



**Food and Agriculture Organization of
the United Nations**

Business Models for Small Farmers and SME's

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ALL ACP AGRICULTURAL COMMODITIES PROGRAMME



Background

This paper outlines the rationale behind the approach that FAO will adopt when supporting small farmer groups, producer organizations, and local service providers under the EU-ACP programme. The goal of FAO interventions, under this area of support, will be to strengthen small farmer market linkage capabilities, focussing on activities that build rural capacity and skills, stimulate value chain dialogue among actors, and facilitate access to finance and agro-enterprise services. It will do this by working with the service providers most appropriate for guiding farmer groups and producer organizations on agro-enterprise functions. By adopting this approach FAO assistance will address the needs of the Programme's core beneficiaries, while simultaneously, strengthening the sustainability of local agro-enterprise service provision.

This paper was written by Bill Vorley, Mark Lundy and James MacGregor under the guidance of Doyle Baker (FAO) for the Global Agro-Industries Forum, India, April 2008 (www.gaif08.org)

Abstract

Small farmers and SMEs are increasingly tied to markets and agro-industries through business linkages and alliances with each other and with other value chain stakeholders. There are many models of business linkages, some driven by producers, some by buyers and some supported by intermediaries including NGOs. The business model critically impacts on how value is created, captured or shared by farmers, SMEs and other chain actors. It is therefore important to establish inclusive, equitable and sustainable business models for farmers and SMEs. Factors which influence sustained and equitable inclusion of smaller scale farmers and SMEs are producer organization, market coordination and intermediation, business support and financial services, buyer behaviour, and enabling policies and infrastructure.

Introduction

Agrifood markets are in an unprecedented state of flux, with domestic markets undergoing rapid but uneven modernization. Market modernization offers increased economic opportunities for producers, small and medium-sized enterprises (SMEs), and other actors in the value chain, but there are also risks of local producers and domestic businesses being bypassed, or failing to meet costly market entry requirements which favour the better-resourced. If the Millennium Development Goals (MDGs) are to be even partially met by 2015, then market modernization and restructuring has to deliver a growth and equity 'win-win'.

There is a growing body of experience showing that "win-win" outcomes are possible through commercially viable **business models** – ways of creating value within a market network of producers, suppliers and consumers – which involve small farmers and SMEs. These business models for small farmers and SMEs must deliver essential services to producers and ensure reliable supply to buyers, while also addressing the high transaction costs and risks that buyers face when purchasing from large numbers of fragmented, cash-strapped small farmers and SMEs. This brief gives an overview of lessons learned about business models for including small farmers and SMEs in modernizing markets and agro-industries.

What do we know about the main market and agro-industry changes going on?

Policies of privatization, liberalization and accession to the WTO or EU in the 1980s to 2000s were followed by a wave of investments by food manufacturers and retailers. Combined with rising urbanization and changes in consumer preferences and purchasing power, these have led to a growth of modern food processing and retailing which often have requirements or industry standards for quality and safety built on traceability and certification. Conformity with labour and environmental standards may also be required, with compliance costs proportionately much higher for smallholders.

To achieve the multiple objectives of quality, safety and consumer assurance, reliability of supply, lower prices and sustainability, the business models of modern processors and retailers are being built on collaboration, co-investment and knowledge sharing between producers, suppliers, processors and retailers. Ultimately, the extent of collaboration and co-investment depends on the nature of the product (perishable, differentiated or branded product, or bulk commodity) and the nature of the end buyer (branded retailer, wholesale, etc.), but there is a general trend in most sectors and locations towards increased collaboration and co-investment among chain participants. The most collaborative supply chains are for perishable commodities such as fresh vegetables, and certified products such as organic or FreeTrade coffee.

Empirical research shows that modern market channels are not inherently exclusionary to small-scale farms. However, buyers generally seek out larger suppliers and also seek out areas that are already favoured by agribusiness, such as zones involved in export production. Proactive initiatives and innovative business models are needed to create the incentives and conditions for sustained inclusion of small farmers and SMEs.

What models have emerged for linking farmers to agro-industries and changing markets?

The cornerstone of all business models for inclusion of small farmers is organization of the farmers to reduce the costs faced by private companies. Private companies often prefer to work with organized farmers rather than individuals, despite the increased bargaining power that groups can enjoy, to overcome problems such as dispersion of producers, diseconomies of scale, poor access to information, technology and finance, inconsistent volume and quality, lack of traceability, and management of risk. Producers may be organised by producers themselves, by the companies buying from the producers, or by an intermediary such as an NGO.

