Sustainable inclusion of smallholders in agricultural value chains

Scaling up note

A value chain development approach to scale up results in agriculture

In the coming years, agriculture will require profound changes in order to fulfil its multiple functions in a context of harsher environmental conditions and demographic and market transformations. Global agrifood systems are undergoing a rapid transformation towards higher-value products, stricter food standards, and closer international and vertical integration. Developing countries, in particular, face technical and institutional constraints, potentially impeding their participation in emerging value chains. At the same time, these changes present opportunities for poverty reduction among IFAD’s target group, i.e. small rural producers. For example, the large-scale commercialization of fresh vegetables through domestic as well as international market channels has been a successful scaling-up story, with positive impacts on small vegetable growers in Kenya. The growing importance of rural-urban linkages, structural change in many middle-income countries and overall increased demand for food and fodder globally manifest a big market opportunity for small producers.

Commercialization of smallholder production through a value chain (VC) approach is a promising strategy to improve rural populations’ incomes and livelihood situation by helping to link producers to processors and markets.

Scaling up is forward looking, i.e. planning and implementing current projects in a way that allows components to be scaled up to multiply the results in the future. Project design should consider how investments, policy dialogue and knowledge management can influence various stakeholders (public, private and the target communities), and leverage resources, knowledge, social and political capital from other actors to bring positive results to a larger scale in a sustainable manner.

2 There is a need to ensure food and nutrition security for 8 billion people by 2030, and 9 billion by 2050. How to Feed the World in 2050. FAO, 2009.
Over the last ten years, the IFAD portfolio has experienced a very prominent shift towards value chain development (VCD) projects. Seventy percent of IFAD-supported projects approved in 2014 included a VCD component. A reflection on the suitability of VC approaches to reach IFAD target groups and on its scaling up potential is thus timely.

What is to be scaled up?
Scaling up aims at increasing the number of farmers and small producers with sustained market access, translating into improvements of their welfare. Thus, the objective is not to scale up VCD projects, but to identify from the outset how to expand the long-term benefits of VCD to more beneficiaries by ensuring sustainability and leveraging additional resources and expertise. It also means increasing income benefits for those beneficiaries included in the chain. Direct beneficiaries typically include small producers, processors and traders. Most IFAD projects focus on small producers and processors, but poor traders and labourers working along the VCs could also be a scaling-up target.

A VCD approach is based on a comprehensive analysis of the entire commodity chain, from producers to end-market consumers. Inherent in the VC approach is an acknowledgement that in addition to the IFAD target group, there are other stakeholders in the chain 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 just the production stage in the VC can have a greater impact on poverty reduction.

There is no blueprint for how to successfully design a VCD project, nor for how to successfully scale up VCD project results. Given the fast movements of markets, the complexity of actors involved and the changing context, only some key principles for scaling up VCD results can be outlined:

- The market is the basic driver of all VCs; therefore, before scaling up the results of a VCD intervention, the level or capacity of market demand to absorb the additional production or producers should be assessed.
- VCs are mostly driven by private-sector actors, such as primary traders, processors, wholesalers or retailers such as supermarkets; therefore, scaling up VCD results would naturally entail greater involvement and engagement with these private-sector entities.
- Organizing farmers into groups and bulking or aggregating their products facilitates their integration into VCs and improves their bargaining power when interacting with private-sector actors along the chain; thus, scaling up VCD results will often need farmers to be organized into groups in order for their integration in the VCs to be viable and sustainable.
- An enabling policy environment is critical for regulating VC players, while creating the necessary incentives for them to invest; to allow the VCs themselves to grow and function efficiently; and to enable smallholder farmers to participate actively in them. Helping governments to get the policy framework right is thus often a necessary part of an approach for scaling up.
- VCs can be very dynamic, responding to shifting consumer preferences, competition, input costs, and changes in technology – the scaling up of VCD results can be more sustainable if it focuses on empowering producers and building their capacity to respond to market changes and fluctuations within and among VCs rather than penning producers to a limited number of VCs.
- VCD can be a powerful and sustainable poverty reduction tool; however, there are risks that need to be mitigated when supporting and/or scaling up specific VCs, such as strong price and market fluctuations (including gluts), environmental and climate-change risks, food security and nutrition risks, and creating or accentuating possible gender imbalances.

