World Development Report 2008 :
« Agriculture for Development »

Rural Producers Organizations for Pro-poor Sustainable Agricultural Development

Paris Workshop – 30, 31 October 2006

Theme n°2

Farmer organisations and pro-poor market development

Introductory Note

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1. Introduction

This paper focuses on the role of rural producer organizations (RPOs) in fostering pro-poor growth by linking small farmers with input and output markets.

2. The context: global market restructuring

Small farmers form one of the most vulnerable groups in the world – half of the world's undernourished people and the majority of the poor can be found on small farms. To improve their incomes and livelihoods, small farmers face the challenge of integration and competitiveness in a market context that, in the past 20 years, has changed dramatically to become more integrated, globalized, and consumer-driven. At the same time they are constrained by a drastic reduction in the public provision of basic services as a result of policy reforms, and increased imports of foodstuffs from OECD countries (IFPRI et al., 2005).

The WDR draft outline recognizes a four-tier differentiation of agricultural markets with different sets of opportunities and constraints for small farmers:

a. Traditional staples: Staple crops still dominate on small farms. Growth requires improved infrastructure, mechanisms for exchange, and risk management.
b. Bulk commodity export: This remains an important sector for agriculture-based countries. Growth requires quality improvements and new financial arrangements.
c. Modern urban markets: In this rapidly growing market, economies of scale and scope limit the competitiveness of smallholders. There is a need for institutional innovations to better link these farms to these markets.
d. High-value export: The very stringent sanitary and phytosanitary requirements in OECD markets require significant investments in the capacity of LDCs. Small farmers may have opportunities on regional export markets.

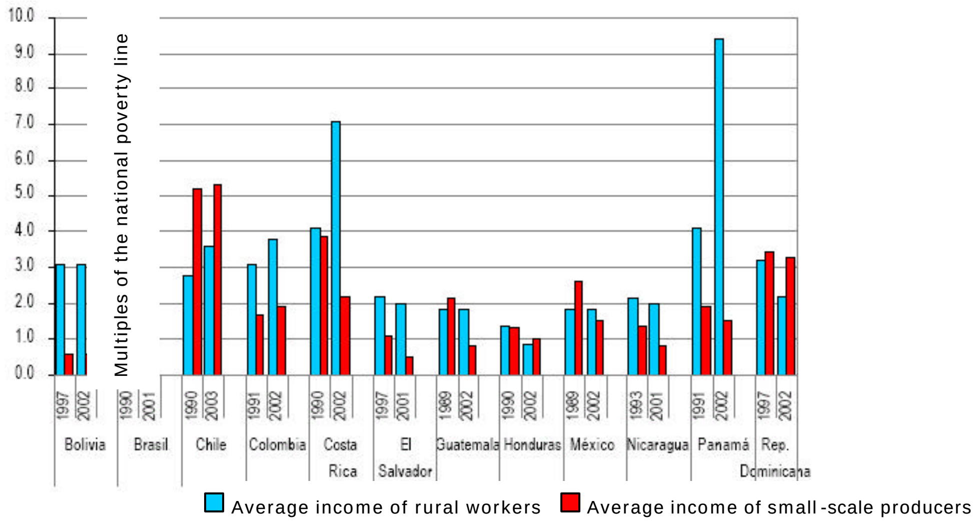
Evidence suggests, however, that there are important linkages between these market types. All are affected by the rapid modernisation and concentration of food processing and retailing (it can take developing regions as little as ten years to reach the levels of market restructuring that took five or more decades in OECD countries). Where the impact is not direct on farmers, it can be indirect, through effects on the traditional markets that are competing with supermarkets and large-scale processors for market share. The direct and indirect impacts on farmers occur through 'four pillars of change' in procurement systems (Berdegué et al., 2005):

a. From local, decentralised procurement to centralisation and regionalisation of procurement. This means that in order to stay in the market, the producer needs to be competitive at the country and regional levels rather than just the local level.
b. From use of traditional wholesalers to specialised/dedicated wholesalers as agents of procurement. This means a greater capacity from the buyer's side to impose large volumes and consistency of supply.
c. From the use of spot markets to use of preferred supplier systems. This means that there is a "toll gate" – a filter of judgment of producers that are either on the list of suppliers to the supermarket or the food processor, or are not.
d. From informal standards to the establishment of private standards. Often even traditional wet markets are increasing and formalizing their standards in order to compete with retailers.

