group of poultry farmers in Hungary. In western Hungary, small to medium enterprise (SME) 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 that has grown into a successful medium-sized company.

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 also asked for volumes 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 into 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 from the government in particular (reefer trucks, chillers, and pre-cooling facilities) that allowed NorminVeggies to improve its marketing capacity. With NorminVeggies becoming known on the dynamic markets, other marketing clusters were 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 that benefit from NGO support. The current last step in the process of inclusion was the organization of NorminCorp, which is a private corporation acting as the marketing division for the clusters formed by the core of independent farmers.

Yet traditional markets are resilient and can co-exist for significant periods of time with restructured markets. In fact, the restructuring process often includes interactions and spillover effects between 'old' and 'new' markets. There are instances of 'partially restructured' markets, with faster and bigger changes downstream and continuity of traditional patterns upstream. Small-scale farmers usually operate in different market channels, new and traditional, displaying diversified marketing strategies in order to meet different economic needs (e.g., access to credit or improved cash flow, controlled risk levels) or social needs (e.g., inclusion in the social networks that are interlinked with the marketing networks).

Box 3.4: Resilience of traditional markets

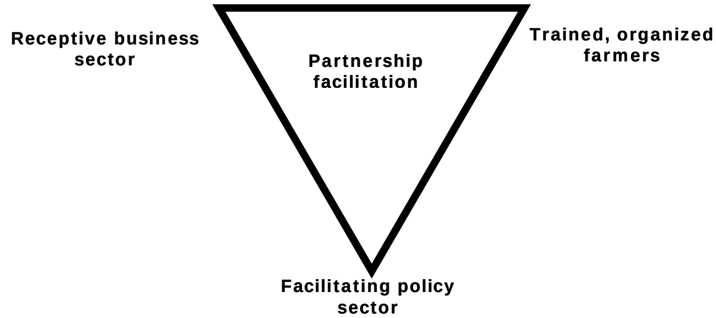
Evidence of the resilience of traditional markets is found in several of the Chinese case studies, in Mexico, and, not surprisingly, in almost all of the African case studies. In Uttarakhand, India, tomato producers that had successfully gained access to a major supermarket chain opted to divert some of their produce to the traditional markets. In China, mushroom producers who supply modern market channels still sell 60 per cent of their output to traditional traders and wholesalers. In Morocco, the COPAG cooperative has been investing in branding, advertisement, and diversification of its range of dairy products. This was done as part of its strategy to enter the supermarkets channels. It also reinforced COPAG in the more traditional retail sector that is still representing around 90 per cent of consumer sales. The fame of COPAG's brands in these traditional markets positioned the cooperative more favorably in its negotiation to enter the large retailers' market and remain included in it.

Broad-based and small-scale farmer inclusive market restructuring takes many forms. However, heterogeneity does not mean that there are no patterns. A key pattern across case studies, countries and continents often occurs through collaborative arrangements between;

- trained and organized farmers;
- a receptive business sector; and
- conducive public policies and programmes.

Such arrangements are in most cases supported by specialized partnership facilitators. In other words, there is not one single driver behind the innovation. The role and relative importance of the various actors and the required level of coordination are functions of the capacities, skills and level of commitment of the different actors at different stages, as well as of the characteristics of the market and the business and policy environments. 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.

Figure 3.1: Keys to inclusion of smallholder farmers in dynamic markets



Box 3.5: Multi-actor collaboration for market access

India: Two success case studies from India show the importance of specialized partnership facilitators. In the Uttarakhand case study, small-scale farmers are producing tomatoes for a supermarket, and in the Punjab case study farmers are producing under contract for private agribusiness firms. In both case studies, in the beginning, the farmers were not willing to participate due to lack of trust in the buyer. The involvement of farmers was very low but progressively increased as trust was built. In Uttarakhand community leaders and an NGO were needed to initiate and mediate the business relation with the supermarket. In Punjab this role was played by the Punjab Agro Foodgrains Corporation (PACF), which is the nodal agency for promoting and coordinating contract farming and diversification of agriculture in the State of Punjab.

Colombia: The case study from Colombia illustrates the dynamics when the commitments, incentives and actions of actors are not well aligned. Under an agreement with national government agencies, Carrefour and other supermarket chains provide shelf space and supportive payment policies for products certified as 'Environmentally Friendly' and 'Community-Based'. An example includes the products developed in the Amazon from indigenous plants, by a farmers' organization (APAA) under the brand Majina. The effective demand for these products is low. In addition, APAA and its allies have not been capable of mobilizing sufficient support to meet the high level of investment at the producers' level. This is required for developing brand new products and for transporting them from the remote areas in the Amazon jungle to the Colombian cities.

South-Africa 1: The case study of SPAR supermarkets, in which almost no public or external support is provided, does not contradict the general pattern that multi-actor collaboration is needed. It constitutes an extreme case that could only be developed successfully without external support due to very specific conditions. The case study is located in a remote rural area, which makes the supermarket more dependent on local suppliers. However, there are particular internal conditions such as good farming knowledge from the SPAR management, and the use of farmers' networks to top up small-scale farmers procurement and provide extension to the small-scale farmers.

South-Africa 2: In the case study on Thandi fruit and wine, former farm workers have been included as newly established landowners and shareholders in a new business model that focuses on partnerships with existing growers, retailers (both domestic and overseas), established export firms and the state. The Thandi project is a success in the sense that it has been able to grow and sustain itself for ten years – in a domestic and international environment where a skewed trade regime and unforgiving competition alone decide whether a venture survives or not. However, the strength of the Thandi project is also its weakness. The partnerships and overlapping shareholding arrangements are complex and not easy to grasp, especially for workers and communities who are not highly educated, or often lack the confidence to participate in decision-making, even when offered the opportunity.

Some of the innovations documented by the Regoverning Markets programme change the structure of incentives guiding the behaviour of agents along a market chain. Other innovations change the capacities of some of the agents in the chain to respond to a given set of incentives. Failure often comes from a lack of balance between changes in the system of incentives and changes in the capacities of the agents. Failure is often also the product of insufficient time to achieve such balance.

Box 3.6: Dual change in incentives and capacities

Mexico: Within the framework of structural adjustment, the Mexican government decided to downsize the state phyto-zoosanitary agency, transferring some of its functions by law to farmer organizations. This created a political opportunity for farmers to control trade flows in agricultural products, as they were now issuing the phyto-sanitary permits. At the same time a free trade agreement was being negotiated with the US and Canada, creating economic opportunities for increased exports. The farmers organized in local and state-level Juntas de Sanidad Vegetal to create the capacity to take advantage of the new institutional and economic context. This dual change in incentives and capacities has generated enormous growth and prosperity for avocado farmers.

Bulgaria: After the fall of the Berlin Wall, Bulgaria introduced a free market economic regime with more opportunities for private enterprise. The increased access to the EU created enormous market opportunities but also imposed new standards for quality and food safety. One Bulgarian entrepreneur took advantage of the new economic and institutional context, establishing a dairy supply-chain with numerous smallholder farmers, offering training, procurement practices and payment policies that all focused on quality. This combination of incentives and capacities has generated growth and turned the entrepreneur in one of the success figures of Bulgaria's new entrepreneurial community.

