

Commodity value chain development projects

Sustainable inclusion of smallholders in agricultural value chains



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Guinea - The National Programme to Support
Agricultural Value Chain Actors

Value chain development and poverty reduction

Government and donor agencies increasingly use a value chain (VC) approach as part of their development and poverty reduction strategies and interventions.

There has been exponential growth in VC development initiatives over the past decade. Developing VCs is widely considered to be a suitable approach to inducing growth in rural areas, increasing marketed food surpluses and enhancing rural livelihoods.

In addition, the widespread alarm following the 2008-2009 global food price spike has driven more and more private companies to seek sustainable sources of raw materials and supplies, and to expand their outreach to poorer rural and growing number of urban consumers in developing countries as part of their strategies for building long-term business competitive advantage.

Background and context

What is a value chain?

A VC is a vertical alliance of enterprises collaborating to varying degrees along the range of activities required to bring a product from the initial input supply stage, through the various phases of production, to its final market destination (Figure 1). The term “value chain” is credited to the business strategist Michael Porter¹ and has been widely adopted in business and development circles.

The expression “farm-to-fork” is often used to describe food VCs. This means that a food product moves from upstream in the chain, where farmers grow and harvest it, towards the market – through intermediaries including producer organizations, processors, transporters, wholesalers and retailers – and on to the downstream level of consumers.



Source: World Bank, *Rapid agricultural supply chain risk assessment: a conceptual framework* (Washington, D.C., 2010).

Figure 1: A VC system

What is a VC approach?

A VC approach is based on a comprehensive look at the entire commodity chain, from producers to end-market consumers. Inherent to the VC approach is acknowledging that there are other stakeholders in the chain (in addition to IFAD’s target group) and that they are interrelated; for example, improved business opportunities for processors or other downstream actors can have a positive influence on IFAD’s target group. Sometimes, intervening at stages other than at the production level in the VC can have a greater impact on poverty reduction.

¹ M.E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York: Simon and Schuster, 1985).

What are the key elements of a VC?

The market is the basic driver of all VCs. Without market demand from consumers, there is no force pulling a farmer's production through the VC. "The possibility of achieving any development impact with VC promotion depends on the growth potential, the prospects for market expansion. Market demand and the interest of buyers are killer criteria in selecting a VC. Unless the final product can be sold and value-added increases, there is no additional income for poor people either."²

A VC serves a specific market. Different chains entail different opportunities and constraints for poor farmers: the costs of entering a VC serving export markets may be too high for a farmer who lacks the equipment and skills to ensure production of high enough quality for that chain; in contrast to this, a farmer's production may enter several diverse and sometimes overlapping VCs serving different sets of consumers in the end markets.

There is no single right or optimal way to organize a VC. However, there are ways of enhancing the small-scale producer's involvement in a VC, and this is the basis of IFAD's VC approach. A VC approach can imply a strategy of improving the product (e.g. quality enhancement) or the processes (e.g. more efficient production and organization of farmers, market information) so that producers capture a higher share of the profit margin within the chain.

VCs can be very dynamic, responding to shifting consumer preferences, competition, input costs and changes in technology. In some VCs, major actors and processes can shift from season to season.

Macrolevel factors (government regulation, quality of utilities) and **mesolevel factors** (industry standards, business association activities) play major roles in shaping the structure, functions and efficiencies of a VC.

VC actors and channels

In a commodity VC marketing system, there are actors (input suppliers, producers, processors, traders, consumers, etc.) and channels (the flows through which commodities move and are transformed, from production to consumption). In this system, farmers are linked to the needs of consumers and work closely with suppliers and processors to produce the specific goods required by consumers (Figure 2). Using this approach, and through continuous innovation and feedback between different stages along the VC, farmers can enhance their market power and profitability. Rather than focusing profits on one or two links, players at all levels of the VC can benefit. Well-functioning VCs are reported to be more efficient in bringing products to consumers and, therefore, all actors – including small-scale producers and poor consumers – can benefit from VC development.

Rationale

A majority of newly designed projects at IFAD are either VC projects or include a VC development component. In 1999, only 3 per cent of projects had a VC development component; by 2009, 46 per cent³ did and the figure is well over 50 per cent today.

The greatest increase in commodity VC projects occurred around 2005, at the same time as IFAD's Private Sector Development and Partnership Strategy was adopted. VC development projects now focus more directly on the private sector. This is a substantive change from the "farm-to-market" projects of the past.⁴ Most, albeit not all, earlier projects made support to cooperatives the key to market access for small-scale producers. In contrast, the current generation of commodity VC development projects seek direct collaboration with the private sector.