Producer organization models such as co-operatives are established to provide members with economic benefits in terms of access to dynamic markets. These differ from social organizations in their entrepreneurial focus, and may build on existing informal networks of farmers and traders as well as inputs and support from buyers or other chain actors. Models that are driven and owned by small-scale producers – like Cuatro Pinos in Guatemala – allow producers to market collectively despite widely differing farm assets. Various specific arrangements include clustering around lead farmers, whereby financially independent growers create market opportunities for small-scale farmers. Producer-driven models have had a mixed record of performance in provision of economic benefits to the producers, but collective action remains an important strategy for increased small farmer participation in emerging modern markets. Steps to improve the effectiveness of producer organizations in business-oriented services provision are critical.

Buyer driven models seek efficiencies in the chain to the benefit of processing and retail companies. There are some very promising cases where organizing supply from a small farm base – frequently a necessity with milk procurement – has led to sustained inclusion of small farms. Much has been written about contract farming, which can be successfully used by businesses to link small producers to modern markets where capital, technology and market access constitute key limiting factors. New models of rural retailing such as the Hariyali Kisaan Bazaar in India are emerging. These use a ‘bottom of the pyramid’ approach for poor producers as well as poor consumers. Working with small farmers is also a means to build community goodwill, contributing to a company’s long term licence to operate.

Intermediary models include a strong dose of service provision – usually by the intermediary organization or specialized providers in order to balance the needs of small farmers and SMEs with the realities of emerging modern markets, in terms of quality and volume. Other key aspects of intermediation models include increased knowledge management (to improve chain coordination and quality), closer links to buyers, and incentives for product and process upgrading. This can be an important new role for NGOs, though there also is a growing appreciation that intermediation can be a commercial business service. There are examples of producer organizations adding their own commercial intermediary in the form of consolidation and marketing units.

How are these models impacting on smallholders and SMEs?

All the models identified above seek to improve farmers’ technical and managerial skills, to ensure consistent volume and quality of supply to buyers, and to develop stable trading relationships.

Changes achieved through **producer organization** models can improve negotiating skills and result in enhanced access to service provision. In some models, producer organizations vertically integrate by becoming co-owners of the supply chain or one of its segments in pursuit of added value. These models can make sense when built on a business mentality, but downstream ownership may not always be in the best interests of the farmers when compared to models based on a network of specialized actors.

Buyer-driven models affect smallholders and SMEs through the application of (often strict) norms and standards relating to quality and volume. These models can provide clear incentives for market-driven product and process upgrading. However, additional benefits tend to accrue to buyers and steps are needed to ensure transparent assessments and sharing of gains. Where a buyer organizes a network of producers from a corporate responsibility ethic, the risk is more one of paternalism and dependence.

Intermediary models drive change through processes of negotiation among actors. They achieve improved efficiency through greater organization, improved information flows and shared standards along the chain. While it is tempting to want to “cut out the middleman,” chain intermediaries are often vital in linking smallholders to dynamic markets and are of particular importance to the poorest farmers and to those located further away from markets. Working with a new generation of “doubly-specialized intermediaries” (business-oriented *and* development-motivated), such as the Tongzhou Agricultural Broker Association in China, is an area that appears to offer great potential for linking business with small-scale producers.

None of the above business models is inherently superior for smallholders. In models driven by private businesses, small farmers have less say in the governance of the chain and there is less capacity building of small-scale suppliers. However, case study analysis (Berdegué et al. 2008) found no evidence that in such situations small farmers have lower direct economic benefits, at least in the short run. Also, under these conditions small farmers do not need to incur the costs of coordination or collective action. In the medium term, however, the promotion of stronger producer

organizations to build resilience is critical. Overall, comparative evidence on benefits and impacts is weak. The effects of diverse models should be measured using a range of possible tools, including quantifiable and qualitative indicators.

What can be done to help prepare smallholders to participate?

Despite recent trends, the participation of smallholders and SMEs in modern markets is still the exception rather than the rule. What needs to happen at the farm level and in value chains to sustainably increase small farm participation? Several reviews of successful farmer-owned rural businesses, farmer-market linkages, and farm-agribusiness linkages point to the importance of skills development for: (a) market linkages for goods and services, (b) internal and bridging social capital, and (c) professional business and technical management capacities. The development of these skills requires access to effective support and financial services, alliances with other chain actors and an enabling environment (Shepherd, 2007).

Effective **support services** may be technical, managerial or financial in nature but they share several common factors: (a) effective solutions to bottlenecks that lead to small farmer exclusion, (b) a business orientation to guarantee sustainability over time, (c) flexibility linked to clients' needs, and (d) provision by operators close to the clients. The topic has been covered in depth in the Business Development Services (BDS) literature (www.bdsknowledge.org) and includes services provision by diverse types of formal and informal service providers. For many smallholders and SMEs, services provision between commercial actors – termed embedded services – holds promise in that these services depend on commercial incentives rather than public or development subsidies. The use of participatory tools that strengthen the capacities of informal service providers to improve their embedded services is of critical importance.