Uganda: Uganda has seen a significant rise in the food service segment, such as prepared meals, fast food and restaurants. This creates new market opportunities for value-added food products. Donor and research agencies worked together with a group of smallholder farmers to strengthen their capacities to take advantage of these new opportunities by introducing radical innovations in technology, management and organization. The farmers are supplying high-quality potatoes to retailers and restaurants and their revenues have increased by 75 per cent in only three years. Again, the combination of change in incentive and capacities has been crucial for success.

Sri Lanka: An innovative urban entrepreneur decided to go back to his home region in the countryside to set up a spice processor-exporter to contribute to the development of his community. He invested heavily in the establishment of a quality-orientated supply-chain with smallholder farmers, offering training, credits and premium prices. He also invested in cutting-edge processing equipment and quality certification schemes. His business became a huge success, awarding him several distinctions at national level. However the business has now hit a critical limit because the economic-institutional context of Sri Lanka does not offer space for continued economic growth. In this case study the lack of incentives puts a limit to the innovation.

4 Innovations by small-scale farmers

Small-scale farmers need to change their way of working to be able to access restructured markets and, above all, to sustain participation over time, as these markets continue to evolve in ever more demanding ways. Again, there are patterns of change across case studies, countries and continents. There seems to be three common elements to all successful case studies of smallholder farmer participation:

- upgrading of technical skills, infrastructure and management capacities;
- specialization within multi-agent organizational arrangements;
- increased working and investment capital, usually requiring subsidized external support for prolonged periods of time.

4.1 Technical and managerial upgrading

It is well known that technical upgrading is essential to meet the quality requirements of modern procurement chains. In Jordan, it was essential for sheep farmers to introduce new technologies to;

- manage fat, pH and hygiene standards;
- introduce milk cooling tanks;
- stabilize year-round supply by securing access to forage in the winter months; and
- increase the volume of milk production.

In Bulgaria, EU quality standards for dairy products have forced local processors and producers to make large changes to improve hygiene of production and milk quality. Interestingly, in the case study 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. The contract system could be seen as an intermediate step in linking small-scale producers to modern markets where capital, technology and market access constitute key limiting factors. Their technical innovation allowed them to reconnect with more traditional network of brokers, but on their own terms.

Innovation is also important in management, especially in supply management and marketing. Branding is a strategy that farmers' groups often use in order to gain a stronger foothold in competitive markets. Filipino organic rice producers started with a 'made by indigenous people' brand, as recommended by an NGO. Eventually they realized that many consumers interpreted that as meaning 'people who may not know how to prepare food in a manner that complies with sanitary standards.'

The farmers then established a producers' brand that emphasized the organization behind the product: 'Pecuaria Healthy Rice.' This was a step forward in their understanding of consumer behaviour, as using the word 'healthy', rather than 'organic', was easier for most consumers to associate with. However this new brand left the supply of organic rice vulnerable to localized disturbances, as the region in which the cooperative is located is exposed to the frequent and strong typhoons. By removing the word 'Pecuaria' from the packaging, they were able to let seven other groups from different parts of the country market their rice under the 'Healthy Rice' brand. This resulted in a much greater consistency of supply, which satisfied the supermarkets. It also meant that the marketing costs could be shared among a higher number of farmers' groups, which satisfied the producers. In short, what is rewarding from the perspective of development agents (indigenous, organic, strong producer identity) is not necessarily most practical and rewarding when it comes to operating in dynamic markets.

Something similar is observed in the case study of sauce marketing from Amazonian chilli peppers in Colombia. In order to highlight the 'natural' characteristics and the Amazonian origin of the product, advisors from the Ministry of the Environment and NGOs recommended using a cover made of natural fibres surrounding the glass jar. This would create an additional source of income for other people in the community. Such a seemingly small detail pushed the price up and made the product uncompetitive.

In the Philippines, the Upland Marketing Foundation Inc (UMFI) has developed an innovative marketing strategy using 'champion products' to assist emerging or small-scale products. Champion products are those that are required in high volumes by buyers and whose production can be expanded quickly as new markets are opened. Marketing costs can be absorbed due to the high volume produced. Rider products can take advantage of the supply-chain of champion products, giving a chance to develop new, low-volume products, assisting small groups with limited production capacity, and so on. However this does require a marketing organization such as UMFI, which is specialized and dedicated to a market and not to one particular producers' group.

Critical management innovations sometimes come down to very basic decisions. In the case study of UMFI, the decision to hire competent people, who knew how to dress appropriately, how to talk the language of supermarkets, and who had the contacts and networks, instead of the dedicated social reformers that used to constitute its sales force, made a major difference for the small-scale farmers who depended on those salespersons.

Small-scale farmers' organizations engaged in dynamic markets eventually face the dilemma of sustaining the participation of the organization or sustaining the inclusion of all the members, which can threaten the competitiveness of the organization. The very successful Aj Ticonel in Guatemala, for example, has had to establish different categories of suppliers among its small-scale, indigenous farmers base including;

- year-round suppliers;
- suppliers only in certain seasons;
- those certified in good agricultural practices;
- those non-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 opportunities for poorer farmers, while not impairing the flexibility of the organization or its capacity to be competitive in its market. These include quasi-membership arrangements and top-up suppliers. One example is the decision by the TACA cooperative in Jordan to collect sheep milk not only from its organized members, but also from privates. This resulted in greater inclusion of a greater diversity of small-scale producers. The successful Morakert cooperative in Hungary is accepting a very significant proportion of produce from non-members. More than half of the total production supplied at some stage is from non-members.

The same can be observed at NorminCorp in the Philippines, 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 crops. They also facilitate the 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 ('quality related to reliability of supply from farmers through the clusters'). To ensure this, the independent farmers are planting crops as a back-up to allow small-scale farmers to learn how to build up regular production. This creates a learning process for the small-scale farmers and the changes in practice ensure delivery reliability. However, the ability of the larger farmers to access development support is related to their inclusion of small-scale farmers ('more financially independent farmers are acutely aware that much of the assistance they tap into as an association is because of the small-scale farmers').

In conclusion, one of the key factors for successful smallholder participation in dynamic markets is the ability to implement technological innovations and to introduce new management models such as supplier differentiation, supplier clusters, and mainstream marketing techniques.

4.2 Specialization in multi-agent arrangements

A second 'key to inclusion' of smallholder farmers in restructured markets is their ability to engage in durable cooperation with multiple stakeholders from the public and private sectors, whereby each actor plays a specialized role to make the cooperation work. This requires the farmer organizations and their service providers to understand their specialized (and limited) role and, hence, the need for strategic partnerships with actors from a different background. This may be quite a difference for many of these organizations, who tend to distrust actors from the for-profit sector.

