How to do

Strengthening community-based commodity organizations

Strategies and organizational design options for optimizing smallholder farmer engagement with the private sector

IFAD
Investing in rural people

Smallholder institutions and organizations

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Kenya - Smallholder Horticulture Marketing Programme

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List of acronyms

4Ps	public-private-producer partnerships
CSR	corporate social responsibility
EADD	East African Dairy Development
JLG	joint-liability group
KASCOL	Kaleya Smallholders Company Limited
KSFA	Kaleya Smallholder Farmers Association
KTDA	Kenya Tea Development Agency
LLC	limited liability company
MFI	microfinance institution
NAT&L	Nghe An Tate & Lyle
PPP	public-private partnership
VOCGA	Vanuatu Organic Cocoa Growers Association
VBARD	Viet Nam Bank for Agriculture and Rural Development

Introduction

With populations growing, fast emerging middle classes are demanding quality produce, luxury goods (tobacco, alcohol) and animal proteins, and there is pressure on domestic agricultural production to meet these needs. Smallholder farmers, those producing on less than 5 acres, remain the backbone of agricultural production: smallholder farming is the livelihood of more than 50 per cent of the population in most developing countries. With this rising demand, agribusinesses, both local and multinational, are growing and increasingly seeking to source production from smallholder farmers. While such business relationships have been formally occurring for decades in certain export crop value chains, there is now growing pressure from export market countries for “fair trade” and “sustainably produced” products, which actively engages those at the base of the pyramid.

Given this growing potential, how can smallholder farmers make decisions to optimize their relationships with businesses along the agricultural, and other, value chains? This How To Do Note examines parameters affecting how smallholder farmers engage with business to maximize new opportunities; provides a decision tree for smallholders when entering into relationships with aggregators and businesses; and examines the potential challenges faced by both parties.

Key issues

From the onset of designing an initiative, development practitioners and implementing partners need to thoroughly investigate and understand how farmers are currently working through direct discussions and exploration into upstream and downstream value chain access. Practitioners must be able to identify the current situation, why farmers have not previously engaged with the private sector, and what goals the farmer groups seek to achieve through closer linkages with businesses.

The challenge

For effective interactions between farmer organizations and business, farmers and development practitioners need to understand what organizational structures make the most sense and will provide the best platform for long-term success and financial viability. Once a sound analysis has been undertaken of the proposed farmer organization and its enterprises, this guide can be used, through the decision trees, to determine the best structure.

Opportunities

Smallholder farmers producing crops and livestock across Asia, Africa and Latin America provide opportunities for local and international businesses to source high-quality products and support economic development. With demand for food increasing as populations shift from rural to urban areas, potential food crises loom, crises that could be mitigated by the increasing productivity of smallholders attracted to the profitable market offered by businesses. To access the commercial sector, farmer groups can engage with businesses operating broadly across agricultural value chains, including importers and exporters, processors, traders, buyers, banks, financial institutions and agribusinesses, or reach directly to the end consumers by conducting value added processing and marketing themselves.

Linking with businesses provides smallholder farmers with an array of benefits, including extension services, agricultural inputs (seeds, fertilizer, agrochemicals, etc.), transport free-of-charge or on credit (FAO, 2004), a reliable income, improved buying power at scale and a means of transitioning from subsistence to pre-commercial and commercial farmers. While businesses sourcing from smallholder farmers may have social benefit motives, the underlying incentive and reason for engaging farmers is often business and profit. In most cases these companies will act rationally, based on developing a long-term, reliable, sustainable, stable and high-quality production sourcing value chain with the farmers. Having smallholders and farmer groups/organizations engaged in quality production, and on professional terms, is in the long term the most profitable approach for both the farmers and the companies – a "win-win" situation.

Box 1. Broader aims of collaboration between the private sector and smallholder organizations

While maintaining the underlying business interests of the partners, such collaborations can also strive to fulfil certain broader aims, including:

- Designing business collaborations wherein farmer group representatives are better positioned to negotiate with businesses on contracts and other agreement terms – making it more likely the terms will be fulfilled by the smallholders, with less need for arbitration.
- Enabling smallholders to be integrated into the management and decision-making of aggregator organizations (professionally run farmer groups or societies)
- Ensuring compliance on social and environmental standards
- Linking to corporate social responsibility (CSR) initiatives from business to improve the well-being of the rural community where production is sourced as well as building "social capital" and trust in the business collaboration with the local population. Common initiatives include supporting health, education and water services.
- Ensuring consistent delivery of production from farmers, including rewarding loyalty and quality supply. Some firms offer benefits in addition to a fair market price, such as health coverage schemes and compensation for funerals.
- Developing a culture of respect for contract law and the enforcement of agreements, without the need for legal intervention or arbitration.

The 4Ps – public-private-producer partnerships

With this growth in smallholder farmers more effectively accessing the local and international private sector, the conventional public-private partnerships (PPPs) can be reimagined as public-private-producer partnerships (4Ps) (IFAD, 2015). IFAD is leading development programming regarding the 4Ps, with the main objective being to increase small producers' access to markets and improve their livelihoods sustainably through the promotion of private-sector investment in the smallholder agricultural sector. Semi-commercial smallholder producers (those farmers between the commercial and subsistence segments) have the greatest potential to become reliable partners for the private sector in long-term business relationships. The farmers discussed in this paper largely occupy this segment. These smallholders offer opportunities for productivity and quality increases and for going to scale, if they can access production factors, markets and technology, and reach the level of internal organization required – the latter being what this note focuses on. Private companies, at both international and national level, are targeting this segment to expand their supply base. This provides IFAD with an opportunity to address the viability gap by gradually reducing the transaction costs of doing business with smallholder farmers through the financing of some of the public and semi-public goods required to make a specific value chain viable for smallholders.

Key principles for farmer decisions – parameters

With increasing demand for processed agricultural goods in domestic markets, as well as a global emphasis on sustainably sourcing and supporting smallholder farmer development in emerging markets, smallholder farmers are realizing opportunities to better capitalize on their production. However, to optimize and stabilize income, farmers must be able to evaluate how to best engage business. Developing the right farmer organization for the sales opportunity is critical to levelling the playing field with the savvy bigger company and to ensuring a secure and profitable arrangement. From the farmer's and the business partner's perspectives, there are a number of criteria influencing the optimal structure of engagement. The following subsections detail particular parameters relevant when farmers (and external advisory organizations) are evaluating possible engagement structures that support farmer decision-making.

