FROM SMALLHOLDER TO SMALL BUSINESS

Private sector insights on service delivery models that boost profitability along the value chain
The smallholder farmer is at the heart of the economic transformation of African agriculture. As demand for agricultural products rises, partnering with smallholder farmers offers agribusiness companies significant opportunities. For this to succeed, we need to improve the profitability of smallholders, their integration into value chains and build economically-viable service models.

How to reduce side-selling? How to viably ensure smallholders have access to quality seeds, fertiliser, information and financial services? How to aggregate small land parcels to create better scale for production? These kinds of practical, commercially-driven questions are now being asked by pioneering companies and farmer organisations, but they tend to be addressed in isolation. This we need to change. To achieve transformative scale we need to rapidly accelerate innovation and up-take of best practices.

Grow Africa and IDH – the Sustainable Trade Initiative (IDH) – have partnered to support companies and farmers in harvesting the opportunities and in addressing the challenges. We have convened a Smallholder Working Group, a network of remarkable people at the heart of businesses and farmer organisations working directly with smallholders. The group examines concrete challenges faced by its members, and then taps in to their collective knowledge and experience to highlight and share emerging best practices. And because these are people with “muddy boots”, the group is building a body of practice rooted in commercial realities, rather than development theory.

This paper offers a first set of insights distilled from the knowledge of leading practitioners. We still have plenty more questions to unpack – harnessing ICT, accessing affordable finance, delivering training, gender differentiation, aggregation models – so please join us if you too are ready to get your boots muddy. We believe that through collaboration and knowledge sharing, smallholders can thrive, companies can profit, and Africa can grow.
IN AFRICA, 90% OF AGRICULTURAL PRODUCTION IS CARRIED OUT BY AROUND 33 MILLION SMALLHOLDER FARMERS. THE MAJORITY OF SMALLHOLDER PRODUCTION IS DRIVEN BY SURVIVAL FARMING, WITH MULTIPLE CONSTRAINTS TO COMMERCIALIZING SMALLHOLDER PRODUCTION.

However, the globally increasing demand for food production creates large opportunities, and urgency, for the private sector to work directly with the smallholder supply base to secure supply of agricultural commodities, especially to serve growing domestic and regional African markets.

Socially inclusive business models, in which the private sector works with their smallholder supply base have tremendous development potential. They can create shared value for companies, producers and consumers alike, with economies of scale lowering risks and costs. They can also provide opportunities for farmers to become more productive and profitable by capturing and adding value to their products.

However, as new trends emerge in the development of socially inclusive business models, in some cases smallholders are seen as “suppliers,” working solely to fulfill the obligations of a contract. In these instances, off-takers often find their supply chain is unsustainable or unreliable. Farmers on the other end struggle to continue to supply cash crops, and are unable to transition into commercial farming. They often have a range of unmet household needs; such as food security, payment for school fees and healthcare, and are exposed to uninsured lifecycle risks that often lead to increasing indebtedness.

Achieving a holistic farming system in which smallholder farmers are well embedded, able to uphold their contractual obligations and engaged in a mutually profitable relationship with off-takers and investors, therefore requires a deeper understanding of smallholder farm dynamics. Increasing the productivity of smallholders through technical assistance, inputs and finance is starting to be understood as an integral piece of the overall profitability of the off-taker. If a smallholder farm is more viable, farmers are better able to make use of services delivered by an off-taker effectively, as well as to repay them without default. They also potentially have more resources (time, effort and funds) to invest in the contract crop, because their other needs are adequately met.

Although access to inputs and support services is seen as the way forward for successful smallholder inclusive business models, many businesses are struggling to set up service delivery models for farmers as clients. Therefore, this publication was developed to share some lessons from agribusiness companies working with smallholder farmers across sub-Saharan Africa, as they “learn by doing.” These cases and strategies have emerged from the Grow Africa – IDH Smallholder Working Group (SWG)1, which organizes private sector learning and engagement on topics selected as relevant to the day-to-day operations of these businesses working with smallholders.

The publication begins by setting a common understanding of service delivery, with case examples from companies actively working in the field. This is followed in chapter three with examples of some of the key challenges that must be overcome on the ground, like side-selling, ensuring there is access to finance for smallholders, and aggregating land to enable larger-scale commercial production. In our conclusions, we endorse a new approach to inclusive business taken by agribusiness in Africa, and raise some additional questions that are still to be addressed in the next stage of the work of the Smallholder Working Group.

1. In the publication there are also two cases from the IDH Network.
2. SERVICE DELIVERY MODELS

2.1 MAKING SERVICE DELIVERY MODELS WORK FROM FARMER TO OFF-TAKER

1. WHAT ARE SERVICE DELIVERY MODELS?

Service Delivery Models are the mechanisms or structures in which support services are channelled through a supply chain to improve performance and value creation. Off-takers sometimes invest in weak value chains, offering services to farmers, as a means to secure the required volume and quality of supply. Value chains are typically weak if they include many smallholder farmers, who often face challenges in meeting the increasing demands of off-takers and in making the transition from subsistence farming to market-oriented production.

LIST WITH DEFINITIONS

**Off-taker**  
The party that is buying the produce of the smallholder farmers.

**Outgrower model**  
A contractual relationship between smallholder farmers and a company in which smallholder farmers receive inputs, technical assistance, the purchase of their crop is guaranteed subject to meeting predefined standards and smallholder farmers typically receiving a pre-agreed percentage of the final sales price of the product.

**Service delivery model**  
The mechanisms or structures in which support services are channelled through the supply chain to improve performance and value creation. Types of services include training, inputs, financial services, markets and value added services.

**Smallholder farmer**  
A smallholder farmer is generally defined as farming 7 hectare or less, although this may differ per crop and country. Other indicators that determine whether a farmer is a smallholder farmer are market orientation, labor input, level of income and type of farming system.
II. WHAT ARE THE TYPES OF SERVICES SUPPLIED?

The types of services that can make up a service delivery model including:

- **Training** – quality and productivity training, as well as training on farm management practices, such as record keeping and business planning.
- **Inputs** – planting seed, fertilizer, crop protection products, pesticides, insecticides.
- **Financial services** – inputs on credit, cash advances, pre-harvest finance.
- **Marketing** – bulking of produce and creating access to markets.
- **Value adding services** – services that add value to the product of smallholder farmers, such as mechanisation (use of tractors), processing, post-harvest handling and storage services.

Training, inputs and farmer credit are interdependent, as extension and training informs and affects which inputs are used, which is in turn shaped by access to credit. Hence, ideally, only smallholder farmers who have adequate knowledge of input usage would also get access to inputs on credit. These services are often delivered together (bundled) to optimize their effectiveness. There have been some successes, which will be discussed in this paper; however, despite significant investment in service delivery, there is scant evidence on proven models or mechanisms, and few established benchmarks and best practices.

III. WHAT ARE THE DIFFERENT MODELS OF SERVICE DELIVERY AND WHEN ARE THEY USED?

The different models of service delivery are grouped into broad categories according to the relationship between off-taker and farmer, the type of service delivery model and the negotiating power of farmers.

The model that has been adopted in the value chain takes into account the trade-off between increasing investment by the off-taker and increasing risk of inconsistent supply. Typically, there is higher off-taker investment in service delivery when end-market requirements are complex and the quality of local input markets is poor. For example, specialized export commodities, such as fine beans, mangoes and malting barley, require specific seed varieties, high-quality fertilizer and other agrochemicals to achieve off-taker requirements. These inputs are often not available on the open market; it is therefore in the interest of the off-taker, if he is interested in specialized commodities, to invest in providing access to these inputs. Alternatively, in captive markets, where there are limited outlets for the farmer’s output, it is in the interest of both off-takers and farmers that inputs are supplied on credit, with the cost recouped through the farm-gate price. Or, in open markets, where side-selling is high, off-takers mitigate their risk by transferring it to financial institutions, which facilitate input credit for farmers.

The degree of influence that a smallholder farmer has on the business decisions of the off-taker, particularly around farm-gate price, generally decreases as the relationship tightens. For instance, nucleus estate models often require a purchase monopoly, which undermines local negotiating power. However, there is a trend towards investments with both high financial and social returns, which actively cultivate fairer relationships – for example, in the land aggregation cases of Value Farms and Phata Cooperative (see pages 38 and 39 respectively). In some cases, price negotiation with buyers is being done on behalf of farmers, together with building-in an upside for farmers, who have an equity stake and can benefit from the profits of a processor or farmer association. These practices support the transition from subsistence to commercial agriculture.

### MODELS OF SERVICE DELIVERY

#### INFORMAL
- **Services:** Purchase, Planting, Processing
- **No relationship between farmer and off-taker**
- **High off-taker-farm coordination with direct purchase of supply by off-taker from farmer**
- **Combination of direct contracting of out-growers with centralized production and processing**
- **Increasing off-taker investment**
- **Decreasing negotiating power of farmers**
- **Increasing risk of inconsistent supply**

#### CENTRALIZED
- **Services:** Plants, Fertilizer, Purchases, Processing, Training
- **No services provided**
- **Off-takers subcontract intermediaries to provide services**
- **Increasing negotiating power of farmers**
- **Decreasing risk of inconsistent supply**

#### MULTIPARTITE
- **Services:** Inputs, Outputs, Investments
- **No services provided**
- **Off-taker provides services directly**

**SOURCE:** modified from TechnoServe, 2011

3. The price not including costs for shipping, storage, marketing, and profit margins of the involved companies.
4. Where a producer has committed to selling to a particular off-taker, but breaks that commitment to sell to someone else.
5. For example, AgBlue’s investment in Empresa de Comercialização Agrícola Ltd Mozambique, and AfricaJUICE, a joint venture company in Ethiopia exporting Fairtrade-branded juice.
### IV. WHAT ARE THE RISKS AND BENEFITS OF SERVICE DELIVERY MODELS FOR OFF-TAKERS AND FARMERS?