The critical success factor of multi-actor collaboration can be found consistently among the successful case studies that are documented. In the Philippines, the NorminVeggies association is a collaborative organizational arrangement between NGOs, a smallholder farmer organization and a private company. The private company, NorminCorp, acts as a marketing agent with a social enterprise emphasis ('operated with keen business sense but also full empathy for the small-scale farmers'). The NGOs and the farmers' organization work together as a rallying point in providing development support to the small-scale farmers. Support is aimed at addressing the vulnerabilities of small-scale farmers and enabling them to be part of the clustering effort. Financial support provided by NGOs consists of a production fund functioning in a similar way to financier/traders. Support is funded by NGOs but operated by NorminCorps as it is perceived as a business transaction and not as project fund. A technician is also provided to guide small-scale farmers on integrated pest management to answer to market requirements in terms of food safety.

In Togo, the soybean ESOP exemplifies an innovative shareholding structure with participation from a farmer organization, a private entrepreneur and a support agency. NGO support is focused upon the development of innovative multi-agent arrangements that are organized around a processing enterprise, creating innovative niche products and developing specific relationships with buyers. Financial, technical and organizational supports are provided for the creation and the functioning of the enterprise. This enterprise links up with groups of farmers under the scheme of the 'tontine' with 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, however, there are questions concerning the governance capacity of the farmer organization and the exit strategy for the support agency.

The NorminVeggies and the ESOP Togo case studies share some similarities;

- clusters or groups that are based on farmers' solidarity for delivery;
- a marketing or processing private company owned at least partly by farmers specializing in developing markets and with a social enterprise emphasis; and
- targeted support of small-scale farmers to assist the technical effectiveness of the scheme, with a strong market orientation.

Other case studies of innovative multi-actor collaboration are presented in Box 4.1.

Box 4.1: Innovative multi-actor collaboration

Tanzania: The Mara Smallholder Horticultural Project (MSHP) has developed a low cost and flexible form of business organization. A development agency mobilized farmers into marketing groups and connected them to form a network of suppliers of horticultural produce for hotels and camps. The agency assisted the small-scale farmers to acquire support from various institutions in the region to improve their skills and knowledge in horticultural production and related issues. After four years of innovation, farmers have increased their household income, access to credits, extension services, and marketing skills. Each group has a vegetable marketing committee responsible for collecting the produces from individual farmers, grading, packaging, delivery to the hotels, and payment to the farmers as per volume supplied. The supplies must meet the standards and grades for the produce and quantities to be delivered while the hotel pay the price as pre-agreed among farmers, MSHP and hotels on delivery. This has resulted into regular and smooth supplies since farmers are satisfied with the payment system.

India: A large retailer (Mother Dairy) promoted and supported the formation of four farmers' federations to coordinate the supply of tomatoes in the summer months. An NGO (HARC) played an important support role in building the link between farmers and Mother Dairy. The federations plan production to coordinate a steady supply of tomatoes, organize procurement at their collection centres, monitor quality, act as intermediaries between the retailer and the farmers, and provide a range of other services and inputs to the farmers.

Kenya: A particular alliance of researchers, supply-chain actors and policymakers has taken important steps to redesigning policies enabling pro-poor change in the dairy sector. The policy change unleashed the potential of the informal small-scale traders and other supply-chain actors, rather than project-like chain building efforts.

Brazil: An innovative multi-partner arrangement has allowed thousands of Brazilian family farmers to have an important participation in the expanding Brazilian biodiesel market. Brazil's public national oil agency buys biodiesel from private processors in order to meet national energy policy targets. Private biodiesel firms wanting to sell to the oil agency need to have a 'social seal', which is administered by the Ministry of Agrarian Development (MDA). In order to obtain the seal, a given percentage of the raw materials for biodiesel needs to have been purchased from family farms, under contracts that are negotiated through the local (municipal level) rural unions that represent family farmers and rural workers. These are organizational changes at the level of a whole industry, designed explicitly to expand the opportunities for small-scale farmers in a very dynamic and lucrative market.

China: In Hai Men county very small-scale farmers traditionally raised chickens for the local markets. An agriprocessor (Jing Hai) tried to establish a business on the basis of this traditional production but faced very strong problems of quality and consistency of supply. With the support of the local government, Jing Hai set out to organize a farmers' cooperative, taking advantage of China's new Specialized Farmers Cooperatives Law. The cooperative (now with 105 members) organizes and coordinates the supply of chicks to the farmers, the technologies to be used to raise the chicken, and the marketing. There is very tight integration between the cooperative and the processor, to the extent that the general manager of Jing Hai is also the president of the farmers' organization.

Russia: Small-scale tomato producers in Astrakhan were limited to selling their produce in the local markets or to informal traders who paid extremely low prices. Marketing options expanded when the truck drivers organized themselves into a dispatch service, similar to that of taxi companies in any urban centre. The farmers deliver their request for transport to the dispatch agency, who allocate the request among the truck drivers. The trucks pick up the produce at the agreed place and time, and receive half of the pay from the farmer. They then deliver the tomatoes to places as far as Moscow or Saint Petersburg, over 1000 km away. On arrival, the tomatoes are received by an agent of the farmer (usually a close friend or a relative), who pays the remaining 50 per cent to the truck driver. The price of tomatoes in Moscow fluctuates between 30 and 60 RUR, compared to about five RUR in the local markets in Astrakhan. Discounting the additional costs, the farmers still make an additional profit of between US $200 to 800 for a three ton truckload, while the truck drivers earn US $600 to 800 per trip. Policemen, who bribe the truck drivers in the numerous checkpoints between Astrakhan and Moscow, make a profit of US $200.

South Africa: In both the fruit and wine sectors, important new 'players' have come on board and joined the Thandi group. In fruit Capespan, South Africa's biggest fruit exporter, took over the Thandi brand in 2002. Since then seven more fruit producing farms have joined Lebanon as suppliers of Thandi fruit. Capespan markets all Thandi fruit. Likewise in wine, one of the major private cellars in the Cape wine industry, Omnia, acquired a 34 per cent share in the newly-formed Thandi Wine Company in 2005. In the same year three additional grape farms joined Lebanon as suppliers and acquired minor shares in the Thandi wine business. Together they supply grapes to three cellars where Thandi wine is made – one being Paul Clüver's own cellar on De Rust, while the other two are in Stellenbosch owned by The Company of Wine People. Workers and their families included in the equity share arrangements in Lebanon and other Thandi affiliated farms have benefited significantly over the last ten years. All have acquired shares in a fruit and/or wine business. The Thandi case study shows that it is complicated and time consuming for ordinary South African farm workers to become co-owners of a successful commercial agribusiness. It requires political will, partnerships, capital, knowledge, patience and trust. However, if based on sound business principles it is likely to be more viable and sustainable in the long term.

