

## Facilitating Smallholders' Access to Modern Marketing Chains

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### SYNOPSIS

**M**odern marketing chains can heavily influence rural employment, poverty, and asset ownership, especially the concentration of land, physical assets, credit, and social capital in the hands of farmers with access to those chains. Only farmers with strong capabilities for innovation can survive in these highly competitive marketing chains, in which a dominant actor close to consumers (usually a supermarket or broker) organizes many producers and intermediaries and coordinates their interactions. The private sector or nongovernmental organizations (NGOs) will lead the development of modern marketing chains, but the public sector should play an important supporting role by improving infrastructure, facilitating access to input markets and financial services, modernizing traditional wholesale markets and linking them with modern marketing chains, improving rural education, and supporting extension and advisory services. Project managers, field staff, donors, and policy makers require sound knowledge of the dynamics of modern marketing chains, niche markets, and innovation processes, along with the opportunities and challenges they pose for small-scale farmers. For a group to identify and maintain market links, strong leadership with the appropriate experience is the most important factor. External facilitation can help to access modern marketing chains, but only if it uses appropriate approaches that target farmers with strong innovation and managerial capabilities. Building social capital should be an important component of projects to develop marketing chains, and social capital should be an important criterion in allocating funds to participating groups. Projects should not impose a model of interaction. Interventions generally should not organize the poorest farmers to sell directly to modern chains but rather to develop niche markets, sell to wholesalers, or obtain training for specialized off-farm employment.

### BACKGROUND AND CONTEXT FOR INVESTMENT

Modern marketing chains can foster economic growth and alleviate poverty directly and indirectly. Direct effects include higher incomes for farmers who participate in the marketing chain; the development of innovation capabilities (through interactions with other actors in the chain); the diffusion of technical, organizational, and institutional innovations; and the creation of employment in rural areas. Indirect effects include expansion of local economies, exposure of local entrepreneurs outside the chain to the operation of modern markets, the development of links with new actors in the AIS, and the modernization of traditional wet and wholesale markets. Given these benefits, donors, multilateral organizations, and governments have assigned high priority to improving poor farmers' access to high-value agriculture and modern marketing chains, yet only a fraction of smallholders have managed to succeed, either individually or through organizations (Hellin, Lundy, and Meijer 2009; Wang et al. 2009).

What differentiates modern marketing chains from farmer organizations and innovation networks? *Modern marketing chains* have many features of buyer-driven value chains: an actor close to consumers (usually a supermarket or a broker) dominates, organizing many producers and intermediaries, deciding who participates in the chain, overseeing all the links from the farm to the shelf, defining the nature of the interactions and commercial conditions, and setting quality and safety standards. *Farmer organizations*, on the other hand, are member organizations that include only one type of actor; *innovation networks* are open organizations formed voluntarily by different types of actors. Other important features of modern marketing chains are that they focus on marketing specific products (vegetables, fruits, meat, and so on), access to the chain is highly restricted, verbal contracts based on trust are common but informal transactions rare, and

technologies are generated mostly in developed countries and imposed by the leading agent.

High-value products are commercialized through four types of modern marketing chain. *The first type* includes traditional export crops produced on plantations, such as coffee, tea, and bananas, and marketed mainly by large companies and traditional agroprocessors. Most innovations in these marketing chains are technical, because the organizational aspects have already been resolved. In a few cases, such as the Kenya Tea Development Agency (TN 4, box 1.22) or the Colombian Coffee Growers' Federation,<sup>1</sup> small-scale farmers have created large, successful organizations that compete internationally.

*The second type of modern marketing chain*, which supplies developed countries with fresh and processed fruits and vegetables, fish and fish products, meats, nuts, spices, and flowers, started in the early 1980s following trade liberalization and improvements in logistics. Traders and agroprocessors usually work with large-scale farmers under different associative forms, although occasionally they provide financing and technical advice to smallholders. Both technical and organizational innovations are important in this chain, and local actors have to develop strong innovation capabilities to remain competitive in global markets.