Box 2. Processing requirements dictate value chain organization – tea

The key factor with these crops is how quickly they need to be processed after harvest. Tea requires that the leaves reach the factory for processing within six hours of picking, and tobacco must be cured immediately after harvest. The degree of processing, and the up-front investment necessary to establish the infrastructure to carry out quality processing, also dictate how much value addition farmers or farm groups can do prior to the production being sold to business – and the degree of ownership farmer groups can have in the infrastructure. Since these crops are also vital for foreign exchange earnings for national governments, there are often government agencies regulating the production, processing, and selling of the crop. These agencies may bring farmers together in various types of groups to better facilitate access to inputs, extension services, processing, quality control and sales.

Type of crop/product

The type of product the smallholder farmers are producing is the first key factor in determining collaboration options. For this paper and the decision tree, these crops are divided into:

- Processed export cash crops (e.g. coffee, tea, tobacco);
- High-value perishable crops (e.g. horticulture, dairy);
- Medium-value cash crops (e.g. sorghum, potato, sunflower);
- Staple food-security crops (e.g. maize, beans/pulses).

Processed export cash crops in many cases provide the clearest option for a formal relationship between farmers and businesses. Coffee, tea and tobacco grown in East Africa provide examples from past decades of farmers, in varying degrees of aggregation, selling production for export. Since these crops are for export, the contracting business often engages directly for quality control. Many of these crops are sold at national auctions. Currently, numerous agribusinesses source raw production via contract farming such as outgrower schemes (described later).

Box 3. Dairy perishability and optimal farmer organization structures

Dairy milk, as a high-value product, has many options for sale in its raw form or as a value added product. These sale options provide a range of organizational structures that farmers and farmer groups can evaluate and pursue to maximize potential benefits, depending on factors such as available capital and processing abilities, among others. Fresh milk, apart from home consumption, needs to be delivered to a collection centre linked with a chilling plant within hours of production, so dairy farmers must have a relationship with an aggregation point, often on a formal basis through farmer-owned and farmer-operated cooperatives. However, with milk there exist more options for selling, including to traders at the farm gate or to other nearby competing cooperatives; these options affect the farmer groups and how farmer aggregation and milk collection is done. In order to create loyalty and ensure a consistent supply to a particular farmer cooperative or milk processor, beyond offering a good price, farmers may access “credit, extension services, as well as … assistance in establishing produce collection centres” from the milk processors/business (FAO, 2004).

While most dairy farmer cooperatives sell directly to large dairy processors, there are increasingly options for groups to own the chilling plant and do value added processing to produce yogurt, butter or milk for local shops, restaurants and food services or vending machines. The choice to go into processing depends on an assessment of local market demand, current players operating in the anticipated space, investment capital available, farmer group size, and risks farmers are willing to take. Selling directly to a processor provides a guaranteed market for their milk at the current market price. However, this price can greatly fluctuate during the course of the year, while prices for value added production may remain more stable and provide a higher profit margin for smallholders. In India, Amul (www.amul.com) – the apex organization of the dairy cooperatives of Gujarat – has increasingly diversified the value addition activities it supports, and now offers several dozen different products processed to varying degrees. Its sales have grown by 187 per cent over the last six years, reaching US$5 billion and making it the 13th largest dairy organization in the world (International Farm Comparison Network, 2016).

High value perishable crops, such as horticulture and dairy, already have fairly organized value chains linking to domestic and international businesses, though there are considerable opportunities to scale up current relationships to engage more smallholders. Developing countries have provided Europe and the Middle East with fresh produce, such as French beans, for years. Several export companies engage farmers at an individual level, aggregated into collection centres for ease of collection, quality control, training, etc. The combination of high value and perishability necessitates quick delivery and increases the difficulty of side-selling by farmers outside of the contract. The organized supply chain creates a stronger connection between sourcing smallholder farmers and the business. Since horticultural crops mature quickly and have several seasons a year, partly due to irrigation, the farmer receives more regular income and the buyers a relatively reliable supply. Outgrower and other contract farming schemes, where farmers are formally or informally contracted to produce for a business, have been an effective model with several of these crops.

Box 4. Contract farming in Mexico illustrates differences between types of crops

Some similarities and some differences emerge from the analysis of the variety of contractual relations in grain and vegetable production. The frozen vegetable industry resorts to contract farming mainly in order to assure continuous supplies of products that meet certain quality standards, as does Impulsora Agrícola in the case of barley and Cargill in the case of wheat. For other grain-buying companies, the main incentive is to obtain government-sponsored subsidies, either at the production stage or in the process of marketing.

Contract farming is significantly more important in the case of vegetable products than in grains, in part due to the dependence of American vegetable-processing companies on production in Mexico, while grain purchasers can obtain supplies through imports from different areas of the world. The perishable nature of vegetables is another factor that explains this difference.

In the case of vegetables, contracts are exclusively individual, while grain-production firms look to establish relationships with producer organizations, especially when the individual growers are small-scale. With the exception of barley, which has been produced through contracts since Impulsora began the practice in 1958, the expansion of contract farming in grains emerged in the mid-1990s, thanks mainly to government policies. This contrasts with the case of vegetable production, where the sector has expanded solely due to the initiative of private companies.

Source: Echánove and Steffen, 2005.

Medium-value cash crops, such as sorghum and sunflower, are not as high value on a per kilogram basis as coffee or tea and usually do not have international export potential. They do provide farmers with options for selling and relationships with local businesses through offtake arrangements with private companies. These crops may require processing, although they can be used locally in a raw state: for example, sorghum can be consumed locally or processed into beer, and sunflower is used for oil extraction.

Staple food-security crops, such as maize, rice (in some regions), beans and pulses, are often grown for home use in addition to selling any surpluses on the open market. These crops often have lower value per kilogram, with a high transport cost relative to their market value. They are grown widely across regions during certain seasons. These elements can make formal contract-selling production from farmers to businesses less likely than with higher-value crops. For these staple crops, selling to businesses may be through local mills or traders who come at harvest to buy any surplus at the farm gate at market price, or farmers may take their production to the local market for sale.

