



# The Business Model Approach

*Improving Linkages between Producer Groups and Buyers*



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The objective of this technical note is to provide background and points for discussion on the implementation of the business model approach adopted under the aegis of the AAACP project. The programme of work, concept and methodology described was developed under the technical guidance of Doyle Baker, Chief, AGS, and in collaboration with Heiko Bamman, Agribusiness Officer, AGS.

DRAFT TECHNICAL NOTE

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## **1. Introduction**

There has recently been a surge in the use of the term “business model” by development agencies and practitioners. Unlike the value chain approach however, which has been adopted from business school literature and is based on the work of the business economist, Michael Porter, the business model approach does not refer to an already established framework or an existing body of business school literature. The business model approach has been developed instead on a looser concept and with no defined framework. The term itself in business schools is often used to refer to an enterprise’s “way of doing business” or of targeting a specific market with the intention that each enterprise has its own unique business model regardless of its level of success. As such, the essence of a business model is how an enterprise carries out its business, views its customers’ needs and puts in place a strategy on how it intends to respond to those needs.

While there is still no defined approach and development practitioners apply different interpretations and uses for the concept, the aim of the business model approach implemented under the aegis of the AAACP is to facilitate the appraisal of performance gaps and needs between producer groups and buyers relative to the priority needs of the rest of the chain. The approach therefore complements the value chain approach which provides an overview of linkages and interrelationships among all chain actors.

FAO (AGS) under the EC-ACP commodities project is implementing a programme of work in 15 countries in Africa, Pacific and Caribbean (ACP) to pilot test the *inclusive business models approach*, the aim of which is to support the strategic prioritization of activities that contribute to more effective business relationships between smallholder suppliers and small, medium or large agribusinesses. The approach includes a diagnostic appraisal to understand how business is being carried out and focus group meetings to identify the success factors critical for improving commercial ties between the smallholder group and the buyer. The identification of the critical success factors guide the prioritization of activities which can be financed by the enterprises’ themselves or by donors, projects or local funding.

## **2. Integrating smallholders in value chains using business models**

Since the opening up of markets and the closing down of state marketing boards all players in agriculture face increased competition. Today’s markets, in both developed and developing countries, demand larger volumes, lower prices and higher quality produce, and suppliers to these markets, no matter how small or large, have to constantly cut costs to survive and make profits.

If players in the agriculture sector, including smallholders, want to compete successfully, in addition to responding to customers’ demands, they also have to focus on efficient operations that are cost effective and reliable. However, as the efficient delivery of fresh or processed produce to the market is not dependent on any one, or indeed on any number of actors, but moreover on the interaction between actors, which taking on the respective roles of suppliers and buyers, move the product towards the final consumer. While the complexity of the interaction and communication between these players varies depending on the commodity and the local market structure, modern business shows that better coordination can translate into added value, lower transaction costs, and ultimately a significant competitive advantage over competitors.

Communication is nonetheless a major challenge in developing country markets where decisions generally take place independent of one another. Getting an unprocessed agricultural product to the urban market in Africa can for instance involve no less than 7 different players, including the producer, the labourer, the price scout, the collector, the trader, the transporter, the retailer and finally the consumer. For processed products the number of actors and tasks involved can double.

Representatives of small-farmer groups are acutely aware of the need to communicate more strategically with downstream players and have been helped in the last decade by an increasing number of programmes aimed at strengthening smallholder-market linkages. Many of these initiatives have adopted the value chain approach which, based on the principle of promoting competitiveness, improves collaboration and trust by focusing on the relationships between actors in a chain. As a result of analysing the interdependence between the actors, the approach enables a better understanding of the formal and informal dynamics as well as the opportunities for improving the chain, offering a framework for better transparency and more efficient linkages. The issue still remains however, that smallholders are the most disempowered members of the chain due to various constraints that need to be addressed before they can participate in and contribute to a value chain strategy.