The risks and benefits for both off-takers and smallholders within each type of Service Delivery Model are listed according to type of model:

<table>
<thead>
<tr>
<th>Model</th>
<th>Offtaker</th>
<th>Farmer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Informal</td>
<td>Risks: No control over supply</td>
<td>Risks: No agreement or guarantee for off-take of their produce, no access to services</td>
</tr>
<tr>
<td></td>
<td>Benefits: No costs involved, fully flexible to make changes around who to source from</td>
<td>Benefits: Free to sell to anyone</td>
</tr>
<tr>
<td>Intermediary</td>
<td>Risks: Dependent on quality of intermediary, risk of misunderstandings with smallholders due to indirect relationship</td>
<td>Risks: Dependent on quality of services of the intermediary – quality of services can be low, no direct contact with off-taker, which can result in lack of understanding of requirements of off-taker</td>
</tr>
<tr>
<td></td>
<td>Benefits: Service supply is outsourced, not core activity of the off-taker</td>
<td>Benefits: Access to services</td>
</tr>
<tr>
<td>Multipartite</td>
<td>Risks: Can be difficult to coordinate, different agendas for different stakeholders</td>
<td>Risks: No clear division of roles on service provision between multiple parties, risk of difference in agendas between multiple parties</td>
</tr>
<tr>
<td></td>
<td>Benefits: Specialized service supply</td>
<td>Benefits: Specialized service supply (each party can act on its strengths)</td>
</tr>
<tr>
<td>Central/Nucleus</td>
<td>Risks: High costs involved, low return on investment due to side-selling</td>
<td>Risks: Locked into supply chain of off-taker</td>
</tr>
<tr>
<td></td>
<td>Benefits: Direct control over supply chain</td>
<td>Benefits: Centrally focused service supply, direct off-take of the produce. Off-taker has on-the-ground experience, vested interest in the business since off-taker also runs a nucleus farm</td>
</tr>
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### V. WHAT ARE THE CHALLENGES FACED IN SERVICE DELIVERY MODELS?

Significant investment in delivery of services to smallholder farmers does not always result in better crop supply. Challenges include:

- **Ineffectiveness of service delivery** – for instance, due to diversion of inputs to subsistence crops.
- **Side-selling** – by farmers.
- **Poverty** – service delivery models tend to focus on the contract crop, but smallholder farmers manage a whole farming system that includes subsistence crops for own consumption and sale. When farmers cannot afford to feed their families adequately, production of contract crops is also affected.
- **Inequality** – outgrower schemes can lock smallholder producers into relationships where they bear an unequal burden of cost and risk with limited returns; unequal bargaining power in particular results in farm-gate prices being forced down and ultimately to under-investment in their farms. Where they fail to meet commitments, farmers are frequently locked out of future engagement with specific off-takers.

Some off-takers are working on models to address these challenges by better understanding and meeting the demand for services by smallholders and creating more equal relationships. This is expected to increase the consistency of volume and quality of supply available to off-takers and ultimately secure the value chain.
2.2 CASE STUDIES OF DIFFERENT MODELS

1. THE DUPONT PIONEER CASE (GHANA) - SMALLHOLDERS AND DUPONT PIONEER INVESTING IN ADVANCED SEED TECHNOLOGIES, BOOSTING THE SMALLHOLDERS' PRODUCTIVITY AND CREATING NEW BUSINESS OPPORTUNITIES FOR BOTH

About the business
DuPont Pioneer is a leading developer and supplier of advanced plant genetics, providing high-quality seeds to farmers in more than 90 countries. DuPont Pioneer develops and distributes high-quality corn, soybeans, sorghum, sunflower, alfalfa, canola, wheat, rice, cotton, pearl millet and mustard seed, as well as forage additives, and a variety of services and expertise.

Main sustainability issues
The average farm size in Ghana is 1.2 hectares; there is very little use of technology: yields are low (up to 2 metric tons per hectare) and farmers are not well integrated into the supply chain. GAMSAP provides a range of services to increase household incomes by improving access to credit, hybrid seeds, better agronomy, secure input and output markets, post-harvest handling practices, and market links with end-customers.

Risks and benefits
The partnership is designed to demonstrate the benefits of new hybrids, and to encourage farmers to invest in their businesses with productivity-boosting technologies. In 2014, 111 comparative demonstration plots were established on smallholder farms to expose farmers and their neighbors to the yield increase potential of hybrid seeds. In 2015, the program will set up more than 258 demonstrations to boost the maize supply chains of at least 70 nucleus farmers. Training is provided on agronomy of hybrid maize, including soil tillage, plant spacing, timing and application of pesticides, identification and management of pests and diseases, as well as harvesting and post-harvest techniques to maximize profit.

The link between out-growers and markets, through nucleus hubs, supports farmers to overcome production constraints. For example: timely land preparation with tractors owned by nucleus farmers who provide ploughing services to be repaid in kind after harvest; extension services such as access to quality inputs, information and training on good agronomic practices; and providing guaranteed markets. Selection criteria developed for an out-grower business to participate in the program include their own farm acreage, level of existing and potential engagement with smallholder farmers, willingness to plant improved seed, and ability to secure the other inputs for their commercial operation.

The benefits and successes of the project so far have included:

- The program has raised yields from 2 metric tons per hectare to an average of 6-7 metric tons per hectare (up to 8-9 metric tons per hectare was realized on some smallholder farms) for participants.
- In 2014, GAMSAP directly impacted 3,000 farmers. This will increase to 7,000-10,000 in 2015. The aim of the program is to scale up to 50,000 farmers by 2018.
- Links to formal and quality markets have increased for 3,500 maize farmers who are trained on the required standards, and how to grade produce to receive better prices.
- There has been increased awareness about the interdependence of agricultural value chain players and the need for their collaboration and investment.

Challenges
- Risk aversion and initial reluctance by smallholder farmers to engage with new technologies.
- Access to reliable extension services to ensure correct use of the seeds and inputs once farmers have actually overcome their initial scepticism and purchased them. Pamphlets have been produced to provide farmers with information on correct usage.
- Lack of support for women farmers, who are often not present at demonstrations and who do not have decision-making power in the household, although they generally do a greater percentage of the manual farm work.
II. THE ECOM CASE (GHANA) – SETTING UP AN INNOVATIVE MODEL FOR ACCESS TO FINANCIAL SERVICES FOR SMALLHOLDERS TO BECOME MORE COMMERCIAL Viable, AND CREATING A PROFITABLE BUSINESS FOR ECOM

About the business
Ecom Agro-industrial Corp. Ltd, a global commodity trading and processing company specializing in coffee, cotton, and cocoa, is developing a pioneering model of financial services delivery. Ecom is an origin-integrated company, purchasing directly from farmers and processing products for export, with operations in more than 30 countries worldwide.

About the Service Delivery Model
Ecom has developed a business model to smooth out cycles of trading company profits, as well as to reduce the risk of working with smallholders who are often highly indebted and have a low resource base. They aim to unlock farmers from traditional outgrower contracts and enable farmers to access financial services to reduce indebtedness and become more commercially viable. Off-takers do provide financial services to a selection of their farmer base, but such finance is focused on the contract crop, not other financial needs.

As part of its core business strategy, Ecom is developing a pioneering model of service delivery, to improve the long-term profitability of farmers. Certification hasn’t changed poverty levels, and production will only be maintained if farming is more sustainable and adds more value to the farmers. The new Service Delivery Model changes the way Ecom views the farmer – from being purely a supplier of cocoa, to being a creditworthy entity beyond their primary product.

From 2010-2014, Ecom provided marketing, advisory input supply and community development services to farmers, but found that yields did not increase substantially because of poor access to finance. The new model will establish an independent company to provide financial services to farmers, thereby de-linking financial service delivery from sourcing. Farmers will continue to receive the range of other services but will have access to a wider range of services (including insurance, savings and longer-term loan products). This inclusive all-rounded package is aimed at supporting farmers to diversify production and increase their commercial viability. Ecom expects to have a comparative advantage over other financial institutions because they are able to reach a significant number of farmers; they already have structures in place in rural areas; and they have long standing relationships with the farmers.

Main sustainability issues
Ecom is currently focusing on product development that will address the main threats to sustainability. Insurance products for life-long events (life, accident, work disability, terminal illness) will be introduced first, followed by savings for smaller life risks. A loan portfolio will support farmer cash-flow management to facilitate input finance for cocoa and other crop production. Financial literacy training will be provided to reduce likelihood of adding to indebtedness.

Ecom predicts that increased access to financial services by farmers will increase productivity, which means more cocoa will be available for purchase. Farmers will not be contracted by Ecom and will be free to sell to any off-taker, but are likely to continue to supply to Ecom because of the range of benefits provided (premium prices for crops, links to chocolate makers, etc).

Farmers will make repayments in cash rather than through commodities, which reduces the credit risk for Ecom. Farmers who repay will have access to further benefits, to create a positive experience rather than a negative one of over-indebtedness. The sourcing company will recommend creditworthy farmers to the financial services company for a fee, which creates a clear financial incentive between the two companies.

There will be a significant sharing of knowledge between the farmer and Ecom’s sourcing company.

Challenges
• How to set the threshold for profitable gain in a way that is fair to farmers. For instance, in some countries there is a cap on interest rates, but this is not yet in place in Africa, which can lead to unethical practices.
• How to manage the risk of farmers becoming locked into the system for multiple crops. The model is still under development. It will be piloted with smallholder cocoa farmers in 2 districts in Ghana in early 2015 and scaled up quickly to around 100,000 farmers.

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Risks and benefits
The benefits and successes of the project so far have included:
- Partnerships with research organizations to link farmers with new technologies. FONG carries out surveys to identify farmer needs, facilitates access to new varieties (such as striga and drought resistant varieties) and supports on-farm demonstration plots through farmer field schools.
- Supporting farmer organization with access to markets through linkages to off-takers.
- Lobbying government to improve the provision of fertilizer subsidies to farmers, in partnership with Ghana Federation of Agricultural Producers (GFAP).
- Lobbying input suppliers to set up depots closer to farmers to increase access to fertilizer and other inputs.

One of the successes of FONG's advocacy work with financial institutions is for the provision of credit to women farmers on their own merits and without the need for the husband to act as guarantor. They also work with financial institutions to secure better terms for loans.

Challenges
The key bottlenecks in setting up a farmer organization are:
- Leadership has not always been reliable.
- Farmer organizations plan to provide inputs but they are often not provided in the correct quantity or quality.
- The services farmers requirements are not always provided – for example, more tractors or more effective extension services.
- Access to Market

About the network
There are around 168 member farmer organizations, supporting 460,000 farmers, around 35% of whom are women. The members are diverse, with large variations in size, spread across ten regions of Ghana. FONG is funded from membership fees and receives grants from development partners, such as IFAD, EU, and the Network of Farmers’ and Agricultural Producers’ Organizations of West Africa (ROPAW).