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4 Ibid.
Is there a value chain development model to be scaled up?

There is no single right or optimal way to organize a VC – VC models can vary according to country, commodity, local context, presence, nature and capacity of VC actors, policy framework, business environment, etc. The process of scaling up VCD results can also vary according to these factors. Nonetheless, in IFAD projects one can observe three of the most common types of VCD organizational models: producer-driven, buyer-driven and intermediary-driven. In certain circumstances, we also observe commodity VCs where marketing arrangements or prices are controlled by governments. These models are not good scaling-up examples because they tend to distort markets and/or crowd out the private sector. Hence, the focus in this section is on the three models presented below.

In the producer-driven model, producers are organized in groups, associations or cooperatives, which take on production and, sometimes, post-production functions aiming at capturing the largest share of the retail value. Through project support, these groups become strong enough to network, search for buyers and negotiate contracts with them. In many cases, they become the leaders of the VCs and are able to transform, process, transport and market their commodities themselves, thereby earning a higher share of value addition along the VC. Examples of such models are most prominent in Latin America (e.g. Colombia, Guatemala, Honduras and Nicaragua), where the farmers’ organization movement is strong and well established.5

In the buyer-driven model, the private business sector (e.g. processors, retailers, traders, wholesalers) organizes producers into suppliers through various contractual arrangements (e.g. outgrower schemes, contract farming, and – in a few cases – joint ventures). Examples of such models include Uganda’s Vegetable Oil Development Project, where the large oilseed agroprocessor, Bico, drives the VC relying on raw material from its nucleus estate and the outgrower scheme set up through the project. Another example is IFAD’s support to the rehabilitation of Rwanda’s tea sector, where tea processing companies are the main buyers and processors of tea produced by farmer cooperatives. This model is particularly appealing when a private company can be identified and selected at project design to become part of the project from the start and/or when the VCD entails a large investment in processing that only a private investor can undertake.

In the intermediary-driven model, the most common intermediary is usually an NGO or a service provider that brings the parties together, provides them with services (e.g. capacity-building of farmers, information and sourcing to private companies, networking between the parties) and brokers and monitors VC linkages. For example, in Nepal’s High-Value Agricultural Development Project and Bhutan’s Market Access and Growth Intensification Project, the Dutch-based NGO SNV has been retained to play the role of intermediary to develop/improve the VCs, organize the producers to supply private companies, search for buyers and traders, and establish supply linkages accordingly. This model is particularly useful when the VC linkages are not very strong, private-sector presence is weak, and/or VCs are not pre-selected at project start-up, but are identified depending on market opportunities and further market analysis/mapping during project implementation by the NGO or intermediary.

Whatever model is pursued, scaling up VCD results can be horizontal (more products or VCs covered) and/or vertical (more farmers integrated into the VC or more benefits accrued to the same farmers). Once VCD results are established as a result of a project or otherwise, scaling up those results may entail either expanding the VCs to include more farmers; or helping farmers move up the chain and obtain higher revenues from value-added processes, such as when coffee cooperatives in Nicaragua start doing their own coffee roasting, packaging and marketing; or helping farmers access new VCs, such as in São Tomé and Príncipe, where farmers were first supported in the coffee and cocoa VCs and additional VCs (e.g. pepper and other spices) were developed during the second phase of the project.

5 For example, see Guatemala’s Programme for Rural Development and Reconstruction in the Quiché Department, which supports several farmers’ organizations, including indigenous women’s groups that sell fresh vegetables to local exporters and United States supermarkets.
Scaling up pathways

When designing and implementing the scaling up of a VC approach, project design teams and project management units can rely on a number of pathways and actors. Which pathways present an entry point for scaling up will depend largely on contextual factors and the levels at which the majority of the constraints are found: (i) policy level; (ii) project level; or (iii) knowledge-sharing level.