*The third type of modern marketing chain* was triggered by the expansion of fast-food chains and supermarkets that supply mostly domestic markets, although increasingly they reach foreign markets. This type of chain is a product of the internationalization of wholesaling and logistics, consolidation of rural and urban wholesale markets, emergence of specialized and dedicated wholesalers who organize procurement, growth in vertical coordination, and the introduction of private grades and standards. The better-off smallholders tend to sell through this channel (sellers in traditional channels tend to be less well off); they have more capital (especially irrigation facilities), easier access to credit, and greater specialization in commercial horticulture (Reardon et al. 2009). Actors in these chains use sophisticated production packages, but the most important innovations are organizational: coordinating production by large numbers of farmers of products of consistently high quality (frequently highly perishable) and delivering them to numerous distant retail sales points (increasingly abroad). The same products that are sold in modern marketing chains are also sold in traditional wet and wholesale markets; the difference is that the latter usually handle products of mixed quality and operate with spot prices, whereas the modern chains must adhere to high quality standards, and deliveries and prices are set in advance. Box 1.18 describes

the operation of these chains in three countries where they have attained different levels of development.

*The fourth type of modern marketing chain* comprises niche markets in their many forms. Examples include the following:

- Smallholders close to a large city, who sell directly to consumers in a process similar to the “locavore” movement in developed countries.
- Development projects that create new markets for traditional products or new products based on traditional crops (Papa Andina is an example for Andean potatoes; see module 7, IAP 3, and module 4, TN 4).
- The Fair Trade movement, which caters to specific population segments in developed countries.<sup>2</sup>

Some niches are more demanding than others in terms of quality and commercial requirements; for example, wealthy consumers in nearby cities are less demanding than consumers from developed countries who buy in Fair Trade shops. Participation in these markets depends on farmers' capacity to meet their requirements. Although niche markets have had important impacts on local communities, they cannot expand beyond a certain size without becoming commoditized. For this reason, they can make only a limited contribution to alleviating poverty.

## INVESTMENT NEEDED

Investments to support modern marketing chains should support the development of organizational capabilities for innovation along the chain (especially among farmers), coordinate actors operating in the chain, and create the enabling conditions for innovation. It is important to recognize that although modern marketing chains are growing, traditional wholesale and wet markets will probably retain an important share of high-value agricultural produce and remain the main marketing option for most smallholders. As modern marketing chains become increasingly concentrated, it will be harder for smallholders and farmer organizations to access them directly. For this reason, support to modern marketing chains should be accompanied by programs to help the farmers who are excluded.

### Supporting the expansion of modern marketing chains through targeted investments

Private actors make most of the investments to develop modern marketing chains, but targeted public investments

## Box 1.18 Procurement Systems in Modern Marketing Chains in Three Developing Countries

*Mexico.* Supermarket procurement systems have moved from traditional wholesale markets to (1) networks based on centralized distribution centers; (2) emerging regional networks; (3) sourcing from a combination of specialized wholesalers (which are increasingly backward integrated into production zones), wholesaler/growers, and direct relations with grower/packer/shippers; and (4) new institutions, such as emerging private quality standards and implicit preferred supplier (quasi-contractual) relations. These trends make it very difficult for most smallholder and even traditional large wholesalers and medium-scale growers to sell to supermarkets. Supplying directly is increasingly the domain of (1) the large grower/packer/shipper, (2) the backward-integrated, large, specialized wholesaler, and (3) to a certain extent the wholesaler and farm company managing contract farming.

*Kenya.* Supermarkets have a relatively small but growing share of urban markets for high-value products. The leading chains began to modernize procurement by creating systems of preferred suppliers (farmers and specialized wholesalers) for key products, centralizing procurement into distribution centers, and starting to use private quality standards. Smallholders have found it difficult to enter modern chains because most lack the physical, financial, human, and organizational capital to lower production

and transaction costs to a point where they become competitive. Modern marketing chains increasingly are supplied by a new type of “middle-class” farmer emerging between large-scale export farmers and small-scale, traditional market farmers. These middle-class farmers buy traditional farms and convert pasture and grain fields to horticultural crops grown with modern production techniques.

*China.* The expansion of supermarkets has been driven by factors common to other developing countries—urbanization, income growth, and liberalization of foreign direct investment in retailing—as well as a number of China-specific policies, such as government investment in the sector and policies promoting conversion of wet markets to supermarkets. A feature unique to China is that poorer households produce the largest share of horticultural crops; that share is growing, whereas the share of richer households is falling. At the same time, there is little evidence that modern wholesalers or supermarkets source produce directly in rural communities. Instead, they rely on urban wholesale markets dominated by small-scale traders; for this reason, little or no effort is made to impose or monitor quality or safety standards directly among producers. Some researchers have reported the incipient emergence of features common to more developed procurement systems, such as dedicated providers.