Box 5. Farmer organizations as supported by government agencies and NGOs (non-governmental organizations)

A government agency may organize farmers into cooperatives of farmer groups to promote the production and export of foreign exchange-important commodities (coffee, tea, tobacco). This agency may initiate the relationship between farmers and farmer groups and businesses, and may put in place policies to protect smallholder interests when negotiating with multinational businesses. The agency may also control the selling of production through a regulated auction organized by farmer-owned cooperatives or factories.

NGOs with the social objective of improving farmer livelihoods may devote time and resources to helping farmers develop formal groups and structures in order to more equally establish and maintain linkages with businesses. In some cases, NGOs help farmers set up collection or processing facilities, as is the case with the East African Dairy Development (EADD) initiative in Kenya, through which smallholder dairy farmers can attract contracts with business processors as a formal business unit.

Farmer land size

When individual farmers are evaluating the most effective ways to move into the more formal agricultural value chain, one initial factor is the land size the farmer has under production. In most cases, the smaller the farm size/production level, the more need for farmer group aggregation in order to engage sourcing businesses. These groups can also collectively buy inputs at greater volumes, giving greater purchasing and pricing power in the market. By joining a farmer group, the individual farmer minimizes the negative aspects of small land size to the point that the size becomes unimportant. For example, in the horticultural sector of Kenya, farmers producing on plots of less than 0.25 acre can work in groups that are then contracted by exporting businesses. While a farmer may have an individual contract, the set-up is only possible because the farmers are in groups for training and bulking production. The farmer group, either operating as an aggregation point or as a registered business entity in its own right, enables smallholder farmers with any size of landholding to become commercial players on the market, able to access contracts, new markets and profitable means of supporting their livelihood and expanding their production.

How farmers can organize

For smallholders to create any farmer organization (cooperative, collection centre, processing society, limited liability company [LLC], partnership, informal bulk input purchase association, etc.) there needs to exist a degree of trust between area farmers, together with an acknowledged common goal. When determining the optimal way to enter into new engagements with business, farmers need to be aware of the status quo regarding farmer aggregation in the area. Possibilities of pre-existing arrangements include:

- Farmers with historic distrust of farmer groups, no groups present
- Farmers formed into village groups through government agencies/programmes
- Farmers in voluntary groups making some decisions together and providing a basis for group training
- Farmers in voluntary groups, with bank accounts, collective buying
- Farmers in voluntary groups conducting collective buying/selling/processing, acting as a formal business unit that can hold contracts on behalf of all member farmers

External support for farmer organizations

When there is an existing group of farmers, it makes it easier to engage with business, though often such groups of willing farmers are formed when there is an opportunity to more effectively access markets. To better access particular international markets, or to enhance local production, external stakeholders, such as domestic government agencies or NGOs, may play a role in creating farmer groups in various formats.

Farmer aggregation structures

There are numerous options for farmers to organize in order to engage business and access commercial markets. Benefits of farmer organizations include the ability to share information/ideas, pool resources, gain greater bargaining power, access markets, act as a market aggregator or intermediary, be a communication vehicle for international development and government services, access wholesale inputs and share transportation costs, among others. The detailed options below are ranked from the least amount of farmer coordination necessary/least formal structure/quickest to set up, to the most professional farmer company structure. The descriptions also include the level of farmer coordination necessary, start-up costs/legal processes, level of legal authority to enter into contracts, type of ownership possible by farmers/international business interests, and the type of government involvement. Note: the exact definitions and legal structures of different farmer organizations are based on local regulations and may vary greatly across countries and regions. The above examples are based on the authors’ experiences and research in East Africa, in particular Kenya, Rwanda and the United Republic of Tanzania.

Numerous other farmer organization structures are possible beyond the cooperatives, LLCs and outgrower organizations focused on in this How To Do Note. Informal farmer groups, farmer associations and national entities with government-sanctioned control are explained in more detail in annex A.

Farmer outgrower schemes

Farmer outgrower schemes are an increasingly popular way for agribusinesses and other companies to source raw production from smallholders. The sourcing agribusiness may set up a local factory or mill with smallholder production that can be bought at the farm gate or directly through contracts linked with benefits. Such schemes often have nucleus/large-scale farms owned by the agribusiness, better enabling the firm to extend input financing, output markets, extension advice, management services, processing and packaging, transportation, and water to the local smallholders. Outgrower schemes address key constraints that torment smallholder agriculture; the contracting company provides services to smallholders with an interest in the pooled volume of products for the purpose of processing and marketing. Farmers may have individual contracts with the company and/or produce on leased land near the nucleus farm. Zambia Sugar Plc provides a case study on effective smallholder outgrower structures.

Box 6. Zambia – sugar outgrower organizational evolution

Zambia Sugar Plc is the biggest producer and processor of sugar in Zambia, with exports to the European Union. Its growing smallholder-sourcing programme was founded in 1980. The smallholder farmer outgrower links were facilitated through the government's willingness to invest in public water and infrastructure. Kaleya Smallholders Company Limited (KASCOL) is a private LLC with joint ownership by Zambia Sugar, Barclays Bank, Commonwealth Development Cooperation and the Development Bank of Zambia that serves as a farmer-focused aggregating company for smallholder products. KASCOL is the oldest of the smallholder groups, supplying 2,156 hectares of cane, of which 1,070 hectares are grown by 161 smallholders and the remainder run as an estate.

Each outgrower has 6.0-7.5 hectares under a 14-year lease and is supplied with training and extension services, agricultural inputs, mechanical services, cane harvesting and irrigation water. The smallholders are responsible for caring for the infield irrigation, weed control, fertilizer application and removal of diseased cane stalks. Farmers have to sign a cane growers agreement (CGA); sugar cane grown by smallholders is collected by KASCOL, bulked with the estate cane and sold to Zambia Sugar under a single agreement. The outgrower smallholders established the Kaleya Smallholder Farmers Association (KSFA) to mediate all issues pertaining to the farmers. KASCOL is managed by a board of directors on which KSFA is represented. A management team headed by the estate manager leads the company administration, and KSFA has an elected management team for the farmer association (Bangwe and Koppen, 2012).