The inclusive business models approach is an attempt to address this issue by, within the framework of the value chain, analysing the inter-organizational linkages between the producer and the immediate buyer, which could be a processor, trader, wholesaler or supermarket. Similar to the value chain approach, the analysis helps to understand where value can be added, costs reduced and efficiency improved, however the business model approach focuses on two specific players, one of which is the less endowed and weaker member of the chain. As such, the analysis also identifies a number of critical gaps in terms of capacities, infrastructure, finance, services, innovations that need to be put in place in order for smallholder groups to be viable chain partners.

## **2.1 The business model approach and farmer organizations**

For smallholder based supply chains, the difficulty of coordination is made more difficult by a lack of organization among individual farmers, given that smallholders generally supply the market in an adhoc and reactive way. However, in addition to the obvious benefits of smallholder organization linked to collective bargaining power, bulking and economies of scale, it is also a fundamental requirement if smallholders are expected to participate in and benefit from a coordinated and efficient value chain.

There are various ways in which smallholders can be organized, from self-organization to organization with the support of an intermediary, a farmer organization or a third party private company using contract farming. The ways in which farmer organizations can be organized into groups can be described as “driver models” which are namely producer-driven, buyer driven, or intermediary driven<sup>1</sup>. Producer-driven models are motivated and owned by small-scale producers based on collective action for increased smallfarmer participation in markets. Buyer-driven models involve larger businesses organizing farmers into suppliers, which can also include the provision of inputs and technical advice based on the buyers’ needs, also known as contract farming. Lastly intermediary models which are commonly led by local NGOs involve the provision of technical assistance and support to identify and improve smallholder market linkages. Regardless of the type of model used, some type of organization is nonetheless needed if small farmers are to be active players in a value chain. As such, the application of the business model approach should also start from a situation where farmers are relatively well organized.

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<sup>1</sup> This concept was developed in the paper Vorley, B., Lundy, M, MacGregor M., Baker, D., 2008, Business Models for Small Farmers and SME's, FAO.

**Table 2.1 Organizational Models for Smallholders**

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

Building on an established organized smallholders structures, the business model approach provides a framework which enables projects, NGOs, farmer organizations and agribusinesses to focus on understanding and improving the trading relationships with downstream buyers. In addition to supporting the analysis and prioritization of activities that can improve competitiveness and efficiency in a value chain, the approach also promotes the idea of building collaboration and trust between smallholders and buyers so that trading relationships become more interdependent, transparent and sustainable.

## **2.2 What do we mean by business model?**

Based on the above rationale, the development of the approach under the AAACP is to support organized farmer groups mainstream business thinking among their members and to move away from running operations that are dependent on government or donor contributions. The approach supports farmer organizations define how they do business with their customers based on a better understanding of buyers' needs, so that they can begin to prioritize activities and guide smallholder members in responding to those requirements.

Also supported is the strategic prioritization of activities that contribute to more effective business relationships between smallholder supplier groups and small, medium or large agribusinesses. The inclusive element of the concept applied under the AAACP addresses the development constraints and concerns of linking commodity dependent smallholders through farmer organizations to markets. The methodology includes a diagnostic appraisal to understand how business is or is not being carried out and focus group meetings to identify the success factors that are critical for improving commercial ties between farmer organizations and buyers. The identification of the critical success factors guides the farmer organizations, with the support of local service providers, in the prioritization of activities. Strategic actions can subsequently be financed by the actors themselves, donors, projects or with government funding.

As described below, the approach supports farmer organizations improve the aspects of their business related to (i) strategic business management of operations, (ii) better business to business coordination between farmer groups and immediate buyers and, (iii) responding to customer and value chain needs and priorities.

### ***(i) Managing a business strategically***

Strategic Business Management can be divided into two categories - business and logistical management.

(a) Business management relates to the marketing, finance, production and processing activities designed to produce, harvest, store, process and sell a product. To ensure control over these processes requires management teams that have the capacity to understand and manage the organization's systems in line with trends and risks associated with their market. Such capabilities require a core set of agribusiness strategic management capacities that address the above business processes.

(b) Logistical management relates to getting the product from farm to the cooperative, from the cooperative to the processor and from the processor to the market. The logistics operations are often simply regarded as a cost component, but if managed properly can significantly improve a business's response to its customer demands and therefore can be considered a value adding activity. Understanding the business and logistical processes can also help identify and eliminate or correct non-value adding activities. Ensuring that these processes are planned and managed efficiently can translate into added value, lower transaction costs, and increased competitiveness for farmer organizations.