Typical pathways for scaling up a VCD intervention will involve all three levels: policy engagement, projects and knowledge management. When a project is being designed and/or implemented, it is necessary to: identify the VCD policy obstacles and how they will be overcome to allow scaling up; define a VCD model or approach that the project will support; consider how the interventions can be replicated/scaled up once project resources end; identify who will do the scaling up (see key drivers for scaling up below); and specify the knowledge-management processes that will be used to share VCD results and information with scaling-up partners.

Policy engagement

Ideally, IFAD VCD projects should serve as both a vehicle for operationalizing existing relevant policies and a lever for supporting the policy change needed to promote pro-poor and well-functioning VCs. Unless an IFAD project can influence a broader set of policies or policy agenda, it will remain a small-scale intervention with little scope for scaling up and/or having a broad outreach and impact. Furthermore, many VCs simply cannot be scaled up if the policy and regulatory framework is not conducive. IFAD does not necessarily need to do this alone. Partnerships should be forged with other donors who are active in policy analysis and engaged in reform discussions with governments (such as the World Bank, the European Union, DFID, and other lead donors and regional banks).

Common policy obstacles to scaling up VCD projects include a poor business and regulatory environment, trade barriers and license restrictions, market distortions or lack of market competition, fixed or subsidized input or output prices, weak regulatory framework for cooperatives and farmers’ organizations, poor access to financial and business development services, weak food safety and standards, and poor infrastructure. Based on an analysis of policy obstacles, evidence from projects, partnerships with others and knowledge-sharing, IFAD can engage in policy dialogue with governments to convince them that certain laws and regulations that have a direct influence on the functioning of agricultural markets and VCs, or on the rural business environment, need to be changed. A successful example of IFAD’s policy engagement with governments is in Armenia, where IFAD convinced the government to change its agricultural VAT law to support equity investments in the agribusiness sector.

Project financing

A major entry point for scaling up development results is usually a VCD project that has demonstrated its success and potential for replicability. VCD models can vary widely from project to project, but in order for project results to be scaled up by others (government, donors, private sector, cooperatives, NGOs, etc.), a project should:

(i) Provide evidence that the chosen VCD models yield sustainable results. This implies that a VC intervention should document its outcomes and positive impacts on the target group, as well as its overall benefits to the chain. A good project monitoring and evaluation (M&E) and impact tracking system is therefore needed.

(ii) Ensure institutional sustainability of the interventions beyond the project’s duration. This could entail clear exit strategy measures, whereby the private sector or farmers/cooperatives take over market services, market infrastructure or VC financing once the project ends. It could also mean establishing links with the rural financial sector, so that once the IFAD project ends, the financial sector – having “learned” how to work with small producers through the project – continues to do so with its own funds.

A conducive policy, regulatory, and legal framework is a key enabling factor for any VCD effort to succeed.

VCD projects can provide models or approaches that, if proven successful, can be replicated on a larger scale by other actors in both the public and the private sectors.

See How to do commodity value chain development projects (available at: http://www.ifad.org/knotes/valuechain/index.htm) for further discussion on policy engagement and how it should be planned at the design stage.
(iii) Engage with potential scaling-up partners and develop the vision of scaling up early on. The project can be a “pull mechanism” to draw the private sector into a certain value chain, e.g. by sharing the initial costs of learning, providing technical assistance that ensures quality supply, or brokering mutually acceptable and beneficial terms with IFAD’s target groups. This ensures that the private sector retains the VC relationship that was created through the project once the latter ends. Box 2 presents a public-private-producers partnership (4Ps) mechanism that was initiated by IFAD to “pull” the private sector into the smallholder realm through its projects and programmes.