FONG formation was initiated by four networks, including DAA, BARDEC, and EASARD, and Sister Aid. The Development Action Association (DAA) is a farmer organization with 89% female membership (2,000 women) operating in 46 communities across five regions of Ghana. It partners with FARA, Women Thrive Worldwide, FAO, Action Aid and MDFA.

Main sustainability issues
Current projects of FONG include: sweet potatoes fortified with vitamin A, cocoa women's producer program, vegetable irrigation, fertilizer, micro-credit and savings and nutrition.

About the business
FARMERS’ ORGANIZATION NETWORK IN GHANA (FONG) CASE (GHANA) – SUPPORTING FARMER ORGANIZATIONS TO INCREASE ACCESS TO SERVICES FROM RESEARCH INSTITUTES, AGGREGATORS AND FINANCIAL INSTITUTIONS

About the network
Farmers Organization Network in Ghana (FONG) is a network of small-scale farmer and fisher folk organizations, which was registered in 2003. The aim of FONG is to empower agricultural organizations to become profitable and attractive business ventures. FONG functions as an umbrella organization that engages in policy advocacy and capacity building for its members in order to contribute to agricultural development, economic growth and sustainable use of natural resources. They work on rice, maize, palm oil, cassava, yam, vegetables, plantain, banana, cereals etc.

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- Lobbying government to improve the provision of fertilizer subsidies to farmers, in partnership with Ghana Federation of Agricultural Producers (GFAP).
- Lobbying input suppliers to set up depots closer to farmers to increase access to fertilizer and other inputs.

One of the successes of FONG’s advocacy work with financial institutions is for the provision of credit to women farmers on their own merits and without the need for the husband to act as guarantor. They also work with financial institutions to secure better terms for loans.

Challenges
The key bottlenecks in setting up a farmer organization are:
- Leadership has not always been reliable.
- Farmer organizations plan to provide inputs but they are often not provided in the correct quantity or quality.
- The services farmers requirements are not always provided – for example, more tractors or more effective extension services.
- Access to Market

About the network
There are around 168 member farmer organizations, supporting 460,000 farmers, around 35% of whom are women. The members are diverse, with large variations in size, spread across ten regions of Ghana. FONG is funded from membership fees and receives grants from development partners, such as IFAD, EU, and the Network of Farmers’ and Agricultural Producers’ Organizations of West Africa (ROPAW).

FONG formation was initiated by four networks, including DAA, BARDEC, and EASARD, and Sister Aid. The Development Action Association (DAA) is a farmer organization with 89% female membership (2,000 women) operating in 46 communities across five regions of Ghana. It partners with FARA, Women Thrive Worldwide, FAO, Action Aid and MDFA.

Main sustainability issues
Current projects of FONG include: sweet potatoes fortified with vitamin A, cocoa women’s producer program, vegetable irrigation, fertilizer, micro-credit and savings and nutrition.
Pilot activities will start in 2015 on the Village Orchard Model, with use of drip irrigation on one site of 5 hectares of communal land, with 4 hectares of mangoes inter-cropped with legumes and 1 hectare for another innovative program called ‘Garden to Mouth’, which encompasses nutrition, economics and smart agriculture for community food production (expanding to a maximum of three sites), as well as piloting on nearby sites with the Clinton Foundation.

Funding is being sought from development partners to scale up the Village Orchard activities and to start the smallholder component of the Incubator Farm model. Malawi Mangoes is actively involved in lobbying government and development partners to provide targeted infrastructure such as roads, electricity and water to land that is or can be made productive, and recognizing this same infrastructure can be expanded to include the surrounding smallholders. Playing a role of facilitation rather than implementation.

V. THE NAFICS CASE (KENYA) – USING SERVICES SUCH AS MOBILE DRYING FACILITIES AND WAREHOUSE RECEIPT FINANCING TO ADD VALUE FOR SMALLHOLDERS AND SUSTAIN A PROFITABLE BUSINESS MODEL FOR NAFICS

About the business
NAFICS is a grain trading company operating in Kenya since 2013. It is part of a group under Investics Holding, which has established a range of social businesses in East Africa, including AGRICS Ltd Kenya, providing different services along the value chain to support smallholder farmers to become more economically viable. In 2014, 1.872 metric tons of grain were sourced from smallholder and large-scale farmers and traded. In addition, 4,094 metric tons of grain were traded jointly with other agents/grain assemblers (commission sales). In 2015, the target is 10,000 metric tons.

About the Service Delivery Model
NAFICS have established a warehouse receipt system in Western Kenya, licensed under the East African Grain Council. The operation is part of a group under Investics Holding, which has established a range of social businesses in East Africa, including AGRICS Ltd Kenya, providing different services along the value chain to support smallholder farmers to become more economically viable. The core services include:

- **Off-taker**: NAFICS buys maize via direct payment to non-contracted farmers during harvest seasons when volumes are high and prices are low. In 2014, 3,000 metric tons of grain were sourced from smallholder and large-scale farmers.
- **Training**: NAFICS trains farmers on product quality and storage.
- **Financing**: NAFICS provides financing to farmers to purchase inputs.

Main sustainability issues
- **Importation of grain under the East African Common Market and beyond is a threat to the business. It creates volatility in the domestic market and means that a private off-taker does not have any comparative advantage in maize. NAFICS is therefore encouraging farmers to diversify away from maize production to higher value crops for domestic markets.**
- **Price setting mechanisms under the influence of the state/National Cereal Produce Board (NCPB) create political pressure for the government to deliver.**
- **Price setting mechanisms under the influence of the state/National Cereal Produce Board (NCPB) create political pressure for the government to deliver.**
- **NAFICS works with local government, who deliver government subsidies, to share the specific input requirements of farmers and support farmer groups to access subsidies in aggregate. This creates political pressure for the government to deliver.**
- **NAFICS works with local government, who deliver government subsidies, to share the specific input requirements of farmers and support farmer groups to access subsidies in aggregate. This creates political pressure for the government to deliver.**
- **NAFICS buys against market prices, whereas farmers hope for premiums.**
- **NAFICS buys against market prices, whereas farmers hope for premiums.**
- **NAFICS buys against market prices, whereas farmers hope for premiums.**

Centralized

NAFICS have established a warehouse receipt system in Western Kenya, licensed under the East African Grain Council. Farmers can use the receipt as collateral at a bank to access up to 65% of the value of the crop in additional finance. NAFICS currently operates three warehouses and has traded 567 metric tons through the system to date. Mobile drying facilities are also offered prior to storage, to reduce post-harvest handling losses. An SMS system is being developed to disseminate market information by mobile phone to more than 4,000 farmers.

NAFICS buy maize via direct payment to non-contracted farmers during harvest seasons when volumes are high and prices are low. Grain is competitively priced depending on trends and quality. It is stored and treated, then sold to millers outside the harvest season when prices are high. AGRICS operates as a sister company to NAFICS, working with fertilizer and seed suppliers to secure sustainable supply. Farmers are provided with a bundle of services, including technical training and inputs tailored to each farmer’s specific needs, and benchmarked against market prices. Credit for inputs is repaid in cash. In the first year, default rates were high since payment was due after harvest and volumes are consistently insufficient. AGRICS therefore encouraged farmers to diversify their activities to generate weekly income prior to crop harvest, such as vegetable and chicken production, in addition to setting up a robust credit management system. Repayment rates have increased to 95% in 2014 up from 70% in 2013. The customer base has similarly increased to 12,000 smallholders. AGRICS aims to increase repayment rates to 95% and scale up the customers served. Through AGRICS, farmers are linked to NAFICS, who offer a range of additional services as incentives, but are free to sell anywhere.

NAFICS works with farmer groups, supporting them to register and become legally recognized. These groups access government subsidies (see below) and receive social services from an associated NGO. The business model is set up for these groups to own shares in the company.

and savings products, and receiving a range of employment benefits, including access to healthcare, pensions, etc.

- **IFC led investment to Malawi Mangoes to expand operations to an additional 3,000 potential employees, doubling employment in the local area and providing a significant contribution to tax revenue (increasing from US$1 million in 2013 to over US$2 million in 2014).**
- **Expansion of cellphone network coverage by the local service provider to the farm**
- **Building of roads, which improves access to local shops and businesses**
- **Potential decrease in charcoal-burning through creation of alternative employment.**

Challenges
- **Attracting development finance for hardware delivered by a private sector company to another private sector company.**
- **Development finance is mainly available for activities such as training and capacity building, and people are nervous about funding the private sector.**
- **Government not playing an active role in provision (subsidizing) of drip irrigation in Africa, which currently limits the technology.**
- **Creating a critical mass of farmers is difficult because outgrowers are spread over a wide geographical area, which provides challenges for supervision and management.**
- **Financing the expertise required to provide initial and follow-up training to farmers and to build their capacity to utilize the technology effectively. Private sector are best placed to do this, but dealing with smallholders is risky and expensive therefore shareholders are reluctant to invest.**
- **Refocusing Government and Development partners to finance targeted infrastructure such as roads, electricity and water to land that is or can be made productive, and recognizing this same infrastructure can be expanded to include the surrounding smallholders. Playing a role of facilitation rather than implementation.**
VI. THE OLAM CASE (COTE D’IVOIRE & MOZAMBIQUE) – INCREASING SUPPLY CHAIN EFFICIENCY BY DIRECT LINKING WITH SMALLHOLDERS, RESULTING IN BETTER INCOMES FOR SMALLHOLDERS AND MORE SECURE AND BETTER QUALITY BUSINESS FOR OLAM

About the business

Olam International is an agribusiness operating from seed to shelf in 65 countries, supplying food and industrial raw materials to customers worldwide. Olam works with cocoa, coffee, cashew, rice and cotton, among other commodities.

Centralized

Main sustainability issues:

The initiative has developed and implemented a management information system called 3S – Sustainable Supply System. The 3S traces the quality and quantity of cashews from farmer to retailer. With these new levels of traceability, Olam is able to benchmark the production of different farmer groups, identify their specific needs, and offer targeted trainings and inputs so that farmers can improve the quality of the cashew. The quality requirements are very strict and highly dependent on humidity. Farmers are registered and individual performance is tracked. If farmers deliver cashew below the quality threshold, this will show up in the database.

Training on traceability, commercial issues, child labor and organization was provided in the pilot year (2012-2013 in Cote d’Ivoire, 2014-2015 in Mozambique). The 3S provides insight into where production needs to be improved, so that further training/support can be given.