### ***(ii) Business to business coordination***

Between the farmers group and the buyer there are a number of flows of inputs, produce, information and finance. However, decision-making processes often take place independent of one another. A better understanding of the interdependence between these processes and flows will lead to an improvement in business to business coordination and ultimately on how market responsive and cost effective the group's final product is.

The effectiveness of the coordination between two businesses is also highly dependent on the actual trading relationship between the two parties, an aspect which can often be underestimated. It is often assumed for instance that a business will source its goods from the most reliable and efficient supplier around. It is often the case however that, once the immediate business need has been met, business linkages are forged or maintained due to a trading history, contacts and proximity.

### ***(iii) Responding to customer needs***

Based on a description of the current business model, an analysis of the critical success factors, and the design and implementation of upgrading strategies for the producer-buyer linkage, a farmer-based organization will have a clearer idea of where it needs to innovate, add value or differentiate in order to respond to buyers' requirements. With an overall improvement in the business coordination between the farmer group and immediate buyer, coupled with an improvement in logistic operations, the actors involved, and the value chain as a whole, will be more dynamic and flexible in responding to market demands. More efficient and market responsive ways of working will also open up the possibility of additional lucrative markets that demand better control over production, trade and distribution and which were previously out of reach.

The table below describes sets of proposed activities and tools that, depending on the local context and prioritization of needs, can be supported to enhance smallholder based business models.

**Table 2.2: Activities and tools to enhance smallholder based business models**

Managing a business strategically	<ul style="list-style-type: none"> <li>○ Training in business and financial management and marketing</li> <li>○ Appraise and address logistical constraints</li> <li>○ Training in bulk buying and marketing</li> <li>○ Identify low cost institutional innovations that improve delivery times</li> <li>○ Reduce waste and protect the environment from harmful production and processing activities</li> <li>○ Identify potential sources of credit and support loan applications</li> <li>○ Mapping exercises and workshops to understand the product flow</li> </ul>
<i>Business to business coordination</i>	<ul style="list-style-type: none"> <li>○ Appraise and address sources of uncertainty for a buyer, for instance related to reliability of supply, product quality.</li> <li>○ Facilitating the implementation of contractual arrangements (formal and informal)</li> <li>○ Information exchange mechanisms that improve transparency</li> <li>○ Facilitated business meetings to identify bottlenecks and better understand the role of each actor</li> <li>○ Strategic and operational management planning to enhance the supply of the product through the chain</li> </ul>
<i>Responding to customer needs</i>	<ul style="list-style-type: none"> <li>○ Synchronize product delivery and logistics to suit customer demands</li> <li>○ Implement grading systems and control mechanisms for product quality and safety</li> <li>○ Disseminate information on customer requirements</li> <li>○ Market appraisal and surveys to understand consumer needs and demands</li> <li>○ Training in good agriculture practices and post-harvest handling</li> <li>○ Training in standards and certification processes</li> </ul>

### **3. Implementing the business model approach**

Under the AAACP, the countries and commodities supported were identified at stakeholder consultations in each of the ACP regions between January and June 2008. The products selected, and identified as priority commodities under the AAACP, form a basket approach of cash and food crops that, through innovation, value addition and strategic market linkages, can be commercialized to improve incomes for smallholders. Commodities and countries that have been selected for FAO activities under the AAACP are:-

- Africa: Kenya, Zambia – Cotton; Zambia, Malawi, Cameroon – Cassava; Senegal, Mali, Burkina Faso – Rice; Cameroon – Coffee, Oil Palm  
Partners: Farm Concern International, Zambia Agribusiness Technical Assistance Centre ZATAC) Centre, IITA, Groupe de Recherche et d’Echanges Technologiques (GRET), Amassa Afrique Verte
- Pacific: Samoa, Vanuatu, Solomon Islands, Fiji – Fruits and Vegetables  
Partners: Samoan Crops Corporation Association, Nature Way Cooperative, Farmer Support Association, Kastom Gaden Association.
- Caribbean: St. Vincent’s and the Grenadines, Guyana, Jamaica, Grenada – Roots and Tubers.  
Partners: Caribbean Farmers Network

The following describes the criteria used for selecting the cases used in the pilots and the methodology and implementation steps followed during the course of the application of the approach.