Knowledge generation and sharing

At the global level, IFAD has gained considerable experience with various VC business models and their application or replicability in various contexts. This experience should be brought forward and shared, so that VC actors can replicate and scale up such evidence-based success stories. For example, IFAD’s experience with the three VC organizational models in various countries, the 4Ps mechanism, and the policy dialogue around improving the rural business environment can be presented during start-up workshops, conferences and round tables at the country level, meetings and training sessions with local government, private companies and other stakeholders. This would help the stakeholders understand which particular models have worked and under what conditions, and whether they can be replicated and scaled up.

At the local level, VCD approaches and analysis also generate a lot of knowledge about the requirements of the market, the needs of small farmers, the role of the government, investment gaps, policy obstacles and other bottlenecks. This knowledge should be shared with all VC actors and partners (including governments, farmer groups, private companies, service providers), allowing the various entities to obtain key information on what works and what does not, what needs to be fixed and what can be scaled up. This type of information can then be sustained through the establishment of regular platform meetings (e.g. specific VC networks or working groups), which can attract additional actors, investors and resources.

Key drivers for scaling up

Different actors can be considered as potential “movers and shakers” of a scaling-up process. These include the government at various levels, the rural population and the private sector. These three groups of actors are very heterogenous in terms of their capacities, access to resources, and rights, and they need to work together to achieve successful VCD results that can be scaled up. The role of IFAD and other donors is to bring these partners together (e.g. through the 4Ps – see box 2) to initiate, improve or scale up VCD projects and results.

Institutional space

Grouping farmers and aggregating produce is at the core of scaling up any VCD result. Whatever VCD model (producer-driven, buyer-driven, intermediary-driven or other) is adopted, some sort of organization of farmers is required. Farmers’ organizations help by achieving economies of scale for procuring inputs, reducing produce collection costs, minimizing transaction costs of dealing with other VC actors, enhancing value-added through processing and better handling/storage, and helping producers cope with asymmetrical relationships in VCs. They can also be extremely effective in representing farmers’ interests and improving their bargaining power with private companies. In many instances, IFAD VCD interventions can build the capacity of these farmer groups so they become the main drivers for scaling up and for building partnerships with other actors along the VCs.

Another important institutional dimension for scaling up is the creation of stakeholder platforms where chain actors can meet and agree on terms of trade within their chain, as well as raise common issues and challenges that they can address jointly. For example, in Ghana’s Northern Rural Growth Programme, district VC committees were created to address on a regular basis all issues related to the VCs. In Madagascar, regional and local offices of Chambers of Commerce were seen as the institutional anchors for these types of platforms. These institutional set-ups are ideal springboards for scaling up VCD results and impacts.

IFAD can also assist public agencies in the preparation and management of VC development plans (or similar plans, such as strategic investment plans or commodity business plans) – a common instrument for the
management of VCs in countries or localities where the private sector is still not very vibrant.\textsuperscript{7} Typically, such plans need to be commodity-specific and tend to be very detailed; as a result, they are cumbersome to manage, are often not updated, and are not used as an operational tool on the scaling-up pathway.

\textbf{Box 2: The 4Ps mechanism as an institutional innovation that pulls private-sector partners into the game}

Public-private-producer partnerships (4Ps) along agricultural value chains can be a powerful tool to attract private-sector investments to the smallholder sector, as well as in market segments that would not be profitable to private companies without public support and/or concessional donor financing. Public or donor resources are used to provide incentives to the private sector to reach out to small-scale farmers as suppliers of primary products, or as the "bottom of the pyramid" rural consumers. Public or donor funds can be used through a competitive "pull" process to finance business plans jointly submitted by private companies and farmers’ organizations, in which they propose to enter into a partnership agreement where both parties take risks, invest, and share the benefits. Using public resources is justified on the grounds that the aim of the 4Ps investment funds is to address a “market failure”, whereby the perceived high risks and transaction costs of working with small producers are preventing private companies from forging market-based business relationships with them. Grants are needed to finance the initial start-up costs of such partnerships and for making an explicit link between the delivery of certain types of goods and a particular business plan. However, once the start-up costs of the 4Ps are covered, it is the partners (producers, private sector and public sector) that would sustain and scale up the partnership in the long term.