Farmer cooperatives and processing societies

The most common way of organizing farmer groups is to form a cooperative. As with the other organizational categories, there is a range of tasks this farmer group can undertake, but it often involves formal membership, with farmers paying some kind of membership fee or delivering/selling production through the cooperative. Dairy cooperatives are important to the value chain, especially in East Africa, with farmers delivering their production on a daily basis, accessing credit and improved animal health products through the cooperative's shop, and then being paid at the end of the month for what they delivered (less any fees/product costs). The bulked and chilled milk is then sold on contract to a larger business dairy processor. This contract gives the farmers the stability of a guaranteed market, though often with prices that fluctuate in response to market forces on a daily basis. Other farmers can deliver milk to the cooperative without being members, but they do not benefit from profit-sharing on yearly earnings that are not reinvested into the infrastructure.

Farmer processing societies are created for higher-value cash crops (such as tea and coffee) with processing needs, and which have clear markets and business interest. The processing allows the smallholders to create more value than just selling the raw production, and for some crops it is necessary to process the crop before it can be transported to market. For example, with coffee production there is an up-front capital requirement to build the facilities where farmers can bring their ripe cherries for washing, fermentation, cleaning, drying, sorting and packing. Sometimes this capital is supplied on loan from banks, or from the government or NGOs. This “factory” may be owned by a cooperative as a business unit or by an outside business. The factory would then sell production to businesses directly or at auction, depending on local regulations.

In some countries, cooperatives are negatively perceived by financial institutions, due to the risk of credit default. This is partly due to governments setting up cooperatives without the necessary capacity-building and internal controls to ensure the farmer organization operates as expected. Banks may prefer to lend to farmer companies over cooperatives since companies have a clearer and more liable management structure in case of legal action. While this perception varies by country and region, it is a factor that should be investigated and considered when determining if a cooperative is the optimal structure, or if a more formal management structure would enable the organization to better access credit from the financial sector.

Box 7. Vanuatu Organic Cocoa Growers Association (VOCGA) umbrella apex marketing cooperative

VOCGA was set up when a proposal to establish a producer organization to facilitate the development of a certified organic cocoa production base was prepared by a private company and accepted for funding by the French government. The cooperative was established in 2000 and first received Ecocert organic certification in 2002. VOCGA operates as an umbrella apex marketing cooperative under which there are 10 primary cooperatives that supply organically certified dry cocoa beans. Each primary cooperative operates one or more centralized fermentaries; there are 25 processing facilities in the VOCGA network. Each processing centre operates as a separate registered cooperative with its own management committee. The POP and POPACA projects supplied the initial processing infrastructure of driers, fermentaries and storage sheds. However, some of these units have been subsequently rehabilitated by VOCGA and in some cases expanded. VOCGA now has a total of 1,205 members.

Source: FAO, 2009.

Limited liability companies (LLCs)

Farmer groups can be created as registered companies, often LLCs, with professional management hired (sometimes including some farmer members) to manage the commercial interests of the smallholders. This happens in specialized cases, such as when the organization is vertically integrated, with sourcing from member smallholders (and others) through to marketing and distributing the product to end consumers. When farmer groups structure an LLC, they may also want to act as intermediaries in the market, focusing on distribution of value added goods.

Box 8. Viet Nam – Nghe An Tate & Lyle (NAT&L)

Nghe An Tate & Lyle is a joint venture between a local state-owned company, Nghe An Sugar Co., and an international consortium, Anglo-Vietnam Sugar Investments. It operates a factory in Viet Nam's north-central coast region. Most of the growers in the region are subsistence farmers and therefore unable to invest in a new crop. Credit is an indispensable component of cane growing since it takes about 14 months between planting and harvesting the first crop. The total investment for a new crop, including land preparation, seedlings and fertilizer, ranges up to US$300 per hectare. Foreign investment in the sugar processing industry of Viet Nam came in response to strong domestic demand for soft drinks and confectionary and ice-cream products.

The joint venture project focused on the disbursement of working capital to growers in the form of short-term loans. NAT&L covered expenses for a total of 2,000 hectares, providing either cash subsidies worth US$65 a hectare or free seeds and fertilizer worth about US$300 a hectare. Since credit distribution to a large number of clients was very expensive, it was decided to form member joint-liability groups (JLGs), each consisting of about 50 members, governed by a board. To reduce handling costs, starting capital was disbursed from the district office of the Viet Nam Bank for Agriculture and Rural Development (VBARD) to the JLGs. Thereafter, each group became responsible for disbursement to members. JLG members shared liability for credit and repayments, and savings were mandatory. In the initial stages, the liquidity of the group was equal to the total amount of initial and compulsory savings. When this amount had fallen to 10 per cent of the total balance, the surplus could be used for lending to members. Loans or starting capital from VBARD's district branches to the groups were repaid in instalments over four years. The local government invested funds in promotion of cane growing and provided a subsidy of US$28 per hectare to those wishing to engage in cane cultivation. The distribution of credit was integrated with advice on financial management and other training.

In 2004 the total number of growers had increased to more than 18,000. Foreign direct investment provided opportunities for smallholder producers after they were organized into JLGs. An extensive credit programme, offered as a package with training, was an essential ingredient for the successful organization and integration of smallholders.

Source: Boselie and van de Kop, no date.

Guidance for design/implementation, with farmer decision tree diagrams

The following decision trees, divided by type of crop, are intended to help implementing partners and others choose the appropriate farmer group structure to be pursued, based on several key decision points. This is not an exhaustive decision diagram, but is meant to inform key decisions that need to be discussed and analysed prior to moving forward with an organizational design. All decision trees assume that there are enough farmers in the area growing the crop willing to be involved in a farmer group and that there is a basic level of trust and acceptance of mutual goals between the farmers, with no major land tenure issues.

To use the decision tree in deciding what form a potential farmer organization should take, start with the target crop to be produced. These are broadly divided into high-value export crops, high-value perishable crops (some of which can also be exported, at a higher cost) and staple food crops. In the below sections, start with the first question under the crop type heading and then go to the yes or no answer that best fits the farmer's scenario. Progress through the options, answering and moving on with increasing detail. Note this is not an exhaustive list of possible scenarios. Bear in mind that sourcing technical assistance on production and processing will be important and may influence farmer organization.