The 3S has been installed in Cote d’Ivoire, where 25,263 farmers are linked to the system and work is being done to bring about a sustained improvement in production and product quality. In Mozambique, registration of farmers began in 2014, with the majority being registered in 2015.

Risks and benefits

The perceived benefits of improving supply chain efficiency are:

- For smallholder farmers – increased income through higher grade cashew production; increased quality through a range of inputs; and increased farmer liquidity through direct payment on day of purchase.
- For Olam – in terms of commercial benefits, Olam is diversifying and reducing risk through use of different models of buying (the proportion of direct purchase is still low, so middlemen are still used in many areas), visibility and reduction of transportation costs to the factory, visibility of quality (through a Management Information System – see below) and securing volumes. There are also sustainability benefits through the development of long-term, stable trading relations, and improving the quality and the yield of cashew harvests through improved visibility and transparency.

Middlemen purchase a range of crops directly from farmers and provide credit facilities. As there is no contract between Olam and farmers, Olam encourages farmers to sell direct to them through providing services, as well as delivering payment to farmers on the day of sale.

The project is executed in Cote d’Ivoire and Mozambique under increased supply chain efficiency. The reaction from middlemen is increased supply chain efficiency. The reaction from middlemen is positive.

Challenges:

- Low economies of scale – it is costly to source from scattered smallholders located in remote areas
- Side-selling – there are no structured contracts with farmers because they are hard to enforce around maize production. The focus is therefore on increasing volumes to have enough spare for sale/storage
- Repayment rates on credit scheme – now improving

Benefits and Risks

For Smallholder Farmers

**Benefits**

- One-stop shop to access a market and support, including storage and grain-drying services
- Access to finance/credit through WRS (in partnership with Chase Bank)
- Transparency and ethical practices (appropriate checks and, premium prices)
- Market information provision

**Risks**

- Early-stage business presents itself as high risk to financial investors
- Limited capital to buy and invest in growth
- Inflation and tariffs affecting market prices
- Marketing a new concept (WRS), which makes uptake slow
- Reluctance of banks to support/facilitate the warehouse receipt system
- Government intervention around subsidies (e.g. fertilizer) and price-setting mechanisms for grain (NCPB) undermines investment decisions and efficient operating costs

For NAFICS

**Benefits**

- Scalable and replicable business venture
- Commercially viable – Sustainable Social Business
- Integrated solutions (trade; support services and training in partnership with EAGC)
- Innovative business model and tailored solutions for farmers
- Ability to guarantee quality maize grain to customers through three-stage value chain interventions

**Risks**

- Rain-fed crop failure as a result of changes in weather (delayed rains, prolonged dry spells) as well as pests and diseases.
- Volumes required to participate (10 metric tons) are higher than smallholder farmers can currently produce (less than 0.5 metric ton). NAFICS are defining a better model for entry for smallholders
- Creditworthiness is low for smallholders due to low productivity
- Limited number of financial institutions willing to operate in the smallholder farmer space
- Influence of the National Cereals Board, which sets prices that are different to (often higher) current market prices

For more information on how 3S supports sustainable links throughout the entire supply chain, visit www.supply3s.com
Since the project was established in Cote d'Ivoire in 2012, it has organized 25,263 farmers in farmer groups, and provided training to these farmers in good agricultural practices, with an emphasis on harvest and post-harvest handling and the cultivation and maintenance of cashew trees. At the same time, all farmers were registered in the management information system to ensure traceability and create a feedback loop with Olam. In Cote d'Ivoire, the middlemen have been lobbying against the change in supply chain relationships, but there is protection by a government policy allowing direct purchase to take place.

Since the project started in Mozambique in 2014, more than 1,300 Fairtrade farmers have been organized, trained and linked up with export markets. Processors are guaranteed a more stable supply of better quality produce. Organized farmers negotiate as a group with the local processor, bypassing the intermediaries. Farmers receive a commission for gathering the nuts, plus a bonus for Fairtrade and quality, which provide incentives for further investment by smallholder farmers in the cashew nut chain.

Challenges

• Farmers are spread over a vast geographic area in Mozambique, which means there are relatively few collection points but multiple points for quality checking.
• There is an overall low quality of cashew nuts, which means that farmers have not been used to receiving a premium for their crop.
• Contract management services and collateralization management are not much in practice and changes in buying prices and exchange rates makes it challenging to provide (long term) credit to farmers.
• The scaling up of direct linkage with farmer groups will involve setting collection and evacuation points, financing and cash disbursement facilities, quality checks at each and every farmer location. A minimum number of farmers per group is necessary to ensure that the system will be cost-efficient.

VII. THE UNILEVER TEA TANZANIA (UTT) CASE – CREATING A NEW IMPACT MODEL FOR GREENFIELD INVESTMENT BY SMALLHOLDERS LEADING TO NEW INCOME SOURCES FOR SMALLHOLDERS AND INCREASED TEA SUPPLY FOR UTT

About the business

Unilever is a British-Dutch multinational consumer goods company and is the largest tea buyer in the world, purchasing 12% of global production. In 2007, Unilever became the first large-scale company to commit to sourcing all its tea in a sustainable manner, and certified its tea estates in East Africa, as well as third-party suppliers in Africa and other parts of the world. Unilever Tea Tanzania (UTT) is a fully owned subsidiary of Unilever PLC, focusing on tea growing, primary processing and export of black tea.

In 2013, UTT signed a Memorandum of Understanding with the government of Tanzania, through the Ministry of Agriculture, Food Security and Cooperatives, to further develop tea production and manufacturing in Tanzania. This was in line with the ten-year strategy of the national Tea Board and the five-year strategic plan for the transformation of the tea sub-sector developed by the Tanzania Smallholder Tea Development Agency. UTT partners with IDH on the Multiplier Outgrowers (MOG) project to develop the outreach program, and is part of Grow Africa.

UTT owns a 20,000-hectare estate with three factories in the Southern Highlands of Tanzania, of which over 7,000 hectares are being actively preserved as forest. 3,200 hectares are being farmed, and there is potential to expand production by 2,800 hectares. In order to further increase production, the MOG project is looking to expand the supply sources outside the existing estate and has identified around 20,000 hectares of available arable land in surrounding villages, which is not currently being used for tea production and is sufficiently close to the UTT estate.

About the Service Delivery Model

There are several existing farmers’ associations in the area. The MOG project will encourage farmers to join associations, which will act as points of contact for service delivery. Services to brownfield farmers are delivered through Farmer Field Schools to provide expertise and extension officers to disseminate knowledge – an approach that draws on successful experiences with 560,000 farmers in Kenya through a project between Unilever, KTDA and IDH.

A company will be established using patient capital finance, to provide extension services to the greenfield farmers, supply transport, and provide inputs on credit. The longer term objective is to give farmers ownership, as well as to secure the economic sustainability of service delivery over time. The company will initially have farmer representation and will eventually be farmer-owned. The business model for the service company is still under development, but will draw from the already established Services Company model in Njumbi, led by The Wood Foundation and Gatsby Charitable Foundation, with support from the UK Government.

Price setting for greenfield farmers

The Tea Board of Tanzania dictates a minimum level of return for smallholder farmers. The MOG project will provide a competitive price to farmers. It will also provide an attractive package that potentially supports farmers to increase yields and quality significantly, which will deliver increasingly higher returns and increase household income over time.

Main sustainability issues

A development project has been established with IDH to work with:

i. Brownfield farmers – who are already producing tea, to increase yields from 600kg/ha to 2,000 kg/ha through access to inputs on credit, better agronomic farming techniques and use of sustainable practices, and through training on complementary skills, such as financial literacy and health and farming techniques for other crops and enterprises.

ii. Greenfield farmers in the surrounding villages – who are not currently producing tea due to a range of barriers to entry, including a three- to four-year gap from planting to the first economic return (‘the valley of death’), lack of expertise and knowledge about tree planting and lack of access to supply of quality seedlings and inputs.

A significant part of the MOG project is to support greenfield farmers in entering the supply chain. These farmers have expressed an interest in tea production but lack the means to overcome these barriers to entry. Work has started with community leaders to help explain to potential farmers the commitment required for tea farming. A pilot program will start in 2015 in the target villages, to demonstrate the potential of tea production and to build farmers’ knowledge of best practices. The plan is to roll the program out into 3,200 hectares of greenfield land in a second phase (2016-2020).

Challenges

• Overcoming the barriers to entry for new tea farmers, whereby the MOG project provides inputs and services that will not be repaid until after the first economic harvest in three to four years.
• The need for clarification of land ownership to ensure farmers engaging in the scheme have legitimate rights to use the land, as well as compliance with future Rainforest Alliance certification requirements. Some farmers already have land titles; some areas are village land that will be allotted to farmers; some is ancestral land whose title will need to be clarified.
• Economic viability of the farmer-owner service company, which depends on sustained quality and quantity of production by smallholder farmers.
• Securing patient capital to fund the second phase of the development project, which is based on the terms required to ensure maximum profit is transferred to the smallholders. This will help motivate farmers to continue to supply tea, which will in turn ensure the viability of the service company.

8 This excludes land required for community legal requirements, both current and future.
9 With patient capital, the investor is willing to make a financial investment in a business with no expectation of turning a quick profit.
3. KEY CHALLENGES IN SERVICE DELIVERY MODELS

3.1 EFFECTIVE STRATEGIES TO REDUCE THE RISK OF SIDE-SELLING

I. WHAT IS SIDE-SELLING?

There are a significant number of outgrower schemes\(^\text{10}\) in which off-takers of crops offer services to farmers, investing in both a secure supply of produce and improving the productivity and quality of that supply. These schemes come with benefits and risks for both farmers and off-takers. A risk in these investments for both off-takers and processors is the practice of “side-selling” by farmers, whereby farmers sign a contract, then sell to a different buyer\(^\text{11}\). The off-taker then fails to source the expected supply and does not recuperate the cost of their investment.

II. WHAT ARE THE REASONS FOR FARMERS TO SIDE-SELL?

Some reasons that farmers side-sell include:

• Poverty – where poverty is high, farmers have an urgent need for cash and cannot afford to consider the long-term benefits of building a relationship with a firm. Instead, they adopt strategies to sell to the bidder that meets their immediate need for cash (this can also be before the produce has been harvested). Poverty levels also influence the repayment capacity of the farmer. Many rural households do not have bank accounts, savings or insurance, and are reliant on informal lending.