### **3.1 Criteria for implementing the approach**

#### **1. Significant number of organized and empowered farmers willing and capable of supplying the target buyer/market.**

To begin with, the approach needs an existing group of organized farmers that have experience supplying markets. The group needs to already have a functioning governance structure with a significant number of capable members relative to the needs of the buyer. The group leaders or cooperative staff also need to have a clear understanding of members' profiles and their capacity to serve the targeted market.

#### **2. Receptive business sector willing to engage in dealing with smallholder suppliers.**

Supplying a specific and pre-identified buyer is a cornerstone of the approach as it provides the farmer organization with a defined target market with specific deliverables to respond to and the promise of real business partnership. This is as opposed to trying to respond to the general demands of the broader market. If smallholders have a comparative advantage in supplying a crop either through access to land, know-how or low cost labour, then the buyer will be more willing to assume the risks of dealing with smallholders and will withstand initial trials and errors of supply for a longer period.

#### **3. Local enabling business environment that promotes/support or at a minimum does not impede small-business initiatives.**

Despite the numerous challenges of doing business locally, whether they involve complex or unclear local contract law or paying regular bribes, the benefits and economic value of the business partnership needs to be worth the effort of having to deal with the daily obstacles to business.

#### **4. Experienced and market-oriented local service providers and NGOs to facilitate the business partnership and oversee the implementation of technical activities**

The existence of a local market-oriented NGO or service provider that has experience linking smallholders to markets and that can guide the farmer organization, without unduly taking over activities that should be carried out by the farmer group itself. The intermediary organization is also an important third party in trying to consolidate the relationship between the supplier group and the buyer and can act as a neutral mediator when disputes arise.

### **3.2 Methodology and framework for implementing the business model approach**

The following are the main steps to be followed when applying the approach. Table 3.3 provides a brief overview of each of the steps.

- a) **Current business model:** The implementation of the approach begins with a description of how the farmer organization is or is not doing business with the target buyer. The analysis looks at the group's resources, capacities, the product on offer, its flow through the supply chain, and the respective buyer's requirements. The objective of this analysis is to give a brief but better understanding of the farmers' organization, its structure, capabilities and what it is selling to the targeted buyer relative to the markets'

requirements. Table 3.1 provides more details on the contents of a business model description.

**Table 3.1 : Business model description**

<i>Products and services exchanged</i>	Describes the produce sold and services offered to members; anything that differentiates the produce from the rest of the market (e.g. low price, good quality, reliable supply), any research being developed on improving produce; e.g. new crop varieties.
<i>Customers</i>	Describes the farmer organization's types of clients (e.g. agro-processing firms, traders, supermarkets, hotels, exporters etc.) numbers and why they buy the produce.
<i>Suppliers/partners</i>	Describes the farmer organization's and their members' suppliers (small-farmers, inputs/seed suppliers, credit unions, banks, projects, local government, transporters, others etc), and respective constraints faced when trying to procure (price; quality, transport; volume, access to finance).
<i>Activities</i>	Describes the farmer organization's key activities required for business (growing, harvesting, collection, post-harvest handling, grading, packaging, primary processing, agro-processing, marketing, distribution etc.).
<i>Costs and revenue</i>	Describes roughly the organization's costs and profits generated.
<i>Expectations</i>	Describes the respective expectations of the parties. For instance, do they want to;-increase market share; enter into a new market, consolidate an existing market; diversify into a related value chain etc.