High-value export cash crop

Initial question: Is there a national/government board/agency, or an industry-wide organization (umbrella organization) involved in farmer training, establishing groups and linking to markets?

Yes

- If required, assemble an informal farmer group for initial discussions with the umbrella organization.
- Individual farmers attend umbrella organization meetings and express interest.

For the above two options: Is there financial and capacity-building support available to set up a farmer cooperative/processing society with processing facilities?

Yes

- Set up the farmer cooperative/processing society as a business unit with processing facilities sourcing from member farmers and others in the area. Bring in professional management to advise on the business, with clear farmer interests in mind, and apply for necessary certification from the government body. Use the umbrella organization to make linkages with buyers of processed goods or establish a strategy to sell through national auction (regulation-dependent).

No

- Set up a farmer association (formal registration, small capital required, clear management in place – potentially elected) that is linked by the umbrella organization to deliver raw production (with or without a formal contract) to a local processing operation – may be owned by government or by sourcing businesses.

  To set up a farmer association: 1) check the legal requirements; 2) conduct a needs analysis; 3) convene a formation meeting; 4) choose manager(s)/office bearers (president, secretary, treasurer); and 5) register.

No

- If there are NGOs/international organizations interested in establishing a value chain for smallholders in the farmers' area:
  - Apply to have a group of farmers included in the project.
    - If the project requires an established group, set up a farmer association.
    - If the project allows informal farmer groups, join the project.

    For both the above options: engage in project trainings, capacity-building, and set up a farmer-owned cooperative with a processing plant to enable contracting with businesses.

    To set up a farmer association: 1) check the legal requirements; 2) conduct a needs analysis; 3) convene a formation meeting; 4) choose manager(s)/office bearers (president, secretary, treasurer); and 5) register.
- If there is agribusiness (usually exporters or their agents) actively sourcing from smallholder farmers:
  - Contract individually for raw production with agribusiness, no group needed (no capital required, minimal time, no group security).
  - Be grouped into informal farmer groups by agribusiness for means of sourcing raw production and training, depending on agribusiness requirements (no capital required, minimal time, non-intensive management structure, no formal registration).
  - Set up a farmer association to aggregate production and negotiate contracts with agribusiness (formal registration, some capital required, clear management in place – potentially elected).

    To set up a farmer association: 1) check the legal requirements; 2) conduct a needs analysis; 3) convene a formation meeting; 4) choose manager(s)/office bearers (president, secretary, treasurer); and 5) register.
- If there are large-scale nucleus estates in the region with smallholder outgrower sourcing programmes:
  - Individual farmers or informal farmer groups approach the smallholder programme to be contracted as outgrowers. Produce on leased company land or on farmer's own land and deliver harvest to estate for bulking.
    If the outgrower scheme is structured by farmer associations, set up an association to take part in the scheme, thus ensuring the farmer representatives have a voice in outgrower scheme decision-making with the estate management.

No (cont.)

- If the farmers in the proposed group have substantial assets to set up a processing operation:
  - ➲ Set up a farmer cooperative and pool resources to build a processing operation. This requires considerable resources, formal government registration/certification, clear management structure, formal loans for the financial structure, professional management, capacity to do processing, and linkages to buyers in the market for either minimally processed goods or goods processed to a semi-final state. If doing value added processing, it may evolve into a limited liability company (LLC), enabling the farmer group to more easily brand and sell final goods or export goods.

    To set up a farmer cooperative: 1) check the legal requirements; 2) conduct a needs analysis; 3) elect a steering committee; 4) convene a formation meeting and raise awareness of cooperative principles; 5) choose the directors and hold a first meeting of the board of directors; and 6) register.

High-value perishable crops

Initial question: Are there existing collection centres and companies sourcing for the perishable crop nearby?

Yes

Can individual farmers supply to a buyer directly?

Yes

- Sell at farm gate or directly to supplier's agent at a nearby village based on prices and terms.
- Evaluate the benefits of individual sales versus group sales on formal contracts.
  - ➲ If farmer associations can garner a more guaranteed market, or access to additional benefits, set up a farmer association.

    To set up a farmer association: 1) check the legal requirements; 2) conduct a needs analysis; 3) convene a formation meeting; 4) choose manager(s)/office bearers (president, secretary, treasurer); and 5) register.

No

➲ Set up a farmer association for product bulking, training and, potentially, access to inputs on credit.

To set up a farmer association: 1) check the legal requirements; 2) conduct a needs analysis; 3) convene a formation meeting; 4) choose manager(s)/office bearers (president, secretary, treasurer); and 5) register.

No

Sell to traders at farm gate.

Are there any NGOs or government agencies/umbrella organizations supporting this value chain and smallholder farmer sourcing?

Yes

Is there financial and capacity-building support available to set up a farmer cooperative/processing society with processing facilities?

Yes

➲ Establish the farmer cooperative/processing society (chilling plant) as a business unit with processing facilities that sources from member farmers and others in the area. Bring in professional management to advise on the business, with clear farmer interests in mind, and apply for necessary certification from the government body. Use an umbrella organization to make linkages with buyers of processed goods or establish a strategy to sell through national auction (regulation-dependent).

To set up a farmer cooperative/processing society: 1) check the legal requirements; 2) conduct a needs analysis; 3) elect a steering committee; 4) convene a formation meeting and raise awareness of cooperative principles; 5) choose the directors and hold a first meeting of the board of directors; and 6) register.

No

➲ Set up a collection centre managed by a farmer association (formal registration, small capital required, clear management in place – potentially elected), linked to an NGO or government agency that can help connect the farmers with sourcing companies or processor markets/processing operations.

To set up a farmer association: 1) check the legal requirements; 2) conduct a needs analysis; 3) convene a formation meeting; 4) choose manager(s)/office bearers (president, secretary, treasurer); and 5) register.

Is there a local group of farmers with substantial assets to set up a processing operation?