² GTZ, ValueLinks manual: The methodology of value chain promotion, first edition (Eschborn, Germany, 2007).

³ V. Raswant and E. Heinemann, Access to markets: making value chains work for poor rural people (Rome: IFAD, 2012).

⁴ Independent Office of Evaluation, IFAD's Private-Sector Development and Partnership Strategy, Corporate-Level Evaluation (Rome: IFAD, June 2011).

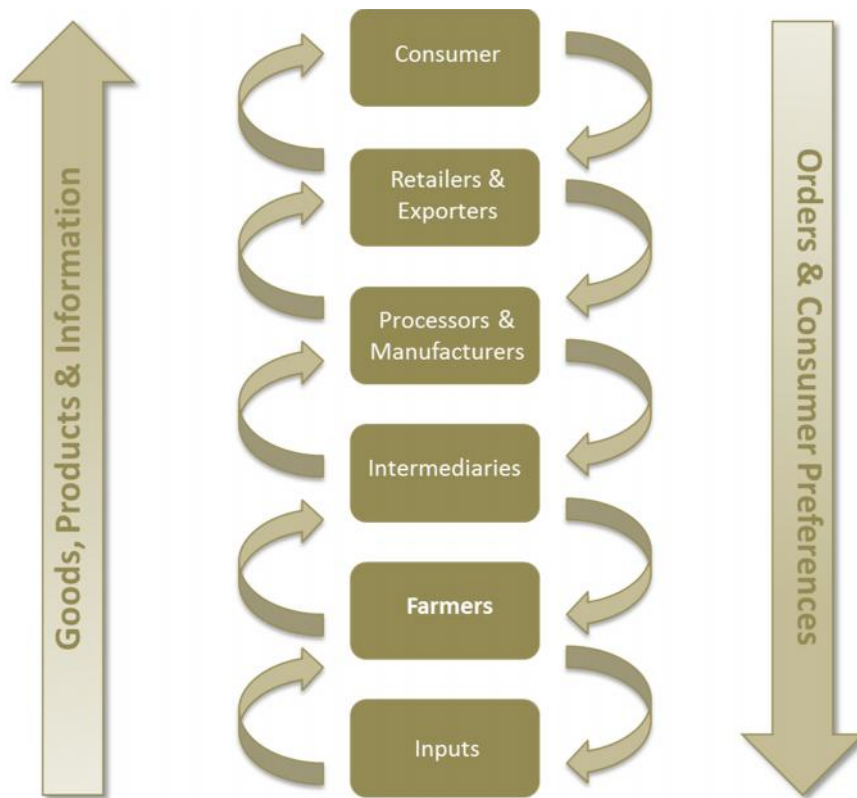


Figure 2: VC actors and channels

Support to commodity VC development in IFAD projects varies greatly from country to country and is commodity-specific. While some projects link small-scale farmers to supermarkets, exporters or large processing units, most projects work with small-scale farmers to link them to new and emerging chains. This variation results from the multiple roles of the private sector in different chains and the diversity of VC models. Most IFAD-supported operations, even when they are called “value chain development projects”, address only selected elements of a VC, with limited support to development of the overall commodity VC.

Highlights of past experience

The Lessons Learned brief on commodity VC development projects mentions many case studies from IFAD and other donor-funded projects. The following are some brief highlights:

- **Considering multiple VC intervention points.** The traditional entry point for IFAD projects is at the primary production level, i.e. building the capacity of IFAD’s target groups – including the more vulnerable groups – to gain access to markets and engage in business relationships along the VC. However, inherent to a VC approach is recognition that intervening elsewhere on the VC can have a highly beneficial impact on IFAD’s target groups. VC projects can, therefore, have multiple points of entry at different nodes (i.e. production, collection, processing, transportation, wholesaling, retailing) along the commodity VC. For example, improving the efficiency and capacity of processors or other downstream actors can create additional demand and higher prices for crops, with direct benefits for small-scale producers.
- **Taking a “win-win” perspective on the distribution of financial benefits along the VC** can often be a cost-effective way of increasing farmers’ incomes. A VC approach recognizes that the empowerment of rural producers may be promoted by assisting the buyers or processors that the farmers supply.