- b) **Critical Success Factors:** This information may already be found in existing market studies, but it can be analyzed and supplemented to ensure that the farmer organization is aware of the key factors that the buyer and other downstream actors value the most. If a study does not exist the information can also be supplemented with a round-table that brings together representatives of suppliers, customers and buyers to rank and provide more insights on the main success factors, which would typically fall under the following headings – price, reliability of supply, quality, standards. Table 3.2 describes the format and methodology for organizing a round-table to identify the critical success factors between the supplier group and the buyer.
- c) **Upgraded business model:** Based on the results of the round-table discussions, customer surveys or market studies, an upgraded business model is designed that provides innovation and places more importance on activities that address the CSFs. The strategy also includes a financial plan that costs each of the activities to be supported under the upgrading strategy.

**Table 3.2 –Critical Success factors Round-table Format**

<b>Critical Success Factors Round-table Format</b>
<ul style="list-style-type: none"> <li><i>i.</i> overview of the organization’s current business model</li> <li><i>ii.</i> overview of the market structure; numbers of buyers and sellers; sales and demand; different market segments/customer groups; competitors; ease of entry and exit to market.</li> <li><i>iii.</i> results of surveys and appraisals to identify customers’ critical success factors, which may include consistency of supply, quality and variety of produce, compliance with global standards, brand/origin preference.</li> <li><i>iv.</i> environmental/social features, eg. organic or fair traded, and phytosanitary features.</li> <li><i>v.</i> finally, based on these elements the participants to the round table validate and prioritise the identified Critical Success Factors.</li> </ul> <p>CSF’s may vary according to the different market segments the cooperative supplies, for instance, export traders, tourist industry, hospitals, supermarkets and fresh markets.</p>

**Table 3.2: Steps for identifying activities to be implemented under an upgraded business model**

<b>Preparatory steps</b>	<b>Comments</b>
1. Characterization of the current business model	Provides a description of how the farmer organization is currently doing business and supplying the market
2. Identification of the critical success factors	Describes what is particularly valued by the buyers and the end customers
3. Develop an action plan	An important part of the action plan is also the financial plan which costs the implementation of the different parts of the upgraded business model.
4. Identify activities that can be supported by the FAO project	The selection and implementation of activities should be done without distorting viability, unduly subsidizing or undermining the sustainability of the linkage.
5. Share and review results and lessons of the process with other chain actors, ministries, farmer organizations and commodity associations.	The process and findings can be replicated for other farmer organizations working on the same commodity with the support of local ministries and stakeholders.

#### **4. Conclusion: Upgrading Farmer Organizations Business Models – A continual process**

Constant revision and, if needed, upgrading of a business model, is crucial if a farmer organization is to become and remain competitive. To do this, smallholder-based groups, even at the smallest level, need to understand agribusiness trends and buyers' requirements and strategically plan, innovate and differentiate products and services according to those requirements. The inclusive business model approach offers farmer organizations, and those supporting smallholder-market linkages, conceptual guidance and a tool on how to upgrade operations including the organizational structure and customer base needed in order to stay ahead in business. The results and outcomes from the analysis help organizations re-define and focus on priority activities that need to take place to ensure sustained competitiveness in a given market.

Based on a description of a current business model and an analysis of critical success factors, business relationships and operational management, an organization will have a clearer idea of where it needs to innovate, add value and, or differentiate in order to respond to buyers' requirements. The initial business model appraisal also provides a benchmark record for measuring progress over time. Essentially, the upgraded business model combines the important activities of procurement, marketing, sales, finance, production, post-harvest and logistics, as well as management, strategy, human resources and capacities etc., in a framework which provides the tools to strategically react to internal and external dynamics and respond to the organization's purpose rather than adopting crisis management or reacting opportunistically. In addition to providing a framework and format for visualizing a business path, the results of a business model appraisal is also useful for communicating and sharing ideas about the organization and its future plans with customers, partners, suppliers, donors and finance institutions.

Ultimately the aim of the inclusive business models approach is to strengthen the relationship between the farmer organizations and a business partner by prioritizing and implementing practical activities that encourage alignment and planning of the business processes between the small-holder and the immediate buyer. The objective of promoting control over these processes is to ensure that upgrading activities are based on transparent needs and clear market signals so that there is a departure from the traditional supplier-buyer relationship which is typically based on mistrust and misinformation. In this way, the upgraded business model will be able to meet customer expectations and to increase efficiency and the farmer organizations' ability to supply the market

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