• Price – controlled markets with fixed prices are not conducive for side-selling, as there is little incentive for farmers. Floating prices, where variation is high, offer significant gains to farmers to sell outside existing agreements. Farmers may be unclear about contractual terms and feel prices are not fair or that he/she is being cheated.

• Influence of government policies – government can interfere with contractual relationships, for instance, by offering free inputs around election time.

• Farmer loyalty – farmer loyalty is low when relationships and trust between firm and farmers are weak, often caused by lack of transparency, and results in farmers not feeling obliged to repay.

• Late payment – firms that pay late encourage farmers to seek other firms that are able to pay.

III. WHAT ARE THE CONSEQUENCES OF SIDE-SELLING ALONG THE VALUE CHAIN?

For off-takers, side-selling can:

• Result in a failure to meet sourcing strategy targets. This makes it challenging to meet their contractual arrangements with their buyers, and forces them to procure from other districts/countries in order to deliver on their promised supply.

• Increase costs due to the need to source supply elsewhere, and non-recovery of the payment for their services. The scale of the costs incurred is likely to vary according to the size of the off-taker.

\(^{10}\) Outgrower schemes are a type of collaborative business model that are inclusive of smallholder farmers. Such schemes involve a central facility surrounded by growers who produce on their own land under contract and guarantees to purchase the growers’ crop subject to meeting predefined standards.

\(^{11}\) In some cases, farmers may side-sell but still meet their contractual arrangements by paying cash for the services received instead of delivering their produce to the off-taker.
For farmers, side-selling can:

- Provide a short-term gain, as they may have an urgent need for cash. This can result in the farmer receiving a lower price than if they were able to wait. In some cases, the farmer may receive a higher price, while not paying for the services they received from the off-taker.
- Result in exclusion from service provision by an off-taker, although the off-taker may continue to source from farmers who are side-selling.
- Result in exclusion from the supply chain of an off-taker; in many cases, it is difficult for the off-taker to take legal action against farmers who breach contract. Exclusion can partly be used as a strategy to set an example to others, but is also used to maintain efficiency of production in the outgrower scheme.

V. WHAT CAN OFF-TAKERS DO TO MITIGATE THIS RISK?

Despite having contractual arrangements in place, off-takers cannot usually rely on statutory and legal redress to influence farmer behaviour. Instead, the following best practices are being adopted:

- Trust-building between farmer and off-taker
  - Supply service – including access to inputs, information, finance, markets etc., which are attractive to farmers and provide tangible short-term benefits. These demonstrate the added value of the service supply of the off-taker, and give the smallholder a feeling of being privileged to be part of the service supply, leading to long-term relationship building.
  - For example, farmers are supported with better quality seeds, training, and access to markets, which lead to better productivity and a higher income for farmers; this decreases the scepticism of farmers towards off-takers and increases the trust between both parties.
  - Incentive schemes to reward farmers who are loyal – creating arrangements that motivate or encourage smallholders to produce more quantity and/or better quality crops; for example, creating savings accounts for farmers, providing inputs as a bonus, paying an after-payment. Savings accounts work well in tight supply chains and can support farmers to purchase a range of services themselves and therefore become more independent.

- Risk of existing and proposed government policies – the current political context, such as planned national or local elections, may also influence farmers’ decisions whether to side-sell. In some cases politicians can be promoting farmers not to fulfil their contracts and promise better prices to farmers just before the election.

Off-takers should assess:

- Expected production volume – when there is a scarcity of crop availability, for instance due to bad weather, the risk of side-selling increases.
- Structure of the supply chain – risk is reduced in a “tight” supply chain where there are relatively few buyers. If there are many buyers, it is highly likely that some will not have provided support to farmers and will be able to pay higher prices and incentivize farmers who received support from other buyers to default on their input loans. The number of buyers needed to create this side-selling dynamic is low (10 to 20).
- Number of potential buyers – crops with a low number of buyers require processing prior to use (which means costly processing equipment), have small and unreliable local markets coupled with high quality standards, and pay a high quality premium (export markets). As such, crops which are prone to higher levels of side-selling include basic food staples, local horticultural crops (tomato, cabbage, green leafy vegetables) and export crops such as cashews (which can be exported prior to processing).
- Reported yields compared to the quantities sold to other off-takers – these can be used to measure the potential for side-selling to competitors over a multi-year period.
- What compels/ attracts farmers to side-sell? – what kind of tangible benefits will encourage them to contribute to the supply chain? Direct payment for example can be a reason for farmers not to side-sell.
- Threshold of side-selling that the off-taker can accept – in terms of the double impact on revenue and at the field level. A margin can be built in based on the perceived risk of side-selling.

VI. THE YAANOVEL CASE – VARIOUS MECHANISMS BEING USED TO REDUCE THE RISK OF SIDE-SELLING

Yaanoval SA is a joint venture focusing on rice production established by Intervalle Geneva SA and the local government of Côte d’Ivoire in 2012. Intervalle holds 70% of the shares while the District of Yamoussoukro holds the remaining 30% of the shares. The goal is to create a business unit of agro-industrial production and outgrower schemes, processing and marketing rice over a targeted area of 25,000 hectares. The model is planned to be extended to cacao and coffee value chains as well.

About the business

Yaanoval SA is a joint venture focusing on rice production established by Intervalle Geneva SA and the local government of Côte d’Ivoire in 2012. Intervalle holds 70% of the shares while the District of Yamoussoukro holds the remaining 30% of the shares. The goal is to create a business unit of agro-industrial production and outgrower schemes, processing and marketing rice over a targeted area of 25,000 hectares. The model is planned to be extended to cacao and coffee value chains as well.

About the Service Delivery Model

One of the components is a pilot project with Syngenta Foundation, whereby Yaanoval SA supports farmers by supplying good agricultural practices, seeds and inputs, and purchasing the crop. The pilot works on 300 hectares of land with 100 farmers, including individuals, cooperatives and one large-scale farm. This will be expanded to 500 hectares and 300-400 farmers in 2015.
3. Challenges

Side-selling is one of the main risk factors of the model with reasons ranging from:

- Farmers do not have a proper understanding of how side-selling undercuts their business model. They need to understand how to make their business profitable, as currently many farmers produce poor quality rice that they struggle to sell.
- Côte d’Ivoire’s government supplied free seeds, which could potentially undercut Yaanovel SA’s sale of seeds to farmers if this subsidized operation should be renewed.
- Strengthening the protection of local markets from cheaper, subsidized rice imports would highly contribute to make local production more viable. Five out of eight companies leading on production in the government allocated zones have withdrawn mainly due to side-selling and current lack of competitiveness in local rice production.

Yaanovel’s risks mitigation approach and benefits for smallholder farmers

Yaanovel SA is working with partners to develop a range of support for smallholder farmers. Companies (collateral management) who are building capacity of smallholder farmers and working to ensure transparency around contracts. This includes various strategies to mitigate the risk of side-selling through providing benefits to farmers:

- Explaining the terms to farmers and negotiating a fair price.
- A holistic package of pre- and post-harvest support including direct inputs (i.e. seed, fertilizer, crop protection), indirect inputs (i.e. agricultural machinery for land preparation and harvesting), extension services, and a purchasing contract at a guaranteed price.
- Supervision and monitoring activities of farmers (“Know Your Customer”) to provide better understanding around how the inputs are being used, tracking the harvest etc.
- Coordination between the various actors along the value chain, which is particularly important for transparency.
- Yaanovel SA is working with various organizations including HEC-Wharton and Syngenta Foundation to develop mechanisms to provide a cross-guarantee between members of farmer groups to support repayment by members.

The main results of this approach have been an increase in the quantity and quantity of the smallholders’ yields and an increase of farmers’ incomes through fair prices and a guaranteed market.

3.2 HOW TO SUPPORT SMALLHOLDERS’ ACCESS TO FINANCE

I. WHAT ARE THE CHARACTERISTICS OF SMALLHOLDERS AND WHY DO THEY NEED FINANCE?

Smallholder farmers in Africa face a number of challenges, including low productivity, limited access to markets for their products, lack of adequate risk management products, and limited access to finance. While agriculture remains a key economic activity in Africa, employing about 55% of the population, only approximately 1% of bank lending goes to the agricultural sector.

Access to financial services is critical to provide funds for farm investments in productivity, improve post-harvest practices, ensure smooth household cash flow, enable better access to markets, and promote better management of risks. Access to smallholder finance is a significant challenge for smallholders, who constitute the vast majority of farmers in developing countries.

Financial services are defined as savings, credit and insurance products. Some institutions focus on delivering a broad package of financial services to farmers.

For instance, Ecom Trading takes a lifecycle approach built on understanding around the past and key life events and farmers’ strategies to respond to them. It is developing insurance products for life-long events to be introduced to farmers first to reduce indebtedness, followed by savings for smaller life risks. A loan portfolio will follow to support cash flow management.

NMB Tanzania (part of the Rabobank network) takes a different approach and offers rural households access to their first financial product in the form of savings, to build up a savings culture; reduce the possibility of becoming further indebted; and provide formal savings facilities often not available in rural areas.

II. WHAT ARE THE CREDIT NEEDS OF INDIVIDUAL FARMERS?

Leans can provide access to inputs and increase use of better quality inputs provided by trusted suppliers, rather than resorting to low quality or counterfeit products.

Credit is required for the following agricultural activities:

- Working capital/seasonal credit
  - Planting/planting materials
  - Farm inputs (chemicals and fertilizers)
  - Labour
- Long-term finance
  - Renovation of plantation
  - Small infrastructure/processing projects

Smallholders also have other credit requirements – emergency needs, such as funerals and hospitalization, and well as longer term needs, such as housing and education – which must also be met, otherwise they can out-compete credit needs for production.

III. WHAT ARE THE KEY ISSUES AND BARRIERS TO SMALLHOLDER FINANCE?

Financing agricultural activities is challenging:

- Agriculture is by nature seasonal, with a time lag between cash outflows and inflows.
- Farming is exposed to the volatility of weather and prices, and vulnerable to pests and spoilage.
- The challenges of irregular cash flows are compounded by a weak repayment discipline, cash diversion and crop theft.
- In turn creates risk and liquidity management challenges for financial service providers, in that farmers in the same area generally want to borrow at the same time, and are often undertaking the same activities, and are therefore exposed to the same risks.
- Further risks include lack of collateral and political risk, as agriculture is prone to government interventions, and risks are often not legally enforceable.
- Most farmers in Africa are women, but they are often harder to reach because they tend to have less education and less access to inputs and capital necessary to grow a business compared with men. In a number of countries, land titles are held by the husband’s name, which further restrains access by women to financial services.
IV. WHAT ARE THE MAIN OBSTACLES TO SMALLHOLDER ACCESS TO FORMAL CREDIT AT DIFFERENT LEVELS?