See: 4Ps Concept Note, PTA

\textbf{Financial/fiscal space}

In general, public-sector resources in VCD interventions should only be used to “prime the pump” until the private sector can come in and take its appropriate place in the VC, either as buyer, investor or main source of finance. Subsequently, public-sector resources should only be used to finance public goods, such as infrastructure (roads, bridges, electricity, communication networks, etc.), basic education and research, as well as to provide a conducive policy and regulatory environment where inclusive VCs and agricultural market development can thrive. Conversely, private goods, such as equipment, processing units, transport vehicles, marketing and other software, should be the domain of the private sector and farmers. Therefore, VCD interventions should look for two important aspects of scaling up into the fiscal space:

(i) In the public good domain, identify the public institutions (central and local governments, ministries, committees, etc.) that have the fiscal authority to invest or influence VCD and include them in the decision-making process of the VC interventions so that they understand what is expected of them in the long run; and assess their capacity to continue financing these aspects of the VCD once the intervention is completed.

(ii) For activities that require private-sector financing, VCD interventions should make sure that whatever temporary subsidies they support can eventually be financed by the private sector. A typical example of a problematic response of many projects to the absence of VC financing instruments is the use of matching grants as a substitute; it is difficult and financially unsustainable to scale up such grants. VCD interventions should build up the capacity of VC actors and related financial institutions to develop and use more sophisticated VC financing instruments. Examples of such instruments that require further development and can be used to financially scale up VC interventions are warehouse receipt systems (e.g. in the United Republic of Tanzania),\textsuperscript{8} leasing (e.g. in Georgia), input on credit with the involvement of financial institutions as intermediaries (e.g. in Ghana),\textsuperscript{9} equity financing (e.g. in Armenia and the Republic of Moldova), and guarantee fund schemes (e.g. in Albania and China).

\textsuperscript{7} For example, Bhutan’s newly designed Commercial Agriculture and Resilient Livelihoods Enhancement Project (CARLEP, to be approved in 2015) will support the Food Corporation of Bhutan, a state organization, in the formulation of countrywide VC development plans for vegetables and dairy.

\textsuperscript{8} For example, see Tanzania’s Agricultural Marketing Systems Development Programme and Rural Financial Services Programme, where warehouse receipt systems were introduced.

\textsuperscript{9} See Ghana’s Northern Rural Growth Programme for the set up of a cashless credit model scheme between farmers, input dealers, commodity buyers/processors and participating financial institutions.
Partnership space

Four types of partners prevail in VC scale-up initiatives: (i) the private sector; (ii) producer organizations; (iii) donors; and (iv) governments at different levels. Partnership is not purely or primarily for resource mobilization, but also to access knowledge and leverage influence and outreach. Within a VC project, the most important step is to identify the key potential VC partners that will address the needs of the target population, and to understand these partners’ business models and risk/profit drivers. The initial IFAD VCD intervention or project serves to learn about these VC partners, and broker the relationship between them by setting up institutional arrangements that can maintain a fair distribution of gains along the chain while satisfying product requirements of the target market. Other donors might either replicate the design features of the IFAD VCD intervention in larger projects, or – more importantly – assist IFAD in creating a political momentum to push the needed reforms to enhance market access for its target group, or otherwise strengthen the institutional capacity of the latter.

There is enormous potential to scaling up VCD poverty-reduction efforts by boosting partnerships that merge the interests of smallholder farmers with those of private companies. Partnering with the private sector allows leveraging the resources of the latter in order to scale up development interventions and reach out to a greater number of poor rural people. The 4Ps mechanism described in box 2 can be used as an innovative instrument to implement IFAD’s scaling-up agenda; i.e. projects should be conceived as tools to achieve more substantive and systemic change in terms of rural poverty reduction by, for example, leveraging private-sector investment and facilitating win-win, sustainable and inclusive business models. The 4Ps mechanism also includes producers and the government as development partners, given that public/donor funds are provided as a grant to kick-start and fill the financing gap of viable business plans focusing on public or semi-public goods that will not be funded by the private sector.