- **Creating incentives for the private sector to provide goods and services for small-scale producers rather than crowding them out.** Wherever possible, a VC approach seeks to create incentives for private companies to provide the necessary goods and services for enabling small-scale producers to expand their participation in the VC, as either suppliers or business partners. This has proved to be far more effective than relying on free-of-charge but often substandard or unreliable government services that risk crowding out possible private investments.
- **Promoting farm and off-farm microentrepreneurial development along VCs.** Support to microentrepreneurial development has often proved to be a key part of an effective VC development project, particularly when rural people face challenges to becoming involved in primary production because they lack assets and skills or when they are less interested in it (often youth). Microenterprises can also provide services and inputs (veterinary, equipment and maintenance, extension, etc.) that are a critical part of the VC upgrading strategy. Support to microenterprises has been effective in several IFAD-funded projects, including in Western and Eastern Africa.
- **Adapting a VC approach in constrained circumstances.** In certain circumstances, a VC approach may seem difficult or inappropriate. For example, food-insecure, isolated, resource-constrained rural populations in a recent post-conflict or insecure zone may appear to have little immediate opportunity to participate in VCs. In these circumstances, investing in building social, physical or natural resource management assets may be an essential activity that has food security and risk reduction benefits, while also laying the foundations for a population to participate in VCs as circumstances change.
Even in highly constrained environments, a VC approach can have a large pay-off for the rural poor if the appropriate right system and commodity are chosen, as in the saffron VC in Herat Province, Afghanistan.
- **Helping VC players build trust and understand the value of long-term relationships.** A critical success factor of any well-functioning VC is the level of trust and collaboration among its actors. Building trust and commitment to engaging in long-term relationships rather than looking for opportunistic, short-term, price-related gains is a key activity for ensuring the sustainability of a VC development initiative. This means promoting a transparent flow of information along the chain, communicating information about prices and quality standards to overcome typical information asymmetries between small-scale producers and private companies, and facilitating and brokering contractual arrangements that are beneficial to both parties. For small-scale farmers, engaging in a long-term relationship with a commercial partner often implies the possibility of receiving financial and technical support to improve their production capacity or the quality of their products and, consequently, their price. This support is often embedded in contractual arrangements (e.g. contract farming), as in Liberia and India.
- **Acknowledging the diversity of business models that allow the sustainable inclusion of small-scale producers in VCs.** Producer organizations are the typical entry point for IFAD projects (*producer-driven models*). However, evidence from the field and the literature shows that this model has limitations and alternative models (*buyer- or intermediary-driven models*) are equally effective in helping small-scale producers achieve the necessary economies of scale to access production factors and services and to efficiently delivery products. Whatever the option adopted (producer-, buyer- or intermediary-driven), some sort of organization of farmers is required. Farmers' organizations can reduce production costs by achieving economies of scale for procuring inputs, reducing produce collection costs, enhancing value-added through processing and better handling/storage, and helping producers cope with asymmetrical relationships in VCs. For example, in Nicaragua and Paraguay farmers' organizations have been extremely effective in representing farmers' interests and improving their bargaining power with private companies.

Key issues

Is VC development a suitable approach for all the rural poor?

Rural dwellers have very diverse levels of access to capital (social, financial and physical), organization, technology and infrastructure. Aspirations, capacities and entrepreneurial attitudes differ across and within different segments of rural populations. In general, involving the poorer segments of the rural population requires extra efforts and investments, making them costly to reach in VC development interventions. Poorer women and men producers, processors and traders face difficulties with access to markets because they lack information, are unable to meet product and delivery requirements, and have limited or no access to finance. Balancing poverty reduction goals with the commercial objectives of the VC is, therefore, a challenging goal; farmers and their organizations require high levels of support before they can be progressively integrated into VC markets and take advantage of the opportunities offered. This often includes building farmers' capacity to identify local market opportunities and make appropriate production decisions, and assisting farmers in organizing themselves to negotiate and lower the transaction costs of market access.

How can a VC project target the rural poor more effectively?

Targeting the rural poor. A project needs a strategy and a set of criteria/tools and activities (“affirmative actions”) that specifically target poorer small-scale producers and the most vulnerable groups. This strategy has to be in line with IFAD's Targeting Policy⁵ and should be based on a sound analysis of the specific constraints and barriers to entry into the commodity VC and the risk profile of both groups.

Risk management. Agriculture is a very risky activity. Attention should be paid to how participation in commodity VCs exposes small-scale farmers to increasing benefits but also additional risks. Poor rural people usually depend on multiple and complementary livelihood activities to protect them from shocks. Expanding cash crop farming to the detriment of food crops might have a negative impact on household food security. Commodity VC development projects need to assess and monitor the impact of planned interventions on household food security to find an appropriate balance between food and cash crop farming, particularly if rural producers have very little surplus beyond that for subsistence.