Smallholder Farmer (SHF) financing is constrained by:

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<th>SUPPLY</th>
<th>DEMAND</th>
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<tr>
<td>1. Products are not available and accessible</td>
<td>Financiers don’t have the expertise to design lending products</td>
<td>There is no enabling infrastructure</td>
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<td>Financiers struggle to roll out lending product</td>
<td>Financiers don’t have the right links with existing networks</td>
<td>There are a lack of credit bureau enable lending</td>
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<tr>
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<td>Financiers don’t have the expertise to design lending products</td>
<td>Regulation and policy does not enable lending</td>
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V. WHAT ARE THE CONSEQUENCES OF LACK OF ACCESS TO FINANCE?

For smallholder farmers:
• As the vast majority of smallholder farmers are too poor and under-capitalized to be considered bankable by formal financial institutions, they often gain access to informal sector finance. This comprises family members, relatives and profit-oriented local money lenders. For instance, only 5% of coffee-producing households operating in the Coffee Partnership for Tanzania took any loan product. Only 18% of these loans were provided by banks and 40% originated from informal credit sources (including SACCOs).
• Informal finance can impact negatively on business growth due to high interest rates. Middlemen or traders often act as intermediaries between producers and consumers. They can enter into agreements with farmers to purchase all output over an agreed period, with interest rates set as high as 50%. Middlemen can further inhibit profitability by setting purchase prices at low rates during the harvest season, which traps farmers into a cycle of debt.

For off-takers:
• When off-takers work with smallholders who are dependent on middlemen, there are relatively few incentives for smallholders to improve quality, since middlemen do not offer price differentials for better quality produce.
• When smallholders do not have access to finance, they cannot invest in their land and are not able to improve productivity, which limits the possibilities for off-takers to buy more products in the future.

VI. WHAT OPTIONS DO COMPANIES HAVE TO SUPPORT ACCESS TO FINANCE BY SMALLHOLDER FARMERS?

Innovative financing models and approaches that find ways to reduce impediments and risks in lending to smallholder farmers are outlined below. They are characterized in terms of three types of lender: financial institutions, off-takers and input providers.

1. Financial institutions providing credit to farmers

<table>
<thead>
<tr>
<th>Financial Institution as the lender</th>
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<tbody>
<tr>
<td>1) Direct lending</td>
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<tr>
<td>A) To the farmer</td>
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<tr>
<td>B) To the cooperative</td>
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<tr>
<td>2) Savings-linked input finance</td>
</tr>
<tr>
<td>3) Leasing/Infrastructure finance</td>
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<tr>
<td>4) Warehouse receipt finance</td>
</tr>
<tr>
<td>5) Tight market value chain finance</td>
</tr>
</tbody>
</table>

13. A development project funded by the Bill & Melinda Gates Foundation, managed by DEG and implemented and co-funded by private sector partners, which aims to increase the net income of 45,000 smallholder farmers.
1.1 Repayment source: financing farmers - whereby collateral involves cash-flow analysis by banks to underwrite anticipated earnings, overall savings and/or group guarantees. Financial institutions work with smallholders through the following means:

1.1.1 Direct lending

Main features
- Lending to individuals or through farmers' associations or cooperatives. The source of repayment is the conversion of working capital into cash flow throughout the production season.
- Success/risk factors of model
  - Banks need to understand farmer needs and cash flow strengths and weaknesses in order to adequately underwrite cash flow and reduce reliance on collateral.

Main advantages:
- Allows distribution of a full range of financial services
- Allows for a segmented approach to agricultural SMEs

Ways to mitigate risks:
- Deep knowledge of farming
- Cap on exposure to a single farmer
- Group lending
- Integration into a supply chain
- Providing cash during lean season to lower risk of side-selling

Main areas of innovation:
- Alternative credit assessment tools - Collecting information to assess smallholder credit worthiness is difficult and expensive. Alternative credit assessment tools have been developed, some of which incorporate agriculture-related data. There are also trials with supply chain data collection systems where the off-taker collects data on smallholders to gain better insight into their performance and thus creditworthiness.
- Product customization - flexible repayment terms linked to crop cycles 'improve farmers' ability to pay on time, when designed in collaboration with local agricultural experts.
- Distribution customization - roaming agents, ideally enabled by handheld technology, service rural customers and enable information collection. Mobile payments can reduce transaction costs.

Examples in use:
- Equity Bank, Kenya – smallholder lending integrated into a larger supply chain partnership and supported by a first loss guarantee provided by donors. Lending using co-guarantors, lower interest rates than standard, and caps loan exposure per farmer.

1.1.2 Savings-linked input finance

Main features
- Savings are an important part of the package banks want to offer farmers: they are a stopping-stone to commercializing farms.
- Savings can be an effective part of the loan security package; they can become the principal collateral to secure a loan.

Success/risk factors of model
- Strong checks and balances that prevent farmers from gaming the system. Checks include ‘Know Your Customer’ signals for example, requiring references or membership of farmer associations. Balances include strong savings incentives and bonuses for high savings balances over longer periods.

Examples in use:
- NMB, Tanzania – farmers open a savings account and a loan account. After harvest, part of the proceeds are used as cash collateral for input financing in the following season. NMB targets farmers participating in warehouse receipt schemes.

1.1.3 Leasing/infrastructure finance

Main features
- A lease is a contractual arrangement between two parties. The lessor allows the lessee to use the asset for an agreed period of time in exchange for periodic payments. Leasing focuses on the lessee's ability to generate cash flow from business operations, rather than credit history or balance sheet. Jump-starting rural leasing may require government and donor support.

Success/risk factors of model
- Leasing is a highly specialized financial activity. Economies of scale, cost and risk factors may require leasing companies to have large urban operations.

Examples in use:
- DFCU, Uganda – specializes in providing finance leases to SMEs for agricultural machinery providing 60% of the asset purchase. They have a longer payment period (3-5 years), and the asset is owned by DFCU during the lease, and transferred to the client or sold after the lease terminates.

1.2 Repayment source: financing movable assets - collateral involves lead equipment or harvested commodities in warehouses. Financial institutions work with smallholders through the following means:

1.2.1 Warehouse receipt finance

Main features
- Form of secured lending to owners of non-perishable commodities, which are stored in a warehouse and have been assigned to a bank through warehouse receipts. The receipts give the bank the security of the goods until they have been sold and the proceeds collected. They represent a liquid form of collateral against which banks can lend. This enables aggregators and processors to secure their sourcing throughout the year and to purchase their raw materials.

Success/risk factors of model:
- Warehouses – good warehouses, good roads, reliable communication, warehouse receipt financing act and operational guidelines are required.
- Markets – properly organized marketing systems, preferably commodity exchange, are needed.
- Banks – banks with easily accessible delivery channels, and well-performing core banking systems and MIS are needed.
- Corruption – fraud or collusion, credit and counterparty risk, storage risk and misappropriation by warehouse operators, price risks, marketing or buyer risks and legal risks are all critical risk factors to the model.

Examples in use:
- NMB, Tanzania – secured loans are given to registered farmer groups, individual farmers and commodity traders dealing with commodities such as coffee, maize, cashew and nuts. The scheme has a 50% guarantee provided by the government.

1.3 Repayment source: financing farmers in value chains. Where a financial institution is the source of credit, they rely on off-takers to act as the repayment source. Strong relationships between farmers and off-takers and formal or informal contracts provide security to lenders. Financial institutions and off-takers work with smallholders through the following means:

1.3.1 Tight market value chain finance

Main features
- Tight value chains have multiple “constriction points” to prevent side-sellings, including incentives (technical assistance, loans, price premiums, etc) and penalties. Providing finance plays an important role in increasing production, yields and quality for the benefits of off-takers and farmers. Finance may be provided through the off-taker or from a bank directly to the farmer, with the security of a tri-partite agreement (bank, off-taker and farmer). Input finance is a crucial added service off-takers extend to farmers to increase loyalty and make supply more stable. There are widely varying types of arrangement under this model.

Main advantages:
- Knowledge of value chains and assessments of buyer relationships help bankers assess future cash flows and improve credit assessments, which reduces risk.
- Bundling of finance with other services, such as improved inputs, extension services and training, can lead to increased cash flow for farmers and better quality for buyers.
- Tying credit with existing touch points and commodity flows can reduce transaction costs of lending.
- Off-takers have a core interest in obtaining the crop and therefore have an incentive to monitor farmers closely and ensure delivery of produce, which also ensures loan repayment.

Examples in use:
- Dunavant Zambia Ltd and Cangilli Zambia Ltd – The two companies process 90% of Zambia’s cotton through contract farming. A structured loan package provides inputs on credit. Land is communal and held in trust by a chief, so farmers lack collateral. Farmers deliver crop to buying point and receive cash on delivery, net of the costs of the input package received. Training is provided to increase quality and promote grower loyalty.

2. Off-takers providing credit direct to farmers

Main features
- Off-takers have a long-term incentive to secure supply and relationships throughout the value chain, and the capacity to experiment with new financing models. To address productivity constraints by smallholders, some global off-takers have provided finance to farmers engaging in their outgrower schemes. There are a variety of possibilities for financing through outgrower schemes. Emerging models include:
  - Direct financing – off-takers provide direct financing to smallholders. In the absence of collateral, direct financing requires trust and contact between the farmer and the off-taker.
  - Warehousing for credit – off-takers allow farmers to use their warehouse for storage in return for credit.
  - Partnering with social lenders – social lenders rely on off-taker support to lend to smallholder organizations. Social lenders use purchase orders or contracts issued by off-takers as collateral to finance producer group loans.
  - Serving as the front office for financial institutions – this is similar to direct financing, where an off-taker acts as the front-office agent for a financial institution. Off-takers originate, manage and collect loans from farmers in their outgrower schemes on behalf of a bank. It leverages partnerships with banks or other financial institutions, which provide the capital for loans.
Off-takers also support financing for smallholders by:

- Helping smallholders obtain certification, increasing their traceability and bankability.
- Investing in smallholder-focused funds (e.g., the Fairtrade Access Fund, which is a joint venture focusing on long-term finance needs of smallholders). Its first investor is Starbucks, which contributed US $1.3 million in seed capital.
- Developing additional models by supporting their Corporate Social Responsibility divisions and NGO partners.