4.3 Increased working and investment capital

Financial services are crucial for farmers to access dynamic markets and sustain their participation in them. Cash flow is vital as smallholder farmers are almost always short of money, especially prior and during the harvesting period. As supermarkets and processors tend to pay only after a certain period, there needs to be a mechanism to bring liquidity into the supply-chain. In addition to working capital, other financial services such as investment capital, alternative collaterals, and risk management can have a strong impact on the success of smallholder inclusion.

It is still an enormous challenge to address these needs. In between the traditional micro-finance schemes and large-scale project finance, there is a 'missing middle' of producer organizations and rural SMEs who lack access to financial services. The businesses caught in this 'missing middle' hit critical growth limits in early stages of their development. Financial constraints can be solved by buyers (through prompt payment), through collective action by the farmers themselves, and through the support of specialized external agents. Box 4.2 presents the financial innovations that were documented in the case studies.

Box 4.2: Financial innovations

Bulgaria: The technological and managerial changes that small-scale dairy farmers introduced to meet the EU quality, hygiene, environmental, animal welfare, and farm management standards carried a heavy financial cost. Part of the success of the private company Madzarov Ltd in building a reliable milk procurement system has to do with the high frequency used to pay its small-scale farmer suppliers. In the case of the smallest farmers (six per cent of the total), 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.

Kenya: 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 support (Family Concern) in case of accumulated delays.

Bolivia: The lack of working capital constitutes a huge barrier to entry into the procurement system of the public sector, which often takes longer to pay than many supermarket chains. In Bolivia, this constraint is solved either by groups that benefit from NGOs' support (DfID has established a special pilot fund in this regard) or by groups who already have a high commercial turnover.

India: In the Uttarakhand case study, federations of farmers are setting up a relief fund to support farmers in cases of losses related to natural causes.

Tanzania: In the case study of vegetables for tourist hotels, savings and credit cooperatives are created in the network with the support of the NGO to be able to access credit from the bank sector. Furthermore, input provision on credit is provided by the NGO as a revolving fund.

4.4 Elements that are not common for smallholder inclusion

Some factors that are often assumed by policy and programme planners to be part of a pattern for market inclusion are in fact not present in many of the case studies that are documented in the Regoverning Markets programme.

- Collective action in the specific form of formalized farmers' organizations such as cooperatives. For example in Tanzania collective action is organized is through local networks of suppliers, as is also the case in the NorminVeggies example in the Philippines. In Mexico, the Local Phytosanitary Boards, that can be defined as a private-public partnership, have created a very informal but highly effective way of coordinating the production and marketing of tens of thousands of tons of avocado from several thousand farmers, most of them small-scale.
- Higher educational levels or larger farms (within the small-scale farmer category). In the Indian Uttarakhand case study, it is shown that both the average size of the land and the proportion of farmers with small areas of land are similar for tomato producers selling to supermarkets or to traditional markets. Also, levels of education are not significantly different.
- Greater participation of small-scale farmers in the governance of the supply-chain. This is illustrated by few of the case studies showing any evidence that small-scale farmers have any significant role in supply-chain governance. Even in cases where the small-scale farmers had an important role in the governance of the supply-chain, such as Aj Ticonel in Guatemala, both sides continually face issues of loyalty and fulfillment of commitments.
- Greater trust between agents in the chain. This is a dimension that is difficult to assess but one that has not been highlighted as a meaningful cause of success, except in a few case studies such as that of UMFI in the Philippines.

5 Innovative support services

New forms of support services are emerging in response to the restructuring of agrifood markets. In this new environment the role of donors and support agents is shifting towards a stronger focus on the facilitation of business partnerships between smallholder farmers and other actors in the supply-chain. This requires a whole new set of skills and instruments. The most successful innovation brought forward by the case studies is the emergence of specialized market intermediaries that are both business-oriented and development-motivated. We call these 'doubly-specialized intermediaries' because they are specialized and dedicated not only to satisfying the requirements of downstream firms such as supermarkets, but also to ensuring inclusion and development of small-scale farmers (see box 5.1).

Box 5.1: Doubly-specialized market intermediaries

India: The NGO HARC played a main role in linking small-scale tomato producers in Uttarakhand to a major retailer. First, it identified the potential buyer and negotiated to convince him 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. Finally, it continues to provide a range of technical and financial services to the farmers and their federations.

Philippines: Farmers' cooperatives such as the Pecuaria Development Cooperative Inc. specialized in organizing the production of organic rice among its members. For marketing a separate, independent organization was set up called UMFI. UMFI faced the challenge of assuring its mainstream supermarket clients that it could supply the needed volumes consistently throughout the year. They realized that this could not be achieved if they only worked with small-scale farmers' groups, particularly in the earlier stages when they were still developing their productive capacities. The low volumes supplied by the small-scale farmers made marketing unprofitable and unsustainable. The answer was to open UMFI to distributing products of private SMEs. In this way, UMFI was able to expand its business and make it financially possible to continue marketing the products of the small-scale farmers' cooperatives.

Colombia: A non-profit organization 'La Red' plays a role similar to that of UMFI in the Philippines – coordinating the marketing and distribution of a variety of 'environmentally friendly' products from many producer organizations to a group of mainstream retailers in the cities of Colombia. Such support is essential for far away groups such as APAA (Amazonian Agricultural Producers Association), whose location and scale of operation would make it unfeasible to sustain a marketing and distribution branch to reach the mainstream markets in the urban centres.

The existence of these specialized intermediaries often makes the difference between successful and sustainable small-scale farmer inclusion and failure. They need support from donors and government agents but they cannot do their work properly, nor develop well, if they are subject to the same rules as traditional NGOs.

In fact, some of the successful ‘doubly-specialized intermediaries’ that we have documented are fully private-sector driven and completely independent from any support from the government or NGOs (see box 5.2).

Box 5.2: Doubly-specialized intermediaries without public support

Indonesia: 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. However the wholesaler also provides services to the farmers such as technical assistance and capital. The intermediary receives a five per cent commission on the sales made between the farmers and Carrefour. The benefits for farmers are multiple. The intermediary has encouraged the farmers from working individually to working in a group and transformed their relationship 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.

Honduras: Hortifruti is a specialized wholesaler supplying supermarket chains with a special programme for including small-scale farmers as suppliers. Only few small-scale farmers succeed in entering the supply programme and, especially, staying within. Those who succeed enjoy secured market outlets, fast and transparent payment, and specialized technical and financial assistance.

6 Inclusive business

Private sector firms (wholesalers, agriprocessors and retailers) in domestic dynamic markets prefer if possible to deal with a small number of large-scale suppliers than with many small-scale ones. When Carrefour introduced its quality line in China it deliberately contracted with large-scale farmers for management convenience only. One can argue that this innovation inspired improvement in the farmers' production methods and played a demonstration role for nearby small-scale farmers. However there is still no strong evidence of smallholders' inclusion in the scheme.

Under certain conditions private sector firms have to, or can be induced to, source from small-scale farmers. Such conditions include;

- scarcity of alternative suppliers;
- the characteristics of the product;
- the possibility of gaining access to subsidized inputs and technical and financial resources; or
- gaining political and community goodwill (see box 6.1).