The market performance of small farmers varies greatly in different regional contexts. Asia and Latin America are witnessing rapid commercialization of farming, while much of Africa is characterized by stagnation. As yet there is only piece-meal evidence on the implications of market restructuring on small farmers; systematical insights across regions are expected in September 2007 in the Regoverning Markets programme. As yet the only available macro-figures are for Latin America, published by CEPAL (2006). These figures show that, in spite of overall agricultural growth in the continent, the incomes of small farmers have decreased (except in Chile and Colombia) and reached below the national poverty line in six countries (Figure 1). The explanation is that:

a. Small farmers are being squeezed out of dynamic markets because they cannot make the investments required to supply to retailers and large processors; and
b. The traditional markets remaining for small farmers are marked by constantly declining commodity prices.

Figure 1: Changes in average incomes of rural workers and small farmers in Latin America (1990-2003)



Source: CEPAL (2006)

Hence, in a continent where agricultural growth is relatively strong, small-scale family farming is in crisis. From a historical perspective, the decline of smallholder farming is part of the industrialization of agriculture – the figures for LAC indeed show increased incomes for rural workers; the question is, however, whether wage labor opportunities are sufficient to absorb the small farmers that are excluded from markets. From a perspective of pro-poor development, however, the figures show that it is vital that LDCs develop the capacity to appropriate areas of value accretion and protect themselves from the competitive pressures that continually drive down their terms of trade (cf. Kaplinsky, 1998). Hence sustainable market development for small farmers is more than merely providing market access and promoting technical efficiency. It is rather about empowering small farmers to upgrade their position in the value chain so that they appropriate a greater share of the returns accruing from the chain.

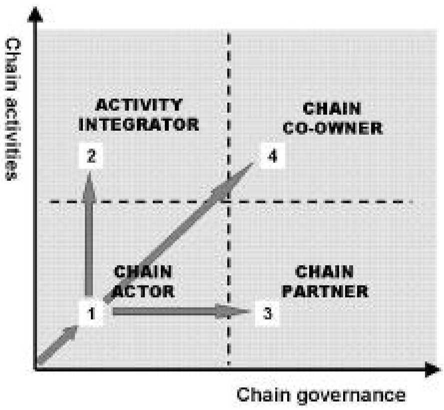
3. Chain empowerment of farmer organisations

The empowerment of small farmers in market chains has been widely promoted in the past decades. To assess these experiences and their results, two dimensions of value chain empowerment are critical:

a. Chain activities: The degree to which RPOs exercise control over chain activities beyond farming, such as input procurement, sorting and grading, warehousing, processing, transport, trading, retailing, etc.
b. Chain governance: The degree to which RPOs exercise control over management processes that cut across the various chain activities, such as the definition of grades and standards, market intelligence, quality assurance, innovation, information management, cooperation arrangements, etc.

Taken together, there are four archetype positions that small farmers can take in the value chain (Figure 2).

Figure 2: Four strategies for chain empowerment of RPOs



1. Upgrading as a chain actor: The farmers become crop specialists with a clear market orientation

2. Adding value through vertical integration: The farmers move into joint processing and marketing in order to add value

3. Developing chain partnerships: The farmers build long-term alliances with buyers that are centred on shared interests and mutual growth.

4. Developing ownership over the chain: The farmers try to build direct linkages with consumer markets.

Source: Adapted from Peppelenbos (2005) and KIT et al. (2006)

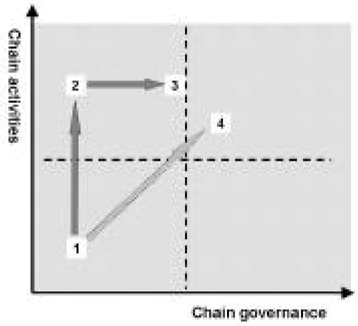
Many attempts to empower RPOs in markets tend to focus on vertical integration in the value chain. Small farmer organizations are encouraged to embark on collective input purchasing and/or output processing and marketing. These ventures are often based around the assumption that cutting the "middlemen" out of the chain will result in more added-value for the farmers. But the results are generally below expectation. For example, in the 1980s several thousands of cereal banks were created in Sub-Sahara Africa, but most of them had stopped their activities in the 1990s. The major reasons for their failure were their lack of professional management skills and lack of competitive advantages vis-à-vis private traders (SOS Faim, 2005). In Chile in the 1990s, the state promoted the creation of 778 cooperative peasant businesses with a total membership of 58,000 farmers. In 2000 only 15 percent was in a reasonable shape; half had higher expenses than revenues, one-fourth was technically bankrupt, and one-third was overly dependent on public subsidies (Berdegué, 2001).