Success/risk factors of model:

- Outgrower schemes present a potential point of entry for commercial and/or social lenders to address smallholder demand. Lenders could capitalize on off-taker strengths, including relationships with farmers, value chain knowledge and loan management infrastructure.
- Where off-takers are already providing financing and technical assistance to producers, lenders can assist off-takers to expand existing programs or take on the off-taker loan portfolio. This would allow off-takers to free up capital and focus on their core competencies.
- Market knowledge and existing relationships enable off-takers to assess risk in the loan origination process.
- Off-taker agents regularly visit farmers onsite and can monitor risk at a lower incremental cost than banks.
- Farmers’ desire to maintain good relationship with large off-takers makes them less likely to default on loans.
- Off-takers can engage many parties along the value chain, so there is potential to spread risk among farmers, buyers, banks and donors.
- Partnerships between off-takers and financial institutions can allow off-takers to take loans off their balance sheets and enables risk-sharing between off-takers and lenders.

Examples in use:

- Nestle – Nestle finances around 32,000 farmers, mostly dairy producers, through outgrower schemes. Loan size ranges from US $500 to US $50,000 and most are for 18-24 month terms, but they can be shorter. The basis for these loans is trust and direct, personal contact. They are delivered by Nestle staff and managed directly during site visits.
- Root Capital – Root Capital is a social lender that provides loans, ranging from US $50,000 to US $2 million, and financial management training to small and growing agricultural businesses that aggregate the products of smallholder farmers. Over US $500 million in lending to more than 425 businesses has provided support to over 750,000 smallholder farmer families in Africa and Latin America.
- Market knowledge and existing relationships enable off-takers to assess risk in the loan origination process.
- Off-taker agents regularly visit farmers onsite and can monitor risk at a lower incremental cost than banks.
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Off-taker as the lender

1) Direct financing
2) Warehousing for credit
3) Partnering with social lenders
4) Front office for financial institution

About the business

Western Fresh Industries (WEFI) Ltd is an agribusiness development company incorporated in Kenya since 2013. WEFI aggregates farmers for specific crop value chains, with a current focus on sunflower farmers to promote production and processing of virgin sunflower oil. WEFI works with around 680 smallholder farmers on 10,000 Acres of land in Western Kenya. WEFI guarantees purchase of the whole crop and carries out processing of sunflowers (with 1 metric ton of capacity). WEFI partners with Bidco Africa, a multinational company that manufactures and markets consumer products to guarantee surplus farmers produce beyond WEFI processing capacity. Bidco has a high processing capacity of 60 metric tons per day.

Main sustainability issues

WEFI has experienced challenges with linking farmers to banks. WEFI worked with a Commercial Bank to supply credit to farmers, but the long distance between the bank and the farmers and the poor road network that would be muddy during crop life resulted in weak loan management and high default rates. As a result, farmers lost confidence in working with banks, which has increased reliance on WEFI to provide financial services. WEFI would like to establish an in-house micro-finance department to build technical capacity around finance to smallholder farmers.

It is more commercially profitable for WEFI to process the whole sunflower crop, and maximize on value addition as transporting raw sunflower to other companies results in additional cost. WEFI would like to increase processing capacity but is currently unable to secure a commercial loan for this purpose.
WeFI is diversifying crops into chili, chamomile flower and recently added Clingstone cherry to improve income. For smallholders who own very small parcels, it is challenging to make a decent living from their land. One strategy is to look for ways to increase land size under a certain threshold. Land size is important in effectiveness of Service Delivery Models in two main ways:

- Smallholders that own very small parcels struggle to utilize services optimally in order to increase productivity to a level viable for profitable, commercial production. Hence, smallholders need to look for ways to increase contiguous land area under production, either in terms of larger individual holdings or through aggregation of multiple land holdings.
- Agribusiness is a significant business opportunity in Africa, which requires large amounts of land and is increasingly engaging smallholder farmers to secure their supply chains. Agribusiness investments that need access to larger land areas include:
  - Certain industries – such as tea, sugar, palm oil, and some export horticulture. In these cases, harvested produce spoils quickly, requiring close coordination of harvesting with processing or shipping; this favours large contiguous land areas centred on a processor.
  - Seed companies may have specialized needs for contiguous land areas to maintain seed purity and protect intellectual property.
  - Products which require high initial capital to improve land (e.g. irrigation) or other infrastructure (e.g. greenhouses) and are beyond the resource capacity of smallholders.

The ability of smallholders to increase their plot size under production is further restricted by uncertainty about land ownership and occupancy rights in Africa. Smallholder farmers often do not have land title, which means they cannot sell or lease land easily. It also acts as a disincentive for investment, as land titles are often only passed on to children after the parents are deceased, which makes it difficult for the children to make investments in their small plots of land since they do not have the land title as collateral for bank loans.

For agribusinesses, insecurity around land tenure greatly increases transaction costs and risks, and can also raise issues around poor and marginalized groups who may be utilizing land. Tenure insecurity is an important precondition for increased investment because it:

- Provides access to land through sales and rental markets or through public transfers.
- Reduces the incidence of land disputes through clearer definition and protection of rights.
- Reduces the possibility that land is taken away arbitrarily and without compensation.

### III. HOW TO ORGANIZE LARGER PLOTS OF LAND FOR SMALLHOLDER INCLUSIVE COMMERCIAL PRODUCTION?

#### Options for investors include:

**i. Land leasing** – land rental markets are developing rapidly in the more densely populated areas. They improve both efficiency and equity by transferring land from less productive to more efficient users to increase productivity and land-constrained companies. For example: Amatheon, a German-Zambian enterprise, has leased 30,000 hectares in Big Concession, a 260,000-hectare area in Zambia.

- Leasing of smallholder owned land for commercial agricultural production – where an agribusiness leases land from a group of smallholder farmers. This is applicable in areas where people do not traditionally sell land and it is inherited from previous generations. However, the land is not used commercially because of limited capacity to invest in farming (lack of skills, income and/or markets). A lease arrangement enables poor people to keep their land title while earning income from the land through a lease agreement and possibly employment from the company leasing the land. For example, see the case of Value Farms (Kenya) below.
- Large-scale leasing agreements to private companies – significant blocks of land are leased to private companies, which use a range of models for crop production, including a nucleus farm to guarantee minimum production levels, an outgrower program to deliver economic opportunities to smallholder farmers, and processing plants.

**For farmers, the main consequences of small land holdings are:**

- The trade-off between cash and food crops increases, as farmers are no longer able to balance production between the two on small land.
- It is challenging for farmers to make a decent living from their land, which leads to rural households diversifying their income sources by engaging in non-farming activities.
- Since insufficient income is generated from farmers’ land, it results in limited possibilities for them to invest in their land in order to increase productivity.
- Participation in markets that require certification is no longer cost effective, due to the costs of the application process for certification outweighing the potential benefits.

**For off-takers, the main consequences of small land holdings are:**

- Small land holdings combined with low investments undermine the future growth potential of production – low volumes do not constitute a solid foundation for future growth.
- Off-takers need to contract increasing numbers of smallholder farmers to secure adequate volumes, which in turn increases costs.
- The supply of certified produce may be more limited since it is not cost-effective for small landholders with low productivity to certify their produce.

**Regarding investors:**

- Options for smallholder farmers:
  - Aggregation of smallholder owned land whereby smallholders secure land titles and pool their land. Larger land sizes enable farmers to enter new markets and hire service operators to grow the volumes required for commercial production. This model is led and owned by smallholders with professional management support. For example, see the case description below of the Phtha Sugarcane Outgrowers Cooperative case (Malawi).

**Options for investors include:**

- **Land leasing** – land rental markets are developing rapidly in the more densely populated areas. They improve both efficiency and equity by transferring land from less productive to more efficient users to increase productivity and land-constrained companies.
- **Leasing of smallholder owned land for commercial agricultural production** – where an agribusiness leases land from a group of smallholder farmers. This is applicable in areas where people do not traditionally sell land and it is inherited from previous generations. However, the land is not used commercially because of limited capacity to invest in farming (lack of skills, income and/or markets). A lease arrangement enables poor people to keep their land title while earning income from the land through a lease agreement and possibly employment from the company leasing the land. For example, see the case of Value Farms (Kenya) below.
- **Large-scale leasing agreements to private companies** – significant blocks of land are leased to private companies, which use a range of models for crop production, including a nucleus farm to guarantee minimum production levels, an outgrower program to deliver economic opportunities to smallholder farmers, and processing plants.

**III. CONCLUSIONS** – a “concession agreement” is a type of negotiated contract that gives a company the right to do business, with some specific requirements. It often refers to a contract between a foreign company and a government, in which the company signs a concession agreement allowing it to do business in that government’s country. The agreement can also grant the concessionaire the exclusive right to do business in a particular area in exchange for some negotiated terms. The government may want to incentivize the company by lowering taxes, relaxing restrictions, or providing other incentives. The company may also offer concessions such as ceding some of the profits to the government or paying a special tax rate which may be higher than that of domestic businesses.

For example, Amatheon, a German-Zambian enterprise, has leased 30,000 hectares in Big Concession, a 260,000-hectare block of land in Zambia. Amatheon began growing wheat and soy beans in 2012. The company is improving the quality of the soil through significant investments in irrigation and power generation.

There are pros and cons to the different land options used in smallholder commercialization of production, as summarized in the table below.

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3. Making the Most of (Smallholder) Land Aggregation for Effective Service Delivery

1. What is the Impact of Declining and Insecure Land Holdings in Africa on Effectiveness of Service Delivery Models?

Africa is typically characterized as having an abundance of land, and at the continent level this may well be true, with 52% of the world’s remaining arable land being in Africa. However, most of this land is concentrated in just nine countries, meaning that most of the world’s remaining arable land being in Africa. Africa is typically characterized as having an abundance of land, and at the continent level this may well be true, with 52% of the world’s remaining arable land being in Africa. However, most of this land is concentrated in just nine countries, meaning that 65% of all the land available for cropland expansion in Sub-Saharan Africa is in just these nine countries, which together account for around 40% of the world’s cropland potential. In Asia, small land holdings have not been a constraint to agricultural production. This model is led and owned by smallholders with professional management support.