Box 6.1: Factors that encourage sourcing from smallholders

Tanzania: Given the hotels' remote location, local supply from small-scale farmers is far less expensive, especially during the rainy season where road transportation from outside the area is not always possible. Furthermore, the local supply has a promotional value in the tourist trade as a support to local communities coupled with the encouragement of environmentally sound production.

South Africa: The SPAR case study shows similar conditions are also holding. Given the remoteness of the supermarkets from the central distribution centres and their operation in rural areas, transportation cost and freshness requirements as well as contribution to community development are also major drivers for supporting the development of a local procurement scheme from small-scale farmers.

Pakistan. A company can, on its own initiative, engage in an inclusive strategy when it serves its own agenda. This is the case of Haleeb Foods Limited, a milk processing and marketing company in Pakistan. The interesting characteristic of this business is the exclusion of big milk traders from the supply-chain when they became a threat to the company and the small-scale milk producers. This strategy ensures the sustainable involvement of smallholders in the chain but does not provide them with any guarantee of future economic security.

Schemes for small-scale farmers' inclusion where private sector firms are engaged proactively have very evident benefits for achieving sustainability faster. However, one condition is that one cannot load the whole development agenda onto the shoulders of these private firms, or expect them to behave as non-profit entities. In other words, private firms serve this development function on their own terms. The contrast between two case studies illustrates this argument.

The dairy processing firm Dimitar Madzarov Ltd in Bulgaria has increased its daily processing of milk by a factor of 20. What is important for our discussion is that the milk is sourced from over 1000 small farms, half of which have less than five cows. The firm has not only expanded, but so far has very successfully met all the requirements to continue selling its dairy products in the demanding and highly competitive European market. The five main reasons farmers give to sell their milk to Madzarov are the short distance to the processing plant, existence of a written contract, good reputation, high trust, and timely payment. The Madzarov case study is one in which the relationship is entirely driven by private agents (dairy processor and farmers). According to the case study, the small-scale dairy farmers are prospering and the link to Madzarov has opened new and very rewarding markets to them. However they certainly are not empowered in the value-chain.

By contrast, in Jordan a dairy processing firm established as a joint initiative of a local NGO, the United Nations Development Programme (UNDP), and the Ministry of Planning of Jordan. The local Bedouin people are the owners of the enterprise, nominally empowered to run their enterprise. In practice, many decisions appear to be made by the NGO and the government staff, and the whole experience has never managed to really get underway, despite substantial subsidized investments.

The case study of MAS Foods in Sri Lanka is very similar to that of the Bulgaria dairy processor described above. In both instances, innovative businessmen 'unlock' an isolated area and connect it to dynamic markets, bringing in numerous small-scale producers and their main suppliers. However there is limited public support to increase the outreach of these experiences. The efforts of both companies remain 'islands of success'. In the case of MAS Foods, this means that the company has hit a critical growth limit. There is an urgent need to develop new mechanisms to support the initiatives of private companies and strengthen their potential to connect small-scale farmers to dynamic markets.

This is particularly true for small-scale traders and middlemen, who often are vital in linking smallholders to dynamic markets. Our case studies document such a role in China, Kenya, Russia, and India (see box 6.2). However in many cases they are not respected let alone supported by public authorities, donor agencies and development agents. Small-scale, often informal traders and middlemen are of particular importance to the poorest farmers and to those located further away from the markets and the main roads. 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.

Box 6.2: Adverse policies on small-scale intermediaries

Kenya: The Kenyan dairy sector was liberalized in the 1990s. However, the inherited legal framework, designed for a state-controlled marketing system, was not adapted to the new reality of a private-sector-driven marketing system. The legislation prohibited trade in non-processed or non-pasteurized milk products, because of concerns about health risks of raw milk. In reality 86 per cent of all milk was sold as non-processed raw milk by informal traders. Only 14 per cent of all milk is pasteurized and marketed through the dairy processors. Consumers have a preference for raw milk due to its higher butterfat content, appealing taste and lower price. Raw milk is 20 to 50 per cent cheaper than pasteurized milk, making it more accessible for poorer households. 99 per cent of all consumers boil the milk before consumption, which effectively kills potential bacterial and zoonotic hazards. Therefore in terms of consumer health there is no difference between raw and pasteurized milk. Small-scale milk traders effectively tailor to the consumer demand for cheap, raw milk. However the ban on raw milk severely hinders their business operations and drives them into the informal sector. When they are seen to be selling milk, the milk traders are chased away by authorities.

China 1: The Tongzhou area traditionally produced cash crops such as vegetables, melons and beans. Although the quality of those products was high, farmers faced difficulties in obtaining a good price in local markets. Consequently they explored other marketing channels and gradually became agricultural brokers. Due to abuses from some brokers, the governments banned them for several decades, therefore preventing smallholders from connecting to urban wholesale markets. In the late nineties, the government realized the vital role brokers play in value-chains and small-scale farmers' inclusion and changed their strategy to organize them into associations, solving the farmer's marketing problem.

China 2: Suguo supermarkets rank among the top three retailers in China. Its procurement system is based on written contracts with small-scale traders, who in turn have oral agreements with farmers. Using the traditional middlemen, Suguo has established a firm base in the countryside both in terms of procurement and consumption. This has only been made possible through the market-oriented reforms in the late nineties that allowed Suguo to expand through the countryside by franchising the existing supply from cooperatives. Those cooperatives, originally state owned, offered the necessary network and became the private chain intermediaries between small-scale farmers and rural consumers.

Russia: Tomato farmers in Astrakhan receive five RUR for one kilo of tomatoes, while the price in Moscow fluctuates between 30 and 60 RUR. They struck a deal with truck drivers to establish a distribution service from a fixed parking lot, which allowed both actors to make more money. However, local authorities forced the transporters to abandon the parking lot, therefore destroying the attractive business opportunity for the farmers.

India: For many years the businesses of small-scale intermediaries have been hampered through the ban by law on direct sourcing from farmers and forced sales through the government-controlled markets.

7 Conducive public policy

Public policy can be a vital factor in promoting smallholder farmer participation in dynamic markets. Smart subsidies and institutional change fostered by public policy can be used to;

- encourage private sector firms to source from small-scale farmers;
- provide support services to small-scale farmers (e.g., technical assistance, access to certification schemes);
- provide direct financing to small-scale farmers or to facilitate their access to financial services provided by others;
- adjust the development of private grades and standards so that the cost of compliance does not lead to widespread exclusion; or
- invest in community development.

This is documented in many case studies (see box 7.1).