*Sources:* Author, based on Reardon et al. 2007; Neven et al. 2009; Wang et al. 2009.

in specific markets and chains can trigger virtuous cycles of investment (IAP 3). These investments may support the formation of farmer groups, finance infrastructure and specialized equipment, build capabilities for farmers and their organizations to meet the standards required by private companies, and help provide market intelligence. For example,

Sam’s Club required cooled, packed, and delivered raspberries by a group of small farmers in Michoacán (Mexico). SEDAGRO/Michoacán [the state department for rural development] discovered exactly what those requirements are in joint meetings with the chain and the group, and then provided efficient and targeted help to the group to make those investments. The group then entered the business relationship and that provided further capital to make investments on their own. [Reardon et al. 2007, 35]

Another type of investment is the facilitation of lead farmer–outgrower schemes. Lead farmers have proven their ability to produce to the standards required by modern chains. Supermarkets or specialized wholesalers encourage lead farmers to organize their neighbors to produce to the same standards; the only incentive the buyers offer is a guaranteed market opportunity. For a fee (usually a percentage of the final sales), lead farmers provide various services that may include production planning, technical assistance, access to inputs, market intelligence, sorting and packing, transportation to market, and financial administration. Lead farmer programs require less external support than support for farmer organizations, but the farmers themselves have to make higher investments (Reardon et al. 2009; Neven et al. 2009). Investments to support these programs include financing farm equipment and capacity

building for the farmers willing to work with the lead farmer, including paying for the time of the lead farmer. Identifying opportunities for targeted investments requires fund managers to have the capabilities and incentives appropriate for operating flexible programs.

### **Fostering coordination among actors in modern marketing chains**

Modern marketing chains usually use sophisticated production and marketing mechanisms to bring perishable products from rural areas to urban consumers in developed and developing countries. In addition, the technologies and market requirements (such as the varieties grown and packaging methods) change often, forcing farmers to adapt. Greater coordination along the marketing chain helps smallholders to adapt by facilitating access to up-to-date information and financial resources (IAP 6). Successful coordination, however, requires coordinating organizations to respond to the needs of actors in the marketing chain and adapt themselves to changing conditions. Otherwise, coordination results only in formal agreements with little impact on the ground (see, for example, World Bank 2006). Investments include market intelligence, development of market and farm infrastructure, facilitation of interactions (usually by the actor that dominates the chain), and the formation of farmer groups, assisted by innovation brokers.

### **Developing niche markets**

Niche markets are a particular form of innovation network, and the investments resemble those described in TN 2. These investments include financing innovation brokers and other actors that bring together potential partners and strengthening the innovation capabilities of nonpublic actors in the innovation system—for example, through consulting services, extension activities, technological interchanges, or seminars and workshops on the dynamics of innovation networks. Investments also include small, short-term grants for potential catalytic agents of innovation networks (researchers, extension agents, and groups of farmers) to facilitate interactions with potential partners (through meetings or electronic communications platforms), build capacity, and facilitate collective action. Still other investments could create venture funds to finance the development of innovations, similar to those used in high-tech industries. Finally, it may be necessary to invest in transforming public research and extension institutions so that they can better integrate into innovation networks.

### **Improving traditional markets to benefit smallholders**

Investments to modernize traditional markets and improve farmers' bargaining power include developing small-scale farmers' human and social capital by fostering the emergence of farmer organizations, providing technical and organizational support, and offering training in modern marketing methods. Another useful investment is to facilitate smallholders' access to modern infrastructure, especially ICTs, as well as to services for business registration and incorporation, which can facilitate contractual relationships with retailers. It is also important to build the capabilities of field staff, project managers, donors, and policy makers to support smallholders; these capabilities include a clear understanding of the dynamics of modern marketing chains, niche markets, and innovation processes, along with the opportunities and challenges they pose for small-scale farmers. Finally, another investment to benefit smallholders is to modernize wholesale and wet markets by improving buildings, storage facilities, communications facilities, and roads.

### **POTENTIAL BENEFITS**

To recapitulate, modern marketing chains can offer the following potential benefits:

- More rapid organizational and economic innovation, resulting in stronger economic growth.
- Faster creation of wealth for the richer tier of small-scale farmers through direct participation in modern chains.
- Creation of jobs in rural areas, some exclusively for women (sorting and grading fruits and vegetables, for example).
- For farmers who sell in modern marketing chains and for smallholders who access niche markets, easier access to input and output markets and other resources for innovation, such as technical advice, innovation networks, and participation in action-research projects.
- Reduced commercial risk for farmers owing to steady demand, more formal transactions, and higher probability of being paid on time.
- More effective use of human, social, physical, and financial resources for innovation.
- Faster creation of wealth and empowerment among farmers who can access niche markets.
- Better interaction and coordination among actors, resulting in a more dynamic innovation system for agriculture.
- In the case of niche markets, more inclusive development.