A key factor behind this disappointing performance is the neglect of chain governance as a critical dimension of market empowerment. In some cases, chain management issues are omitted in the project design, the assumption being that "shortening the chain" will improve farmers' income positions, which disregards the functional roles that traders play in competitive value chains. In other cases, chain governance is artificially taken over by support agencies. State agencies and NGOs tend to play a key role in providing subsidies, technical assistance and managerial support. This often results in paternalistic support structures that take the managerial control away from the RPOs. Case study 1 exemplifies some of these processes in detail.

Case study 1: Shea butter in Mali

Falling world prices of cotton faced farmers in southern Mali with a situation, where they could only sell their cotton at a loss. An NGO sought ways to support local farmers affected by this uncertainty. It saw shea, a tree growing widely in West Africa, as a potential source of income. The NGO organized 1500 women into 40 community-based groups, which later formed a district union**.** They received training on various topics such as quality control, improved production techniques, management, etc. The women improved the quality in several ways, and they now produce an odour-free, clean, white butter; a high-quality product that appeals to urban consumers. The groups buy the improved butter from individual group members, then sell it to the union, which in turn sells it to other areas in Mali. By selling directly, they cut out traders from the chain. The NGO makes information on market prices available to the women, so they can sell their butter when the price is right. The quality improvements and the women's stronger negotiating position have enabled the union to more than double the price from CFA francs 300 (about €0.45) per kg for traditional butter to francs 700 (€1.07) per kg for the improved butter.

However when the donor withdrew from the project, the women were unable to sustain these operations. They had not built up the management skills to function as autonomous entrepreneurs, and depended critically on the support of the NGO in linking with the market. The project was about to collapse when the union was given a last chance. They developed a 5-year business plan that helped them to better understand how to exploit the available resources provided the existing capacities. They hired a professional staff member, partly paid from their own pocket, and managed to negotiate a mixed credit-and-subsidy package with a local financial institution. They initiated a multi-stakeholder dialogue with traders, government agencies, transporters and an exporter to address chain management issues, such as quality control of the product at various stages in the chain, information sharing on prices, final use of the products and emerging market opportunities. Now the union sells kernels instead of butter. Local kernel prices were about 30 FCFA/kg while they currently sell about 150 tons of shea kernels at a price of about 80 FCFA/kg. Their major client, a Dutch company, is considering investing in a local processor in joint venture with the women's union.



The project initially aimed to bring the women from position 1 to position 4 (processing and retailing of high-quality shea butter). But it failed to empower the women in chain governance, hence the women ended up in position 2. After the restart the women are building chain governance skills and are moving toward position 3.

Source: KIT et al. (2006)

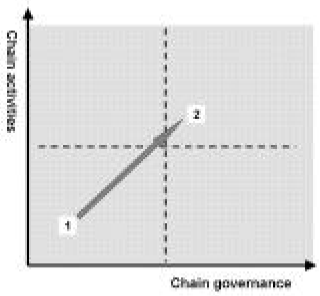
The above makes clear that vertical integration will not generate high added-value for farmers unless it is accompanied by more participation of the RPO in the management processes along the chain. Without some degree of control over chain governance, RPOs remain vulnerable to cost/price squeezes and changing preferences from purchasers. For example, in the early 1990s the coffee cooperative La Florida in Peru was at the verge of break-down due to structurally falling world market prices. In the mid-1990s the cooperative decided to focus on organic niche coffee and to develop a market intelligence unit in Europe. This investment in chain governance capacity revived the cooperative to an annual turnover of more than USD 3 mln (SOS Faim, 2003). Another successful example of how RPOs can build up chain governance skills is provided in case study 2.

Case study 2: Watermelons in China

Supported by local government, a group of small-scale watermelon growers registered the brand "Yulin" for the watermelon they produced. They introduced standardized production through unified growing, quality inspection, packaging and sale. With the expansion to other regions the farmers realized year-round production and supply of watermelon. They formed a formal cooperative to ensure their proprietary techniques and further expand their marketing network. "Yulin" watermelon was recognized as green food in 2005, tailored to the consumers' increasing concern and demand for quality and safety. Nowadays, the cooperative sells watermelon directly to wholesalers, supermarkets and retailers (40 percent, 25 percent and 35 percent of total sales respectively).