Box 7.1: Public policies promoting smallholder inclusion

India: The state agency Punjab Agro Foodgrains Corporation (PFAC) has been the main instrument in a policy from the government of Punjab to mitigate the environmental impacts of the predominant wheat-rice production system in the region through diversification of farm production. The initiative began with the reform of the Agricultural Product Marketing Committee Act (APMC), allowing farmers to sell their produce in places different from the designated government markets. In addition, the state government agreed to reduce taxes and levies charged to produce sold to agribusinesses engaged in contract farming schemes. Finally, PFAC actively intervenes to link farmers and agribusinesses, providing a range of services and acting as an intermediary during the initial years ('tripartite model'), until the relationship is developed to the point where farmers and agribusinesses are ready to deal with each other directly ('bipartite model'). The scheme has expanded the area under contract farming in the Punjab from 120,000 to over 1 million hectares in only six years.

Mexico: The 1994 Federal Phytosanitary Law gave greater responsibility to local farmers associations (Local Phytosanitary Boards) to enforce regulations and standards. Avocado farmers in Michoacan had a direct interest in strict enforcement as this was a necessary condition to open up the highly profitable but highly protected US export market. The local associations have total control over the movement of avocadoes from the orchards to any market, for export or domestic use. The local associations have set up a province-level umbrella organization, where they discuss not only phytosanitary issues but also questions of product quality, marketing and price strategies, and other questions of direct interest to producers. The associations also serve as a collective action platform for participating in an organized fashion in the powerful Avocado Export Association. Without this the large export firms would have an unopposed voice in defining all matters relating to the export market. The local associations are also the vehicles for negotiating with the domestic wholesalers and retailers about such issues as quality, price and payment, and other conditions.

Colombia: The Ministry of the Environment developed the Green Markets National Strategic Plan as a way to respond to the country's obligations under a number of international treaties, such as the

Biological Diversity Convention and the Andean Regional Biodiversity Agreement. Under the plan, the Ministry signed an agreement with Carrefour to promote the marketing of 'green products' derived from indigenous plants from the Amazonian tropical rainforests. The Ministry also provides technical and financial support to producers' organizations, and assists them in developing business plans to respond to the new 'green market' opportunities. However, this policy failed to stimulate effective consumer demand for the green products based on the Amazonian indigenous chillies. In addition, the production, harvesting, processing and post-harvest management of several of the undomesticated species also have proven to be difficult undertakings.

Bolivia: The new government procurement law enacted in 2000 and amended in 2004 and in 2006, establishes a number of measures to remove barriers to participation of small-scale farmers' economic organizations (SFEO) in the government procurement system. It states that 'the school breakfast and nutritional programmes (administered by the municipal governments) have to be elaborated from national products with an emphasis on local production.' The law opened the door for SFEO participation through changes in the registration requirements, establishing a special 'Enterprise Card'. Previously, bidders in the procurement system had to be registered in the Registrar of Commerce. This office did not register non-profit organizations, associations, or cooperatives, only formal businesses. Also, local governments were allowed to procure directly without competitive biddings for contracts up to €20,000. These changes were the result of a policy incidence campaign launched by SFEOs in the context of the country's negotiations under the Highly Indebted Poor Countries (HPIC) initiative.

Kenya: The new dairy policy being discussed in the Kenyan Parliament has signalled a clear departure from the old and ineffective 'command and control' approach to regulation of the informal and traditional milk markets. The Kenyan Dairy Board used to police the informal markets to try to erase the informal small-scale milk vendors (SSMV). After decades of harassment, they still command 85 per cent of the market. Even before the new policy's legislative approval, a new approach was underway. Licenses are issued to SSMVs, linked to compliance of quality and hygiene regulations, and business development services are now available including training and certification. Through The Association for Strengthening Agricultural Research in Eastern and Central Africa (ASARECA), the pioneer Kenyan approach is being promoted in Uganda, Tanzania and Rwanda. Also, there is an East African regional effort to rationalize and harmonize dairy policies and standards across borders, including adoption of common training and certification materials and approaches. A key trigger of the change of approach was a research and development project (Smallholder Dairy Project) jointly implemented by Kenyan (KARI) and international (ILRI) organizations, in close coordination with a range of dairy industry stakeholders.

Brazil: The National Programme of Biodiesel Production and Utilization (PNPB) involves two key players, large biodiesel production firms, and rural unions representing family farmers and rural workers. The programme is operated by the private biodiesel companies, but the contractual arrangements with the family farmers are negotiated with the powerful rural unions, who also play a role in coordinating supply. The biodiesel production from these contracts receives a 'social seal' from the MDA. This opens the door for private firms to supply to the national oil company. Biodiesel produced in the very poor Northeast region of Brazil needs to contain at least 50 per cent of raw materials produced by family farms. The percentages in other regions range from 10 per cent to 30 per cent. In other words, participation by the private firms in the biodiesel market is influenced by their sourcing from family farms under the umbrella of the agreements with the rural unions. To support the programme, the private firms provide technical assistance to the family farmers. Brasil Ecodiesel, for example, has 210 technical assistance units working in 436 municipalities. So far 68,500 contracts have been signed with family farmers, and the projection for 2008 is 225,000. About two thirds of the area covered with these contracts is planted with castor bean, and 29 per cent with soybean.

China: The government support policy for specialized cooperatives served as an incentive for small-scale farmers and a chicken production company to set up a cooperative that acts as an intermediary between them. The cooperative reduces transaction costs and is the channel for benefiting from targeted government support (subsidies and taxation release).

Australia: Competition policy has been amended to give special status to collective bargaining in agricultural markets. Agricultural cooperatives have been given greater room for collective bargaining, avoiding cumbersome legal procedures for obtaining permits. The amendment is based on the acknowledgement that, in agriculture, transaction costs are higher due to scattered production among many producers.

Canada: In many product sectors Canadian farmers are involved in marketing boards which, by law, are allowed to regulate production through quota and price fixing. While marketing boards have ceased in many parts of the world due to their inefficiencies, they continue to work to the satisfaction of its stakeholders in Canada. The Canadian marketing boards have been able to adopt the new consumer requirements as well as the WTO rules, while providing farmers with a fair and secure return to their farming activities.

South Africa: The political pressure on farmers and agribusinesses to become involved in empowerment initiatives is increasing. Under the government's AgriBEE legislation, 25 per cent of the industry must be black-owned by 2010, and 35 per cent by 2014. The AgriBEE scorecard gives credence to preferential procurement and its role in enhancing transformation. In this regard, the government recognizes that agribusinesses can play a critical role in assisting the establishment of black commercial farmers and black entrepreneurs at all levels in the value-chain. In this context the Thandi project may have a 'replication' effect. Instead of opting for a 100 per cent black-owned empowerment project, employers may rather pursue the partnership model exemplified by Thandi. 100 per cent black-ownership may look good, but experience has shown that it can be too much responsibility too soon for workers with no business experience and agricultural exposure.

Importantly, not all conducive public policies originate from a voluntary public initiative. Social pressure can force governments to implement measures that will benefit smallholders' inclusion. When the Argentine Supermarkets Chamber (CAS) started receiving complaints from small and medium sized suppliers about payment terms and other abuses of market power, the government and some national deputies drafted several laws proposing severe sanctions to stop abuses. This was without success. Key private sector players joined forces to implement voluntary self-regulation, eventually resulting in the signing of the Best Commercial Practices

Code (BCPC). Six years of Code (2000 to 2006) showed a record of improvement in both free and fair trading practices.