Microenterprise development. Rural people who find involvement in primary production difficult (because they lack assets and skills) or unattractive (e.g. youth) may participate in VCs through microenterprises. Microenterprises can provide services and inputs (seeds and fertilizers, equipment and maintenance, extension, etc.) that could be a key part of a VC upgrading strategy.

Employment generation. Wage employment opportunities can be provided by farmers at the production level (e.g. for harvesting) and by producer organizations and local small and medium-sized enterprises involved in various stages of the VC (equipment retailing, produce aggregation, grading, processing, etc.). Highly labour-intensive VCs such as horticulture can offer employment opportunities for land-constrained farmers or landless rural poor people.

Policy dialogue. Crops of high political value, such as rice in South Asia, are often subject to serious market distortions (input subsidies, price floors, pan-territorial pricing, export bans) that discourage commodity VC upgrading activities. For example, in Zambia, a country with massive agricultural potential, maize has traditionally been so heavily subsidized that promising new cash crop VCs (such as that for soybean) have been crowded out because small-scale farmers are not interested in them. In these cases, IFAD policy dialogue – in collaboration with other development partners – may help establish a more favourable environment for sustainable VC growth.

Challenges/opportunities/benefits

- The **VC approach is not a blueprint** but needs to be adjusted to each country/context based on a systematic and comprehensive examination of the interactions between small-scale producers and other VC actors (including both the micro and macro aspects). This enables the identification of

⁵ The targeting policy, along with other relevant policies (private-sector engagement, gender, etc.), can be found at <http://www.ifad.org/operations/policy/policydocs.htm>

key entry/leverage points to make the VC work better for small-scale producers. By looking beyond bottlenecks at the production level, the VC approach helps identify issues at different levels of the VC or in the business environment (legislation, regulatory framework, policies, infrastructure, etc.) that affect producers' capacity to be sustainably included in a particular VC.

- At the project design stage, there may not be enough time and resources to carry out an in-depth commodity VC study. However, it is critical to identify in advance those commodity VCs in which there is a business case for involving small-scale producers – i.e. **in which small-scale producers have a comparative advantage** – and in which VC actors are committed to engaging in mutually rewarding win-win arrangements. A more comprehensive analysis of the VC should be carried out during implementation using a **participatory** approach with VC players.
- It is critical to analyse the **roles of women (and youth)** in the commodity VC. Typically, women and youth face additional constraints in obtaining access to assets (e.g. land) and services (e.g. credit) and are underrepresented in farmers' organizations, despite the enormous amount of work they do at particular stages of the production and marketing process. VC opportunities may exist in farming (e.g. branding of women farmers' produce), off-farm microenterprises or wage employment.
- It is important to analyse **all the possible business models** that allow sustainable inclusion of small-scale producers in VCs, in addition to IFAD's typical project entry point (producers' organizations in producer-driven models). Evidence shows that alternative buyer- or intermediary-driven models can be equally effective in achieving the necessary economies of scale.
- The VC approach offers opportunities to identify from the outset **win-win, public-private-producer partnerships** (PPPPs) at the local, domestic and global levels, building on current trends that go beyond fair trade and corporate social responsibility. For sustainability, it is critical to leverage **incentives** that increase the competitiveness of the commodity VC, generate wealth for all participating actors and put the private business sector in the driver's seat of VC development.
- VCs evolve continuously and can change rapidly. Investments should, therefore, focus on **building the capacity** of VC actors, particularly in responding to and/or anticipating market and VC changes to remain competitive. **Flexibility** in project design is critical to allow for adjustment in a very dynamic context.
- **Fair and transparent governance of a VC** is key to ensuring better quality and consistency of production and stable benefits for small-scale producers. The agreed terms of trade, quality standards and pricing structure (including premiums and penalties) throughout a chain should be made clear from the outset. Support to small-scale producers in contract negotiations with other VC actors is a crucial area of support from a development project. Governance should be carefully monitored during implementation to ensure that communication flows along the chain and that no actor takes an "elite capture" attitude.

The tools

To support the design of IFAD-supported VC projects, tools have been developed that offer valuable guidelines to help practitioners address the analysis and design of VCs during the design of country strategies and the design and implementation of projects/programmes. These include:

- How to design commodity value chain development projects
- How to do livestock value chain analysis and project development
- How to do note on public-private-producer partnerships (4Ps) in agricultural value chains
- How to monitor progress in value chain projects
- How to do climate change risk assessments in value chain projects
- Lessons learned in designing commodity value chain development projects
- Scaling up note: A value chain development approach to scale up results in agriculture




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Nepal: High-Value Agriculture Project
in Hill and Mountain Areas




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