Wholesalers are attracted by the cooperative because it can deliver large volumes on a regular and timely basis and can more easily ensure food safety and quality standards. Farmers' income has improved significantly as the "Yulin" watermelon, with its fine taste, standard package, and brand image, fetches a higher price than other watermelons (3.0 yuan/kg versus 1.2 yuan/kg). The Ruoheng watermelon cooperative developed from 0.2 ha farmland in 1992 to an area of thousands hectares, from a registered capital of RMB 500,000 in 2002 to a total stock capital of RMB 21,000,000 in 2005, and from 29 members to 152 formal members and 100 quasi-members in 2005.

In 2004 the cooperative introduced a quasi-membership system. This means that future members need to have at least 3-year experience of growing watermelon, mastering the production technique of "Yulin", and have to go through a 1-year internship before becoming formal member. Besides the technical side of watermelon growing, future members need to have some organizing and managing skills (all formal members will guide and instruct the quasi members). The farmers who fail during the internship will be refused.



By registering a brand name for their product, the watermelon cooperative gained control over the governance of the chain.

Source: Zuhui et al. (2006)

4. Key challenges for integrating RPOs in market chains

There are ample opportunities for upgrading the position of RPOs in value chains along the aforementioned strategic lines. The highest potential is to be expected in national and regional markets (urban consumers and import substitution) rather than export markets. This section discusses some of the key challenges that will be faced.

A crucial requisite for small farmer participation in markets is the bringing together – at the same time – of technical upgrading, managerial skills, collective action, and access to capital. These conditions are unlikely to be fulfilled unless there is a specific intervention from rural service providers, like RPOs, NGOs and state agencies. Usually these services are (co-) financed with public subsidies. In other words, without the support from the public sector, there will be a tendency toward the decline of small family agriculture, with its concomitant consequences for poverty levels. Emerging evidence from Regoverning Markets suggests that even where private firms take the initiative in working with small farmers, there tends to be a (partial) externalization of the costs. Hence a first key challenge to smallholder participation in markets is to devise effective support mechanisms that provide long-term commitment (considering that market development of small farmers usually takes a long time), but that at the same avoid the pitfalls of paternalism and follow a clear phase-out strategy. This does not necessarily coincide with the interest of donors to deliver short-term results.

A second key challenge is develop an organizational culture in RPOs based around entrepreneurial professionalism. RPOs and support agencies tend to follow a holistic approach to improving rural livelihoods, integrating business development with health care, basic education, and more. But competitive markets require the chain actors to specialize in core business activities while seeking efficient liaisons with other actors in the chain. This cultural clash thwarts the everyday operations of market-oriented RPOs (cf. IFAP, 2004; Stockbridge et al, 2003). For instance, many RPOs fail to pass market signals on to their members in an undistorted way; in name of solidarity they subsidize the underperformance of some members at the expense of others, thereby failing to reward efficiency and innovation. Also, RPOs need to apply exclusionary arrangements towards new members, such as strict selection criteria, in order to consolidate their competitiveness. Successful RPOs are those that focus on single business operations, applying strict quality criteria in their business processes, human resources and membership, but that at the same time manage to address solidarity and social inclusion. A good practice herein is provided by the quasi-membership system of the watermelon cooperative in case study 2.

A third key challenge is to ensure effective leadership at farmers' level. Participation in markets requires continuous innovation. Small farmers tend to learn better in practice rather than though training workshops and advisors. Hence one of the most effective ways for integrating small farmers in markets is through an alliance with innovative commercial farmers who encourages them to improve quality and entrepreneurial skills. A good practice of this cluster approach is provided in case study 3.

Case study 3: Fresh vegetables in the Philippines

NorminVeggies is a multi-stakeholder association in the Philippine vegetable industry. It gathers members of various backgrounds, like commercial farmers, smallholder farmers, service providers, support agencies and local government. In December 2003 NorminVeggies started Normincorp, a marketing company supplying vegetables like cabbage, carrots, sweet pepper, bitter gourd and eggplant to the fast-food industry, supermarkets and vegetable processors. Normincorp is not a trader but rather a market facilitator that links the farmer directly to the buyer, in exchange for a 6 percent facilitation fee. The farmer is liable for the product and retains ownership over it all along the chain.