From the examples above, it can be seen that public policies and external support programmes favouring inclusion can be very pro-poor and very pro-market at the same time. They can also be pro-poor and be implemented by private sector actors. In fact, if the objective of a policy is inclusion of small-scale farmers in dynamic markets, pro-poor policies that are not also pro-market, are most likely destined to fail.

8 Costs and benefits of inclusion and exclusion

As a rule of the thumb, inclusion seems beneficial for those who gain access to restructured markets. The box 8.1 presents some examples from the case studies.

Box 8.1: Direct benefits of market inclusion

Uganda: The price per litre of milk in the formal market is about six times higher than in the informal market.

Tanzania: The smallholders participating in the vegetable network for tourist hotels face lower risks and make higher profits than non-participating farmers. Production risks are lower because the demand from the hotels and lodges requires the farmers to amplify their farm production from seven to 23 different products. The seven products were those demanded by the local market, and the additional 15 have been introduced in response to the demands of foreign tourists. In terms of market prices, traditional middlemen pay the farmers an average of US $0.15 per kilo of tomato, while the hotels and lodges pay US $0.39 per kilo. Costs however are also high, between US $530 and US $610 per acre, due to the additional labour and inputs that are needed to ensure the quality demanded by the tourists. However the net revenue of farmers in the networks is still about US $0.24 per kilo (61 per cent of the gross price) compared to US $0.03 per kilo (20 per cent of the gross price) for the non-members working in the traditional market.

India: The tomato growers supplying Mother Dairy retailer have a profit rate of 93 per cent over the direct costs of production and marketing. Farmers in the same villages who supply private dealers have a profit rate of 34 per cent only. The greater profit is the result of much lower marketing costs since collective action gives them economies of scale plus the agreements with modern retailer also lower transaction costs.

China: The establishment of a supply-chain linking small-scale chicken farmers with an agriprocessor through a farmers' cooperative had a huge impact on the production levels and the total income of the farmers. A typical farmer went from raising 5000 chickens before he joined the cooperative to 24,000, and from an annual net benefit of 4,000 to 34,200 RMB.

Inclusion of a smaller group of farmers (usually the better-off) may also have indirect effects that benefit excluded producers or others (see box 8.2).

Box 8.2: Spin-off benefits of market inclusion

India: In Uttarakhand, the arrival of a national retailer to the Naugaon area to source tomatoes broke down the localized oligopoly enjoyed by traditional middlemen, forcing them to compete on price. It also resulted in the widespread introduction of plastic crates to replace the old wood boxes, sharply reducing marketing losses and costs and, presumably, also reducing the pressure on forests.

Russia: The price of one kilo of tomatoes in Moscow fluctuates between 30 and 60 RUR, compared to about five RUR in the local markets in Astrakhan. Discounting the additional costs, the farmers make an additional profit of US $200-800 for a three ton truckload, while the truck drivers earn US $600 to 800 per trip. Policemen who bribe the truck drivers in the numerous checkpoints between Astrakhan and Moscow make a profit of US $200.

The benefits of inclusion in restructured markets is not always present and not in all dimensions. In Colombia, the 'green market' developed through the association between the Ministry of Agriculture and Carrefour supermarket chain has so far proven non-profitable and financially unsustainable. The income from sales of chilli pepper sauce does not compensate for the costs and investments borne by the members of the farmers' organization. In Pakistan, small-scale milk producers seemed to have very little chance to upgrade their standard of living after the marketing innovation. While the processing company guarantees their sustainable inclusion in the chain it simultaneously maintains low producer prices.

Retailers often play groups of small-scale farmers off against each other. Small-scale farmers in Solan in Himachal Pradesh, India, had been working with the retailer Mother Dairy. After some time, they managed to open up other outlets for their tomatoes, making contact with private wholesalers who were willing to compete for their produce. With this asset, they renegotiated price conditions with Mother Dairy. The retailer soon began to look for alternatives, and with the support of a local NGO in another area of Uttarakhand, it promoted the emergence of four farmers' Federations who agreed to supply the needed tomatoes. The small-scale farmers in Naugaon gained. The small-scale independent-minded farmers in Himachal Pradesh did not.

Inclusion is not always judged by farmers to be beneficial even if profits are higher. In the same case study from India, many villages supplying to Mother Dairy have decided to drop out of the scheme because they find the retailers' quality standards and their enforcement to be abusive and discretionary. They also complain that Mother Dairy is not as reliable as it should be when it comes to arranging the transport, sufficient plastic crates, and other such tasks that are its responsibility under the agreement with the farmers. These problems intensify in those seasons when production is abundant and tomato prices are lower. Also, these villages believe that the leadership of their Federation gives the best deals to the villages where they reside. A survey of farmers involved in supplying Mother Dairy found that 55 per cent of them were not happy with the arrangement.

There are cases where very poor farmers are being included in dynamic markets, as in the Tanzania case study. However, since very poor farmers face very large capacity gaps, the costs and subsidies involved may surpass the profits achieved by the farmers. In the Colombia case study, farm-level certification is essential to be able to participate in the green market. However the cost of organic certification is too high for most smallholders. Moreover the poorest farmers lacked the skills (e.g. literacy) required by the relatively complex control and reporting systems. Certification also increases the cost of the product, making it too expensive for most working-class households. Hence, certified organic products tend to be produced in Colombia by less-poor farmers for richer consumers.

The contract farming successfully promoted by the government of the State of Punjab in India, has left behind the smaller and poorer farmers. Less than 15 per cent of the farmers participating in contract farming in Punjab have less than two hectares. Private firms naturally prefer to deal with a smaller group of larger, more capitalized farms. What is peculiar in this situation is that the contract farming expansion has been fuelled with substantial government political and financial support. Hence, the increased competitiveness and lower environmental impacts on water and land brought about by this public policy has also contributed to the process of social differentiation that is a salient characteristic of Punjabi agriculture. In the early 70s, 56 per cent of the farms had less than two hectares, and farms greater than four hectares accounted for only 23 per cent. Three decades later, the small-scale farm group (less than two hectares) accounted for 39 per cent of all farms, while farms of more than four hectares were 37 per cent of the total. However, it should be noted that the sharpest social differentiation took place in the 70s, many years before economic liberalization.

It is questionable whether initiatives focused on very poor farmers will ever be sustainable as they require the commitment of external support over long periods of time. In Tanzania, the MSHP spends about US $88,000 per year to support 56 village-level groups that are organized in two district-level networks. This equates to roughly US $1571 per group per year. Since the project started in 2002, the cost is about US $8600 per group. Since the difference in net revenue per kilo with non-members is US $0.22, the support cost is equivalent to the revenue difference at around seven ton of produce per group. This is 1.5 tonnes more than the total produce supplied per group to the network. On top of that, one needs to add the costs paid by each member to run the network.