- Cheaper food that often meets higher quality and safety standards for consumers.
- Faster expansion of exports, improving the country's balance of payments.

## POLICY ISSUES

Key policy issues related to modern marketing chains involve identifying ways for the chains to spur growth and reduce poverty, ensuring that modern chains are sustainable (some may require more public support than others), fostering more equitable access, clarifying appropriate roles for public and private investors, and identifying appropriate public investments.

### Can modern marketing chains spur growth and reduce poverty?

As noted, high-value agriculture is expected to continue growing and transforming developing country agriculture for the foreseeable future. Instead of trying to impose new directions on this process, policy makers should identify the main trends guiding the expansion of different markets and seek interventions that can steer the process in ways that spur economic growth and alleviate poverty. For example, buyers in modern marketing chains clearly prefer to operate with the better-off smallholders. They buy from the poorest only when they have no other option. Interventions should not induce the poorest farmers to organize to sell directly to

modern chains but should rather organize them to develop niche markets, sell to wholesalers, or obtain training leading to off-farm employment as specialized workers.

## Sustainability and social considerations

As with most private firms, the consolidation of modern marketing chains depends on the central actors' capabilities and on socioeconomic conditions (discussed later). Given the international nature of supermarkets and traders, eventually all central actors develop their own capabilities to organize most modern marketing chains.

Niche markets are a different case, given that they are innovation networks. In addition to external factors, the sustainability of niche markets depends on the presence of effective leadership, on farmers developing strong innovation capabilities (especially collective learning routines and trust), on long-term support from donors, and on monitoring and evaluation systems that allow experimentation over several years (box 1.19).

The expansion of modern marketing chains has increased disparities in asset ownership but has also created employment in rural areas. Smallholders' access to modern chains depends not only on their assets and organization but on being located in the procurement area for a particular crop. Many programs have helped marginalized groups (small-scale farmers and/or women) to organize and access modern marketing chains, but the failure rate has been very high. In general, the participation of small-scale

### Box 1.19 Sourcing Practices Used by Mexican Supermarkets Reveal Experimentation with Contractual Arrangements and Types of Growers

Mexican supermarkets have pursued a number of strategies to source frozen vegetables. Exporters have used backward integration, relying on their own farms, for "high care" products demanding traceability. Some supermarkets adopted intense, highly controlled outgrower schemes in which they provided resources under contracts with small-scale farmers. Others relied on small-scale outgrowers for less-demanding products and market segments requiring less traceability and less technology, with the company providing only extension services to its outgrowers. Other companies chose to contract only with large-scale farmers, with a

combination of large- and small-scale farmers, or only with smallholders through resource-provision contracts. A multinational working with large- and small-scale farmers had seven contract types, ranging from contracts with large-scale farmers under which no resources were provided to contracts with the smallest-scale farmers under which the company provided "specialized inputs and equipment, credit, technical assistance, and insurance." These examples show that projects should allow considerable latitude in the types of contractual arrangements and organizations that can be financed.

*Source:* Author, drawing heavily on Reardon et al. 2009 (quoted text, p. 1722).



farmers has depended more on support and expertise from NGOs and donors than on private traders or supermarkets, and it has been somewhat easier for smallholders to participate in niche markets or sell to wholesalers who supply supermarkets.

### Public and private sector roles

As indicated, different types of agents have facilitated smallholders' access to modern marketing chains. Private agents (brokers and supermarkets) sometimes provide credit, inputs, and technical assistance (Reardon et al. 2009), and research institutes, NGOs, civil society organizations, and farmer organizations have also managed successful programs.<sup>3</sup> The public sector has provided funds, developed critical market infrastructure (roads, electricity, water, and communications networks), and facilitated interactions among actors in modern marketing chains.

Projects led by nonprofit organizations work with small-scale farmers or community-based organizations to identify niche markets (see, for example, Poitevin and Hassan 2006; Vermeulen et al. 2008; Devaux et al. 2009). These programs usually use participatory methods and may involve other chain actors in the process. Components of such projects include stakeholder analysis to identify the key people and organizations that should be invited to participate, visits, skill development, organizational aid to small and micro enterprises and community-based organizations, business plan preparation, assessment of markets and of opportunities to network, and stakeholder workshops.