Yes ➲ Set up a farmer cooperative and pool resources to build a processing operation. This requires considerable resources, formal government registration, clear management structure, formal loans for the financial structure, professional management, capacity to do processing, and linkages to buyers in the market for either minimally processed goods or goods processed to a semi-final state. If doing valued-added processing, it may evolve into an LLC, enabling the farmer group to more easily brand and sell final goods or export goods.

To set up a farmer cooperative/processing society: 1) check the legal requirements; 2) conduct a needs analysis; 3) elect a steering committee; 4) convene a formation meeting and raise awareness of cooperative principles; 5) choose the directors and hold a first meeting of the board of directors; and 6) register.

Staple food crops and medium-value processed crops

Initial question 1: Are there businesses, including millers, sourcing production?

Yes

Are contracts available?

Yes ➲ Set up a farmer association (formal registration, small capital required, clear management) that can be contracted and then negotiate for access to inputs on credit.

To set up a farmer association: 1) check the legal requirements; 2) conduct a needs analysis; 3) convene a formation meeting; 4) choose manager(s)/office bearers (president, secretary, treasurer); and 5) register.

No ➲ Set up an informal farmer group (no capital required, minimal time, non-intensive management structure, no formal registration) to aggregate production for pickup by sourcing business.

Initial question 2: Is there a large-scale nucleus estate in the region with smallholder outgrower sourcing programmes?

Yes

- Individual farmers or informal farmer groups approach the smallholder programme to be contracted as outgrowers. They produce on leased company land or on farmer's own land and deliver harvest to estate for bulking.

  ➲ If the outgrower scheme is structured by farmer associations, set up an association to take part in the scheme, thus ensuring that farmer representatives have a voice in outgrower scheme decision-making with the estate management.

  To set up a farmer association: 1) check the legal requirements; 2) conduct a needs analysis; 3) convene a formation meeting; 4) choose manager(s)/office bearers (president, secretary, treasurer); and 5) register.

Initial question 3: Are there options for value added processing of the raw crop?

Yes

Does an existing group of farmers have substantial resources to set up a processing operation?

Yes ➲ Set up a farmer cooperative/processing society, with sourcing from farmer members and other smallholders, and with direct links to retail businesses for local sales and/or export intermediaries for international markets.

To set up a farmer cooperative/processing society: 1) check the legal requirements; 2) conduct a needs analysis; 3) elect a steering committee; 4) convene a formation meeting and raise awareness of cooperative principles; 5) choose the directors and hold a first meeting of the board of directors; and 6) register.

No Are there low initial resource value added options?

Yes ➲ Set up a farmer association that collectively works on value added production (sourcing from members or externally as a market intermediary) with linkages to businesses that will do additional processing, or linking directly to retail customers consuming the final good (depending on the degree of value addition possible). If required to extend services and credit to members, establish as a farmer cooperative.

To set up a farmer association: 1) check the legal requirements; 2) conduct a needs analysis; 3) convene a formation meeting; 4) choose manager(s)/office bearers (president, secretary, treasurer); and 5) register.

To set up a farmer cooperative: 1) check the legal requirements; 2) conduct a needs analysis; 3) elect a steering committee; 4) convene a formation meeting and raise awareness of cooperative principles; 5) choose the directors and hold a first meeting of the board of directors; and 6) register.

Initial question 4: Are there NGOs or government departments with an initiative to aggregate farmers in the area to better access commercial selling options?

Yes

- Farmers seek information on being part of project or government initiative.

➲ If the initiative requires an established group, set up a farmer association.

To set up a farmer association: 1) check the legal requirements; 2) conduct a needs analysis; 3) convene a formation meeting; 4) choose manager(s)/office bearers (president, secretary, treasurer); and 5) register.

➲ If the project allows informal farmer groups, apply to be part of the initiative.

Considerations and challenges of smallholder-business Interactions

> **Box 9. Kenya – farmer default**
>
> In Kenya, if a farmer defaults on a loan, the business, with police support, may seize the farmer's property (livestock, vehicles, other assets) up to the value of the outstanding loan. This course of action is usually the last resort as it is expensive to carry out; it can cause reputational damage to the business; and then the company must liquidate the assets. If the loan is not repaid due to factors beyond the farmer's control, such as extreme weather, implementing agricultural insurance may be an option to protect both farmer and business.

While there are success stories of smallholders having profitable and long-term relationships with businesses for a range of crops, there still are challenges to these relationships and opportunities for improvement. These are commercial transactions and while the farmer's livelihood will ideally improve as a result of the collaboration, there is an underlying profit motive for both parties. Businesses have other options for production, including sourcing from elsewhere in the world, setting up their own large-scale farms or working only with medium and large-scale farmers. In order to alleviate some challenges, the incentive structures for both farmers and businesses need to be recognized by those seeking to promote sourcing from smallholders so that this becomes the most beneficial option. Researching the literature on market linkages, the work sometimes referred to as "lead firm-driven smallholder inclusion processes" is also worth looking at for inspiration. The below list details select challenges that can be encountered.

- Contract law enforcement can be challenging if farmers fail to produce the contracted quantities, either as a result of negligence, factors beyond their control (such as weather, pests or disease), side-selling or poor yield performance. While a contract provides a certain degree of security for both parties, if there is the possibility of weak enforcement through the national legal structures, or farmers do not view the contracts as binding, the contract may not create as strong a linkage between farmers and sourcing businesses as intended. Having a conflict resolution strategy, communicated and discussed with farmer group management at the start of the relationship, is key. However, mutual trust is more important and can be developed through long-term "fair play" on both sides by means of reliable and fast payment, and reliable and prompt product deliveries (FAO, 2004).
- Side-selling happens when farmers are contracted by a business to produce a certain crop or quantity of that crop, but at harvest decide to sell their production to another buyer, therefore defaulting on the contract. This challenge is exacerbated when farmers are receiving inputs on credit and the loan is supposed to be repaid at the end of the season and deducted from the delivered harvest. Farmers may not deliver any harvest to the business and therefore default on the loan. At this point the business can either cancel the debt or pursue debt collection on the farmer. If the percentage of farmers defaulting is too high, it can compromise the business viability of engaging smallholders and then affect the business's long-term strategy.
- Reliable, consistent supply of high-quality production can be difficult when working with and coordinating hundreds or thousands of smallholders. Businesses often devote considerable time to training and demonstration plots to help farmers optimize production. For export crops, especially those with tight regulations in the receiving markets, like French beans to Europe, the business must conduct field monitoring of farmer practices to ensure they are in line with the contract. For example, if the farmers are contracted to produce organic vegetables, the company will monitor the farmers to check that all inputs used are in line with the specifications, and may do testing on the produce at harvest/delivery to ensure it will pass international standards. It can be challenging if the farmer's produce is rejected by the business for failing tests/standards laid out in the contract.