Very poor farmers can benefit from market restructuring through labour market effects, the development of infrastructure, or through inclusion in schemes sustained by a majority of less poor farmers. Very poor farmers are, in some cases, included in farmers' organizations to benefit from external support. For example, the NorminVeggies network in the Philippines has established production clusters consisting of a medium-scale farmer with a set of small-scale farmers as a successful strategy to include poorer households in dynamic markets.

Cases of inclusion driven by private businesses is characterized by small-scale farmers having less say in the governance of the chain and less capacity of development beyond production and post-harvest management. However, there is no evidence that in such situations small-scale farmers will have lower direct economic benefits, at least in the short term. Also, under these conditions small-scale farmers do not need to incur the costs of coordination or of collective action. This observation holds true for all the case studies of inclusive business that we have documented.

Farmers face trade-offs in accessing dynamic markets, and tangible and intangible costs are always part of the equation. Important costs include larger risks associated with larger investments, increased specialization and the need to work alongside other agents who usually have more power. The market choice decision of the farmer will take into account the market options faced by him/her. For small-scale farmers, the initial choice is not always to specialize as a supplier of restructured markets. This has been shown in the Indian case study, where the small-scale farmers that were initially supplying Mother Dairy were abandoned by the company after their bargaining power had become too large.

Sustainability of inclusion is a much more difficult and elusive objective than gaining initial access to dynamic markets. There is an institutional dimension of sustainability that involves getting all the proper market and non-market incentives in place and in place correctly. There is an organizational dimension of sustainability that involves different agents learning to work together in the context of demanding and competitive markets where power matters and power works.

There is a financial dimension of sustainability, to do with economies of scale. Spreading the greater direct and transaction costs derived from sourcing from many small-scale farmers over large enough volumes should be investigated. Eventually these costs should be internalized in the balance sheets of the agents in the chain, including consumers. There is an attitudinal dimension of sustainability involving external facilitators and the public agents accepting that they need to respect the rules under which markets work, and that they need to exit n time.

And, finally, all these dimensions of sustainability need to be in place simultaneously. Nowhere has this been better demonstrated than in the Mexican avocado case study. Institutional sustainability has been secured through the law that places phytosanitary control in the hands of farmers, in the context of increasing regional economic integration. Organizational sustainability is exemplified by the sectoral cluster organizations where all stakeholders work together (producers, packers, exporters). Financial sustainability is clearly evident in the sustained growth in production and export value over the past 15 years. Attitudinal sustainability is evident as the stakeholders have been able to overcome their conflict of interests within a set of rules that ensures that the sector as a whole continues to be competitive. The combination of these factors explains why the Mexican avocado farmers probably are among the happiest farmers in the world!

9 Conclusions

1. Many of the drivers of agrifood system restructuring are inevitable. It is therefore possible for governments, development agencies, and farmers' organizations and their allies, to prepare themselves and to act proactively. However, the adaptations and responses documented in the case studies often were initiated after the changes had occurred. This gave little time to create better conditions to take advantage of new opportunities or to minimize the social costs. Governments and donors need to shift emphasis from compensatory and reactive initiatives, to proactive, anticipatory policies and programmes.

2. Governments have significant scope to introduce pro-poor policies, even within an overall framework of free trade and liberalized markets. This is underutilized. There is a need to acknowledge the legitimacy of 'regoverning' agricultural markets. No country has developed its agriculture on a model of pure private sector development. Up until now public intervention in agriculture has been of paramount importance in Organization for Economic Cooperation and Development (OECD) countries. If we set aside the paraphernalia of subsidies, there are many economically rational and socially valuable market interventions that governments can implement. Public policies favouring inclusion can at the same time be very pro-poor and very pro-market. In fact, if the objective of a policy is inclusion of small-scale farmers in dynamic markets, pro-poor policies that are not also pro-market are most likely to fail.

3. The potential of the private sector in promoting economic growth of the countryside is high as it is very effective in linking smallholders to dynamic markets. This is illustrated by several examples documented in the programme. However the potential of the private sector as 'partner in development' is underutilized. Private sector initiatives can bring along economic benefits for smallholders plus technical capacity-building but they seemingly do not result in lasting economic empowerment of the farmers or their organizations beyond the trade relationship in question. Moreover the programme did not encounter many strong examples where the development impact of the private sector was enhanced through smooth cooperation with the public sectors.

4. Collective action remains an important strategy for increased smallholder participation in dynamic markets. The case studies show that in view of lower transaction costs and greater effective transfer of capacity, private companies often prefer to work with organized farmers rather than individuals, despite the

increased bargaining power that groups enjoy. The case studies also showed that collective action by small-scale producers need not always take the form of a formalized farmers´ organization. Furthermore, some farmers' organizations have developed different forms of memberships (e.g. quasi-memberships, top-up suppliers) enhancing, at least in some cases, both competitiveness and inclusiveness.

5. NGOs and donor agencies often place great importance on building value-chains that are owned by farmer organizations (vertical integration). The case studies encountered show that the net economic benefits for farmers in value-chains owned by farmers' organizations do not seem higher than in private sector initiatives, though impacts are higher in terms of capacity-building. However, we did not encounter a case study where the collective action or the farmers' organization had become independent from external support. The effectiveness of donor support cannot be measured because there is no data due to a lack of monitoring systems. It appears low in many cases, but this disregards the fact that it is about capacity building and experimental learning, therefore trial and error. Moreover there is no benchmark for comparison with private sector initiatives, where 60 to 80 per cent of new business ventures fail. In general, donor interventions seem rather inefficient as they disregard;
   - the fact that value-chains are composed of various specialized companies rather than one company in charge of everything;
   - that the most effective entry point for intervention may not always be at farmers' level;
   - that value-chains cannot be built by outside agents but must be built around private sector initiative.

6. The world of financial services and that of market access/value-chain development is still largely separated. It is crucially important to create links and develop innovative financial products that cater for the needs of small and medium enterprises (SMEs) in value-chain development.

7. To achieve and sustain inclusion of small-scale farmers in restructured markets, different agents need to participate and cooperate. This is a big challenge. The successful case studies share the characteristics: collaborative arrangements between trained and organized farmers, a receptive business sector, and conducive public policies and programmes. Such arrangements are in most cases supported by specialized partnership facilitators. It is important that all elements are in place for inclusion to be successful. Comprehensive strategies and

specialized and skilled players will help to achieve this cooperation. Such strategies and the engagement of skilled players are expensive and demand time to mature.

8. The challenge of connecting smallholders to dynamic markets is still a new field without proven replicable models and methodologies. Our worldwide search for best practice did provide interesting and inspiring material, but we are still far away from the public sector having anticipatory policies, the private sector being a partner for development, support agencies making effective interventions, and farmer organizations being capable of, and empowered to participate in, dynamic markets. The Regoverning Markets case studies show the overarching need for public and private sectors to understand further how they can complement each other.

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Regoverning Markets

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

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