The private sector will continue to lead the development of modern marketing chains, but the public sector has an important supporting role to play by improving infrastructure, facilitating access to input markets and financial services, fostering the modernization of traditional wholesale markets and helping them to link with modern marketing chains, improving education in rural areas, and supporting extension and advisory services.<sup>4</sup>

### LESSONS LEARNED

*Because buyers establish different types of commercial relations, even with farmers in the same area, projects should not try to impose a model of interaction.* Commercial chains use different suppliers according to the nature of the product and the type of farmers present in the procurement area. They generally buy from small-scale farmers only when smallholders dominate a particular market (tomatoes in Guatemala, guavas in Mexico); large-scale farmers have

several marketing options, increasing the risk of unstable supply;<sup>5</sup> small-scale farmers are more able and willing to follow highly labor-intensive field management practices needed by the companies; and small-scale farmers have reduced transaction costs by organizing (Reardon et al. 2009). If a buyer has only small-scale farmers in its procurement area, it usually assists them with various inputs, credit, and technical advice.

*Social capital should be an important criterion to allocate funds.* Social capital is a significant factor in a group's ability to sell in modern marketing chains. Social capital is strong within mature groups with strong internal institutions, intragroup trust, altruistic behavior, membership in other groups, and ties to external service providers. Older groups that have built substantial social capital should be ranked above newer groups in consideration for support. Additionally, building social capital should be an important component of projects that support the development of modern marketing chains. Such efforts will require sustained commitment and support from external agents, which may include NGOs and innovation brokers.

*Capable and motivated program leaders are important.* Strong leadership with the appropriate experience is regarded as the most important factor for a group to identify and maintain market links, followed by the quality of external facilitation. It is very difficult for one person to have all the required qualifications. Leaders should be supported by teams of specialists, not just in marketing and business management but also in the management of innovation. A similar approach has been used in several countries to support innovation in small firms (see, for example, Shapira 1999). It is important to offer program leaders incentives to experiment and allow them to change programs as needed. To this end, funders and supervising agencies should set up program committees to analyze potential changes or allow program leaders to use small amounts of money to experiment with new approaches, and they should review results annually. Firms use such approaches to develop strong innovation capabilities in traditional markets (Whirlpool is one example; see box 1.7 in the module 1 overview and Skarzynsky and Gibson 2008).

### RECOMMENDATIONS FOR PRACTITIONERS

In addition to improving the infrastructure and socioeconomic policies that are conducive to the consolidation of private firms, facilitating small-scale farmers' access to modern marketing chains requires instruments appropriate for

each of the four marketing channels identified at the beginning of this thematic note.

To foster the participation of better-off smallholders in modern marketing chains,

- Support the development of innovation capabilities in large farmer organizations, as described in TN 3.
- In conjunction with the actor dominating the marketing chain, define criteria to select farmers for support to enter into one of the several contractual modes used in modern marketing chains. Social capital should be one of the most important selection criteria.
- Do not impose specific interaction patterns as a condition for participating in projects.

To foster the participation of poor farmers and marginalized groups,

- Support the modernization of traditional wholesale markets and traditional retailers, and help them to link with modern marketing chains (one example is China's "200 Markets Upgrading Program").<sup>6</sup> Identify high-value products that modern marketing chains must source from smallholders, such as low-volume and niche products, and support associations of market agents and small-scale farmers to provide them.
- Finance investments (cold storage, packaging, and so on) that target specific requirements of specific modern marketing chains.
- Build the capabilities of field staff, project managers, donors, and policy makers to support small-scale farmers.
- Develop market intelligence programs that provide detailed, current information on market developments and trends.

- Implement "business linkage" programs, such as business round tables and conventions, and support travel to those programs by farmers and government officials.
- Foster the emergence and consolidation of farmer organizations through technical and organizational support, as described in TN 4. These organizations, in turn, can work closely with specialized wholesalers.
- Develop new financial instruments to take advantage of the stable relationship between small-scale farmers (individually or organized) and the main actors in modern marketing chains. These actors, operating as intermediaries between banks and farmers, can help farmers obtain credit at market rates. Several countries, including Mexico and Croatia, have implemented such programs.
- Develop small-scale farmers' human and social capital through sustained programs that include facilitation to form associations and training in modern marketing.
- Help small-scale farmers obtain bank accounts, register a business, and transact the other business required to incorporate as formal companies that can enter legal, contractual arrangements with retailers.
- Facilitate access to modern infrastructure, especially ICTs.

To support the development of niche markets,

- Conduct multistakeholder planning exercises to identify potential niches and define strategies to develop them.
- Apply recommendations in TN 2 for the development of innovation networks.
- Finance innovation brokers to support policy makers and all other participants in the development of niches.
- Aim for sustainable results. If niche markets are not profitable, they can create dependency on donors.