Risks of scaling up value chain approaches

Scaling up VCD results can entail a number of social, economic and environmental risks that need to be considered and mitigated (table 1). Some can be addressed ex-ante through better design, while others can only be addressed during implementation of the scaling-up process. Monitoring can thus help to identify and address risks early on.

| Table 1. Risks of scaling up value chain interventions and mitigation strategies |
|-----------------------------|-----------------------------|
| **Risk of scaling up**       | **Potential mitigation strategy** |
| Complexity: What might have worked on a small scale can run into difficulties if scaled up. Varying capacities of actors involved might constrain scaling up beyond a certain point, but also design features of certain mechanisms might only work up to a certain size. | Keep the design simple initially, attempt scaling up in phases. Complement scaling up with capacity-building of VC actors. |
| Market saturation: Prices can collapse because of oversupply. This is a risk especially for annual crops with peak seasonal demand. | Ensure sufficient market intelligence and monitoring, plus sharing of risks along the chain. Diversify farmers’ VC linkages. |
| Changes in market demand: This includes the volatility of prices, fashion or taste that has negative effects for the producers. | As above. |
| Financial constraints to sustain the model: For example, the use of matching grants or similar non-sustainable instruments. | Expand sources of finance and develop more sustainable VC instruments. |
| Bargaining power of IFAD target group reduced: Scaling up can lead to deterioration of the producers’ bargaining situation if the competition at the tail end of the chain increases without additional options to sell further upstream. | Empower target group to have a seat at the table where benefit and risk sharing is discussed. |
| Increase in inequality: If not paired with approaches to include the poorest/marginalized rural people, scaling up of VCs – which usually already involve those that are more economically active – might further increase exclusion and inequality. | Mitigation might be feasible through employment generation for the poor along the VCs, or specific non-VCD activities targeted to those outside the VCs. |
| Adverse impact on food security/nutrition and diversity of livelihood systems: The move out of subsistence production into commercialized production may entail risks, since farmers give up food self-sufficiency and become dependent on incomes and food purchases to feed their families. Increased concentration on only one or two commodities increases farmers’ vulnerability to price and production shocks. Monocropping may lead to food security risks as farmers may switch from food to cash crop production, which may not satisfy household food consumption needs. | Encourage a diversified and mixed farming system for small farmers; avoid monocropping; build awareness; encourage a diversity of income sources and integration into more than one VC. |
Negative environmental externatilities: There is a risk that scaling up might lead to resource depletion (e.g. water, soils, forests), and overuse of pesticides and other chemical inputs. Large-scale processing could also have negative environmental consequences if the technologies used are not climate-smart or green.

Support green and climate-smart agricultural technologies and processing/transport equipment.

Commercialization crowds out women: A VC intervention can lead to changes in intra-household distribution of power, e.g. if men take over women’s crops due to increased profitability. Scaling up of these interventions might exacerbate this tendency.

Mitigation through awareness-raising, improved design and empowering measures (see also How-to note on Commodity value chain development projects: available at http://www.ifad.org/knotes/valuechain/index.htm).

Monitoring and evaluation

In general, scaling up of VCD interventions should result in a greater number of small producers benefiting from the commercialization of agricultural production, as well as in systematic changes in the whole VCD environment in the targeted country. In addition to the common indicators used to gauge the success of VC projects (see the relevant How To Do Note), the project should develop additional indicators to measure the success of scaling up. To do so, the M&E system must look beyond project outputs and outcomes, and encompass the broader, long-term impact of system change – for example, the overall impact on communities’ livelihoods, extent of market orientation of small producers, number of links between the private sector and producers, number or capacity of local business service providers, improvement of access to markets, access to inputs and credit, VC finance. Furthermore, when a VC approach is promoted, the above-mentioned risks to scaling up should be closely monitored to allow early mitigation.

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