Some businesses establish secondary markets, with lower standards for this production, though the loss is often borne by the farmer.

- Clear communication of expectations, for both the smallholder and business, are vital in establishing standards on quality and quantity of production, applied methods of quality control, payment terms and delivery schedules. This can be addressed when the farmer group has representation in the business management, and vice versa. The farmer group can better understand the goals of the business and the challenges faced, and the business can ensure the farmer group maintains records; appropriately engages farmers to communicate on trainings, current contracts, delivery dates, quality standards, etc.; and processes payments to farmers quickly and transparently.
- At the farmer group level, suitable organization management is not always put in place from the beginning, and farmers may need to understand that it takes a specific skill set that not all farmers have to run an entity that interacts on a commercial basis. The group management should possess the necessary experience in commercial matters, professionalism, objectivity and financial understanding to give the group stability, while also being responsive to the farmers' interests/concerns and representing them accurately in negotiations. The people in these roles do not necessarily have to be farmers themselves, and their hiring should be a decision made by the farmer group.
- Land tenure issues should be considered by all parties involved – smallholder farmers, community-based commodity organizations and private sector actors. Under no circumstance should the envisaged organizational arrangement for collaboration make smallholder farmers more land insecure. There may be a need to make use of external tools for community-based capacity-building on how to analyse the land-related issues at stake prior to engaging with the private sector.

Box 10. Ghana and Sierra Leone – palm oil

Natural Habitats is a palm oil sourcing social enterprise operating in Ghana and Sierra Leone that contracts smallholder farmers to produce palm oil in a sustainable and environmentally conscious way. The company provides extension training to farmers, along with a guaranteed market and collection of production from the farm gate. This is the first phase of the collaboration with farmers and in the next phase, farmers will be extended input credit and additional training/monitoring as the company transitions to fully organic palm oil sourcing. With the organic production, the business is able to offer smallholder growers a better price as organic palm oil fetches a premium on world markets. It also creates a closer relationship with the growers by being the main offtaker for organic production. As the company grows, the relationship with the smallholders and types of associations the farmers form will likely also evolve. There are an increasing number of such examples, where companies can be built on sourcing from smallholders or established companies can add these farmers as key suppliers (Thornton, 2015).

Conclusions and strategic recommendations

Smallholder farmers in emerging markets are experiencing growing opportunities to sell their production beyond their local areas, reaching across countries, regions and international markets by linking with the private sector. Through a detailed decision-making process and awareness of options on the part of the smallholders and the organizations working with them, farmers can engage with businesses and financial service providers operating broadly across agricultural value chains and directly reach end consumers. This space of smallholder farmers transitioning from subsistence to pre-commercial to full commercial actors in the private sector will continue to evolve, as will their relationships with businesses that focus on long-term social good as well as profitability. While the decision tree may lead farmers down a certain path, stakeholders should be aware of the need to adapt to market and social forces.

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Thornton, A. 2015. *Natural Habitats*. Author interview.

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Resources on how to set up and manage a farmer co-op

http://www.fao.org/3/a-x0475e.pdf

http://www.daff.gov.za/doaDev/AgricDevFinance/GuidelinesForEstablishingAgricCooperatives.pdf

http://moodle.itcilo.org/mycoop/

Resources on how to set up and manage an LLC (by country)

http://www.dealpoa.com/register-agribusiness-company-kenya/#.VvKvIU0UXew

http://www.company-registration.in/llc-formation/

https://www.hg.org/article.asp?id=23739

Annex A – Other farmer organization structures

Informal farmer groups

Farmers in an area may gather on occasion with no formal structure or legal relationship for agricultural trainings from NGOs, extension services or the government, or to sell their production individually at a market. Such informal groups can allow businesses that prefer to have individual contracts with farmers to conduct outreach in a more cost-effective way.

Individual farmer sourcing is an option if there are no farmer groups established for a crop. Production is purchased at the farm gate, or through traders who buy from individual farmers, or through a farmer contract. In the least formal option, a trader simply comes to the farm or village market at harvest time and purchases crops at the market price. Another possibility is for a business to communicate to farmers at the start of the season that it will purchase all production of a certain crop, at a minimum quality level at harvest, either for a preset price or at the market value. The farmers are not contractually obligated to sell to that business, but they know there is a guaranteed market for their production. The business may supply training to farmers to improve production quality.

If there is a legal contract between the farmer and the business, the relationship will guarantee the farmer a market at a set price and the company a certain volume of production (or all the farmer can produce). In these relationships, businesses are often more likely to extend inputs on credit and advisory services. When the farmers deliver the contracted production to the business at the end of the season, any outstanding input loans are deducted from the harvest value.

Farmer associations

Farmer associations, in some cases known as self-help groups, can range from a loose group of farmers who collectively purchase inputs (seed, fertilizer, crop-protection products) in bulk for price and delivery benefits, to being a more formal and structured group able to access more formal credit and commercial markets. This is the least formal organization that can be registered with a government and receive official status as a group – a requirement to access certain contracts, industry assistance and donor support. The association, as a registered unit, can in some cases receive a loan from a microfinance institution (MFI) or bank for production and labour costs, which the farmers jointly repay at the end of the season. Some governments provide grants to farmer self-help groups to build internal “table banking” portfolios so the group can lend to members to start agribusiness activities.

While not an official business unit, and with fewer start-up costs and elected management requirements than the more formal cooperatives, this farmer group can aggregate to be a source of production for businesses in the agricultural value chain. Farmer groups may also aggregate and add value in ways as simple as cleaning their own grain (or buying grain from others) and packaging it for sale to local supermarkets. This type of value addition activity can drastically increase the profitability of farming and allow access to the outside commercial market, without having to go through an intermediary.