Financial services are crucial for farmers to access and sustain participation in dynamic markets. As supermarkets and processors tend to pay only after a certain period (often 45 days or more), there needs to be a mechanism to bring liquidity into the supply chain. In addition to working capital, financial services in which the commercial relationship rather than collateral assets guarantee the loan can be arranged as 3-way agreements between buyer, producer and financial institution.

What do business partners do in order to work successfully with smallholders?

The biggest challenge for private companies to work with small-scale farmers and SMEs is organizing supply, with a need to reduce transaction cost and ensure that trading agreements are honoured. Much can be done by businesses to ensure that their procurement practices work to the benefit of poor people. Actions that might be taken include: adjustment of reward systems in procurement programmes, prompt and transparent payments, full access to information, and shared decision-making in regards to chain rules and price and quality structures.

Businesses also can set up preferential sourcing programmes for small-scale producers and SMEs. For example, Carrefour Indonesia has established a dialogue with SME suppliers of fresh food, household equipment and textiles, to improve product quality and packaging and improve their shelf access. Similarly Wal-Mart, Honduras has established the 'Una Mano para Crecer' ('Help to Grow') programme for SMEs.

There are pro-smallholder approaches to private sector standards, including group certification, use of local certification agencies, and participatory development of standards. Ensuring transparent and timely access to information, including producers' perspectives in rule setting and enforcement, and developing effective mechanisms to bridge gaps between producer capacities and market needs are important.

Businesses can develop effective initiatives in partnership with governments, donors and NGOs, and can learn as much from the successes and failures of development agencies and NGOs as the latter can learn from business. This is also a way to gain access to subsidized inputs and technical and financial resources. For example, a link between Shoprite in Mozambique and small-scale growers of fresh fruits and vegetables is being supported by an IFAD grant. METRO is working with the Viet Nam Ministry of Trade and GTZ to support Vietnam's distribution network.

What are action priorities for the public sector?

The public sector can play a vitally important role in the establishment of successful alliances between smallholders, SMEs and larger business, especially if successful small initiatives are to be scaled up.

A priority area of intervention is that of the enabling environment. In the case of smallholder and SME participation in supply chains, the enabling environment refers to the consistent provision of key infrastructure services (roads, water, electricity and communications) and the existence of complementary public investments in services such as agricultural research. Policies to improve roads and marketing infrastructure, particularly in regions that are not endowed with the characteristics attractive to downstream agents in the value chain, can be instrumental in facilitating farmers' participation in modern market channels. Relevant public policies to maintain a competitive market, and to oversee the working of contract laws and contractual enforcement are also a central element of an enabling environment.

Recent work by the World Bank on agricultural innovation systems identifies a range of options for the public sector to support market linkages and knowledge management for innovation (World Bank, 2006). Key findings from this research include the importance of linking actors in a way that facilitates discussion and information exchange. Examples include chain-wide committees facilitated by the Secretary of Agriculture and Ranching in Honduras.

Closing comments

The nature of the business model for linking small farmers and SMEs to modern markets and agro-industries is one of the most important determinants of how value is created or lost by supply chain actors, including smallholders and SMEs. Effective business models help farmers and other chain actors by building alliances and linkages by all chain participants. This rarely occurs spontaneously, given the often adversarial relationships that characterize commercial links in the agrifood sector. As a result, specific actions to clarify and develop plans for joint action at the chain scale are needed. Some good tools can be found in participatory chain analysis and upgrading manuals (e.g. Lundy *et al.*, 2006; Vermeulen *et al.*, 2008).

Further Reading

Berdegúe, J.A., Biénabe, E., and Peppelenbos, L. (2008). Innovative Practice in Connecting Smallscale Producers with Dynamic Markets. www.regoverningmarkets.org

Lundy, M., Gottret, M.V., Best, R., and Ferris, R.S.B. (2006). *A guide to evaluating and strengthening rural business development services. Field Manual*. Centre Internacional de Agricultura Tropical (CIAT), Cali, Colombia.

Shepherd, A (2007). Approaches to Linking Producers to Markets. FAO Agricultural Support Systems Division, Rome. <http://www.fao.org/ag/ags/subjects/en/agmarket/linkages/agsf13.pdf>

World Bank (2006). *Enhancing Agricultural Innovation: How to Go Beyond the Strengthening of Research Systems*. World Bank, Washington DC.

Vermeulen, S., Woodhill, J., Proctor, F. and Delnoye, R. (2008). *Chain-wide learning for inclusive agrifood market development*. IIED and Wageningen International.

Credits

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Suggested web resources

Empowering Smallholder Farmers in Markets
FAO Linking Farmers to Markets
Inter-agency BDS website
Making Markets Work Better for the Poor project
Regoverning Markets programme
Sustainable Food Lab
Alliance on Business Solutions for Development

www.esfim.org
www.fao.org/ag/Ags/subjects/en/agmarket/linkages
www.bdsknowledge.org
www.markets4poor.org
www.regoverningmarkets.org
www.sustainablefood.org
www.inclusivebusiness.org