NorminVeggies formed production clusters, in which a group of 10 small farmers allies with a commercial farmer who helps to jumpstart quality production. The clusters commit to undertake a common production/marketing plan for a particular product for an identified market. Each cluster has a designated lead farmer, usually the commercial farmer, who coordinates the production processes at all the farms involved in the cluster. The lead is also responsible for training the other farmers in production techniques so as to maintain the quality specified by the market.

In the beginning the small farmers were unable to comply with the quality and consistency of supply as demanded in the market. Many problems occurred which put the organization under considerable pressure from the clients. The commercial farmers responded by temporarily growing an additional amount of vegetables to counterbalance any lack of supply from the small farmers. This gave the small farmers the time to learn how to produce in accord with the required standards, while at the same time the clients remained pleased with the business relationship.

Normincorp has become preferred supplier for several clients due to its ability to respond to changes in market requirements. Normincorp is handling between 30 and 40 tons of assorted vegetables per month. With the recent opening of a distribution centre in the urban market, the sales volumes have doubled to 80 tons in July 2006.

Source: Concepcion, Digal and Uy (2006)

A fourth key challenge is to engineer alliances with companies downstream in the chain to act as "institutional host" (cf. Altoé, 2006). The private sector is generally seen as having a passive role, buying products when available at the right quality, price, risk profile and transaction cost. They are reluctant to play a role in the pre-business phase, when investments are needed in farmers' capacities. But experiences with Fair Trade show how effective downstream companies can be in building the capacities of small farmers for participating in value chains. Obviously mainstream companies cannot be expected to make similar investments as Fair Trade companies. But they can make important contributions by being more flexible than in normal business relationships, e.g. by sharing information and expertise, testing products and providing feedback, placing early pilot orders, accepting temporary errors, etc. It is an enormous challenge to build capacity in mainstream companies for coaching and developing small suppliers. There are exciting experiences, such as the Chilean program that supports agribusinesses in developing the capacities of small-scale suppliers. But in general the existing programs for poverty alleviation through the private sector have low ambition levels and therefore fail to unleash this potential. There is an urgent need to develop instruments, methodologies and best practice in this field.

A fifth challenge is to foster public policy environments that are favourable to market participation of small farmers. Obviously the elimination of trade barriers, subsidy schemes and dumping practices by the EU and USA will greatly improve the market opportunities for small farmers in many parts of the world. It is discouraging that the WTO negotiations have not significantly reduced these market distortions, while at the same time LCDs are rapidly deregulating their economies (World Bank, 2006). But an equitable world market system does not suffice. There is a need for specific policies to enable market participation of small farmers. Note that not a single OECD country has witnessed agricultural growth without significant public support schemes. Some of the classic policies required for good RPO performance are transparent market regulations (including price information), land tenure policies, rural infrastructure, cooperative law, to name but a few (IFAP, 2004). As there are little systematized insights, Regoverning Markets is collecting evidence on innovative policies such as competition policy, codes of conduct, zoning laws and planning ordinances, support to contract negotiation and management, laws and regulations governing the food wholesale or retail sector, industry ombudsman, franchise laws, etc.

A final challenge is to promote more effective exchange of experience, information, and mutual learning. Significant resources are lost in developing solutions in isolation from good practice and lessons learned elsewhere. There is a need for more systematic documentation of experiences and a practical way to make these experiences available to interested stakeholders.

5. Conclusion

This paper has argued that, in a global liberal economy, pro-poor market development is more than merely providing market access to small farmers. It is about empowering small farmers to upgrade their position in the value chain so that they appropriate a greater share of the returns and protect themselves from declining terms of trade. In the past too much emphasis has been put on vertical integration by RPOs, in the assumption that 'shortening the chain' would lead to high added-value for farmers. However, without some degree of control over chain governance, RPOs remain vulnerable to cost/price squeezes and changing consumer preferences. It is vital that RPOs build capacities for participation in chain management processes, such as the targeting of market segments and the definition of grades and standards. Five key challenges have been identified: (1) effective support mechanisms that avoid the pitfalls of paternalism; (2) an organizational culture of entrepreneurial professionalism; (3) effective leadership at farmers' level; (4) private firms as 'institutional hosts'; (5) favourable policy environments; (6) effective exchange of experience and mutual learning. Significant public investments remain a prerequisite.

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