National entity with government-sanctioned control of specific crop procurement/processing

For high-value export crops, like tea and coffee, the national government may support the formation of an industry organization to control the processing and sale of a crop on the international market. This can evolve from farmer-group level organizations or start as a network of farmer groups producing or processing a particular crop. One example is the Kenya Tea Development Agency (KTDA), the umbrella organization of 46 tea factories in Kenya, fully or partly owned by 344,000 smallholder producers. KTDA manages the tea factories that area farmers bring their production to and then markets the tea internationally via the tea auctions in Mombasa. Farmers benefit from fertilizer and other inputs on credit from the factories, professional factory management, and the profits the factories earn from tea sales (FAO, 2004).

Annex B – Some lessons from IFAD’s experience

Farmer cooperatives and limited liability companies

Cooperatives are well known to feature the most egalitarian form of internal organization, and in most countries they adhere to at least the first four of the seven internationally recognized cooperative principles (http://www.coopscanada.coop/en/international_dev/about/What-is-a-co-op-). This means decisions are, under normal circumstances, based on consensus, and profits generated are distributed fairly (either in equal shares per member or proportionate to personal investment). This mode of decision-making may make cooperatives a bit slower to respond to market signals and to ensure individual members are able to diversify their production to seize opportunities. Of course, the cooperative principles should not be adhered to blindly and in a rigid fashion; for example, there may be times when to consolidate a certain line of business (e.g. for the supply of a specified quantity and quality of products under contract farming), the principle of voluntary and open membership may need to be suspended.

Other drawbacks include the fact that in many parts of the world they have a rather troubled history owing to often heavy-handed government involvement, a legacy that – although largely discontinued – may have done permanent damage to their reputation. Banks tend to be influenced by these factors, and may furthermore be reluctant to lend to organizations such as cooperatives. This is because in case of loan default and subsequent legal proceedings, banks cannot sue a person (such as, for example, the director of an LLC), but must press charges against the organization in question. Cooperatives, being registered, dispose of the moral personality necessary for them “to sue and be sued”, but banks are less likely to take them to court, not least because of a – often unfounded – fear of government interference. In terms of deciding whether to opt for this form of farmer organization, public-sector support may of course be important and sometimes necessary, particularly with a view to promoting the 4Ps.

IFAD’s experience with farmer cooperatives is generally positive, at least in situations where there is a strong dynamic for value chain development. Fairtrade companies tend to favour working with cooperatives and will reinvest a share of their revenue into the further development of the partner cooperative. Because of the need to advance slowly when a farmer cooperative is formed (so that all members, regardless of their individual capacities and competencies, are fully involved in cooperative governance, operations, monitoring, etc.), it is likely that about 10 years may be needed to arrive at a level of strong organizational maturity. Under a 4Ps arrangement, this is when public support may be terminated, after having been phased out gradually over time. During that period, the most important skills to transfer to the cooperative leadership are arguably those of understanding markets and market dynamics, being able to scout for new buyers if necessary, and engaging with them and negotiating contracts and technical assistance on an equal footing.

LLCs are the most common type of small business and as such all countries have established processes for forming and registering them, which may possibly be done online. As companies, these units have the advantage of being more easily geared towards a business approach to agriculture, shaped as they are by their owner(s). Decision-making power is invested in an individual or a board of directors, depending on the size of the company.

Informal farmer groups and farmer associations

For poor rural households, informal farmer groups and farmer associations present lower entry barriers and an opportunity for learning from others for capacity development and individual growth. The obvious limitation of informal farmer groups is that they are not registered and thus not entitled to receive financial support from the public sector or from the commercial banking system. Also, it may not always be easy to nudge them to evolve into a real business case because of a number of limitations, including that they may represent but one part-time, side activity of a typical rural household involved in a vast range of farm and off-farm activities. They are nonetheless the best starting point for beginning to work with IFAD’s primary target groups of poor rural households and individuals with the potential to improve their livelihoods through agricultural development.

IFAD's experience shows that, under certain circumstances, it is easier to craft "home-grown" local organizations by not trying to fit them into a pre-existing, formally recognized typology. Rather, keeping things informal, at least initially for a few years, can help build on local organizing practices that poor rural people easily identify with and are already used to. This fosters a greater sense of members' ownership over the group, promotes the inclusion of local knowledge and skills, and allows for it to be well embedded in the local institutional landscape at the community level. As genuine "grass-roots" institutions of a self-help character, informal farmer groups are a way of simplifying the "rules of the game" for these to become accessible to everybody, including illiterate and marginalized people. They are also easier to closely relate to basic family production units in agriculture, where intrahousehold division of labour exists between, for example, husbands growing crops or fishing, and wives processing and marketing the crops or fish.

Informal farmer groups can be an important first step towards forming a farmer association, which is a slightly more sophisticated type of local organization. These associations vary widely in terms of their characteristics and scope, not least because the legal and policy setting as well as regulatory frameworks for farmer associations are highly country-specific. Farmer associations typically endow themselves with a constitution and internal by-laws to govern their collective activities. Generally speaking, farmer associations are more flexible than farmer cooperatives and more inclusive than LLCs, and lend themselves to the broadest spectrum of partnership arrangements for engaging with the private sector, whether national or international.

Outgrower schemes and national entities with government-sanctioned control of specific crop procurement/processing

Depending on the commodity in question, outgrower schemes may need to follow industry standards, which provide the contours of how farmers may organize themselves, if they want to avail themselves of government sanctioning and support. This may not limit the options for empowerment of grass-roots organizations interested in becoming, adhering to, or organizing their own outgrower schemes.

See: https://www.ifad.org/documents/10180/f9551884-ab4f-4f7b-9108-52689ede13ce.

National entities with government-sanctioned control of specific crop procurement and processing include bodies such as national sugar boards. They are an integral part of policy and regulatory frameworks, and as "umbrella organizations" in most cases determine how affiliate entities are organized and, sometimes, even which shape they take. Typically, the latter involve other national-level as well as meso- and microlevel institutions, including, for example, sugar outgrower cooperatives and companies.

See, for example: http://www.sbt.go.tz/.

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