For example, see the case description below of the Phtha Sugarcane Outgrowers Cooperative case (Malawi).
Adventages and disadvantages of different options for organizing larger plots of land for smallholder-inclusive commercial production

<table>
<thead>
<tr>
<th>INVESTOR OPTIONS</th>
<th>PROS</th>
<th>CONS</th>
</tr>
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</table>
| Land leasing     | • Pooling of resources allows access to markets and efficiency gains  
• Smallholders can in theory (and increasingly in practice) receive dividends | • Formal structures can exclude those who do not meet entry requirements  
• Exposes smallholders to new risks associated with unfamiliar and complex governance and legal frameworks |
| Private companies | • Opportunities for smallholders to obtain employment or outgrower contract | • Land can already be used or claimed  
• Formal structures can exclude those who do not meet entry requirements |
| Land purchasing  | • Facilitates long-term investment in African agriculture | • Negotiations can be complex and lengthy  
• High risk for investors in countries with political instability |
| Concessions      | • Facilitates long-term investment in African agriculture | • Agreements do not always take environmental and local community needs into account  
• Confusion around what rights are included or excluded in concession  
• Weak transparency around land allocation and resettlement |

Managing the risks of land aggregation

Any land aggregation implies changes to land use, and in most cases to land tenure arrangements. In contexts where existing land rights are ambiguous and weakly governed, such changes present both commercial and social risks. Responsible investors must respect the rights of local women and men, as well as communities, to land and other resources, and avoid actions that lead to the loss of these rights and related harms. Failure to do so risks negative social impacts, reputational damage, and delays to investment—especially against a backdrop of increased scrutiny due to fears of unscrupulous “land-grabbing” following a recent global surge in large-scale land acquisitions.

Over the last few years, investors have begun to pay closer attention to how to invest responsibly in land, in particular through the application of international land tenure instruments such as the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests (VGGT), the Principles for Responsible Agricultural Investment that Respects Rights, Livelihoods and Resources, and the African Union’s Land Policy Initiative.

Despite good intentions, however, companies do not always have the technical capacity to operationalize such international instruments. The New Alliance has developed an analytical framework to assist agricultural companies and investors to align their policies and actions with the provisions of the VGGT. The framework helps them distil some of its most important principles and organize them in such a way that company compliance managers and risk assessment professionals can assess whether a project is adhering to best practices, and if not, how to address deficiencies. The framework will be made available in mid-2015, including on the New Alliance and Grow Africa websites.

Challenges

• Pursuing the landowners to lease their land for use in commercial agriculture by Value Farms. Land leasing was a new concept and it took eight months of negotiation to complete the deal. Farmers eventually understood the additional income that could be generated through the lease agreement, as well as the opportunity to receive regular employment (including health insurance and social security benefits).

• Attracting finance, which has slowed down acquisition of additional land and reduced progress in installment of infrastructure.

IV. THE VALUE FARMS CASE (KENYA) – SMALLHOLDER LAND LEASING FOR COMMERCIAL AGRICULTURAL PRODUCTION CREATING VALUE FOR LAND OWNERS AND VALUE FARMS

About the business

Value Farms is an agribusiness company that drives commercial agriculture through land consolidation in Western Kenya, near Lake Victoria.

About the model

In 2014, Value Farms aggregated around 200 smallholder farms (amounting to 240 acres from 111 individual plots) into a nucleus for commercial production. The landowners are predominantly fisher folk, who carried out subsistence agriculture (maize and beans) to supplement fishing. The land was under-utilized as the owners did not have the capacity and skills for commercial production. The land owners have leased the land to Value Farms under an initial 10-year lease and receive a lease fee. They are also employed to work on the commercial nucleus. There are 180 employees, 90% of whom are women from the local area. Value Farms is already meeting its recurrent expenses for daily operational costs.

The landowners formed a Community Based Organization (CBO), which is registered with the Ministry of Social Services. The lease agreement is between Value Farms and the CBO and is recognized by the Ministry of Land. This is underpinned by an agreement signed by community leaders and the landowners for the land to be surrendered for purposes of consolidation to engage in commercial agriculture. As some landowners do not have land titles, the land was surveyed by the Department of Land to identify each individual plot and acreage. The CBO formed a representative committee that engages directly with Value Farms.

The commercial nucleus operates large-scale, mechanized horticulture production under irrigation, including yellow passion for (Aga Khan and Coca Cola Group), kale, capsicum, beetroot, watermelon, chilies and cucumber. The products are currently sold at the farm gate.

In 2015, Value Farms aim to develop a cold chain to deliver washed and packaged vegetables to the market. It is investigating provision of agricultural land development services and guaranteed markets to smallholder farmers operating their own land around the commercial nucleus through an outgrower scheme. An additional 400 acres have been secured for expansion, with support from a US $500,000 grant from USAID.

The commercial hub has generated additional non-agricultural economic activities in the area, including bars, restaurants and hotels, due to the increased income.

V. THE PHATA SUGARCANE OUT-GROWERS COOPERATIVE CASE (MALAWI) – SMALLHOLDER LAND AGGREGATION MODEL LED AND OWNED BY SMALLHOLDERS WITH PROFESSIONAL MANAGEMENT AND TECHNICAL SUPPORT

About the business

AgDevCo is a social impact investor and agribusiness project developer, incorporated as a not-for-profit distribution, limited company in the UK. In 2013, AgDevCo Malawi made an investment into the Phata Sugarcane Out-Growers Cooperative in the Lower Shire Valley, in Southern Malawi. The coop is focused on commercial sugarcane production under center pivot irrigation systems.

In mid-2013, Phata Cooperative was awarded a £2.4 million grant from the European Union to develop a commercial sugarcane production scheme. AgDevCo provided a loan of US $504,000 to Phata Cooperative as part of the project’s funding needs as mandated by the grant terms. The joint funding covered the development costs to install a modern irrigation system to support the scheme’s production objectives. The first year of harvest was successful, with sugarcane yields of 156 tons per hectare, earning each farmer an average dividend of over US $500.
About the model
Phata is a fully registered cooperative of 378 subsistence farmers (with a total of approximately 370 hectares of land) who requested assistance to grow sugarcane from a farm management company, Agricane, which was already operating in the area. Agricane helped the farmers to pool their land and form a cooperative in order to provide the necessary production volumes to meet the supply contract through an off-taker agreement. The coop has a long-term supply contract with Illovo Malawi, a subsidiary of Associated British Foods (ABF). Agricane has been contracted by the coop to provide management and technical services based on commercial farming operations (300 hectares under center pivot irrigation) and capacity building to the members.

Phata has a Board of Directors made up by the members, Agricane and AgDevCo. Furthermore they have an Executive Committee and various sub-committees, all of which are elected and appointed by the smallholder farmer members. The coop employs over 150 people from the local communities, as well as encouraging the landowners to take on full-time positions of employment.

The coop, with Agricane supervision, has set aside 25 hectares for pooled food production for the farmer members, which is set between the pivot circles under dragline irrigation and allows farmers to produce two cycles of food crops (maize) and one cycle of commercial seed production, which is also under contract to a commercial seed company.

Smallholder farmers had informal land title access from the local chief and authorities, which were used to form the cooperative. Each farmer had their land measured and mapped and the local authorities and Agricane verified that: i) the land belonged to the farmers; ii) farmers were not being coerced to join the coop; and iii) the land was not earmarked for other use.

The landowners each gave their land, which was consolidated into one unit, governed by an agreed legal constitution through the coop. The land consolidation process took around 12 months to complete and was relatively straightforward because the initiative had come from the community, rather than Agricane attempting to persuade farmers to lease their land. The coop is in the process of formalizing the commercial title deed through the Department of Lands. Once the title deed has been formalized, the coop will pay an annual land lease to the Department of Lands (most land leases are for a period of 99 years).

The farmers together own 100% of the cooperative. The size of each parcel of land determines the pro-rata share in the coop, and the share determines the size of each farmer’s annual dividend. Dividends are paid in cash from profits. The 2015 dividend, at around US $750, is expected to be 50% higher than in 2014. Total revenue in the first year of production was US $1.27 million, which returned a net profit to the coop of about US $500,000. Profits were partly reinvested in the coop’s activities and partly distributed to members. The coop uses the profits of the commercial seed production cultivated on the 25 hectares of pooled land to pay for both cycles of maize production, with the rest of the profits put into a revolving fund. Capacity building around banking, savings, entrepreneurship, technical skills and other areas is provided by Agricane, AgDevCo, Concern Universal and Scottish Aid.

Challenges:
• Securing a formalized market link through a guaranteed off-taker.
• Farmers initiating and seeing the need for the process, rather than it being externally imposed.
• Securing a land access title for each of the individual members wanting to form the coop.
• Coop members actively taking part in the operation of the company and its day-to-day activities.
• A well-structured capacity-building program for coop members to allow them to gradually lead key components of the scheme.
• A commercial management and technical partner with knowledge of the sector.
• Affordable long-term funding to meet the development and implementation requirements.
Private sector investment is key to agricultural growth in Africa. Agribusiness companies need to realize that for their operations to be profitable and sustainable over the longer term, they must take a leadership role in addressing weaknesses up and down the value chain.

This requires new ways of thinking and new ways of operating. Some of the costs are beyond the capacity of an agribusiness company to finance on their own, and they need to look at ways to share the risks through partnerships — either with other companies operating along the value chain, or with development partners or governments.

One space where partnerships are developing is around effective service delivery models with a view to making smallholders profitable. Companies are realizing that if smallholders are more profitable, they are able to invest in their farms to improve their productivity, increase volumes, and create greater and more sustainable supply.

The companies interviewed for this publication are leading in this area. The Smallholder Working Group (SWG) is supporting them to share experiences and promote learning between companies and with farmer organizations. This publication has explored some aspects of service delivery models, which has been the work of the SWG so far. But there is more innovation to be done. The SWG is encouraging and supporting companies to do this together to achieve scale and profitability across the African continent.

There are other areas of innovation and expertise that we need to tap into, and we expect to work on those in the coming months. Topics include harnessing ICT, accessing affordable finance, delivering training, combatting gender inequality, and building aggregation models.

Companies with experiences to share, and that are interested in learning from each other, are welcome to get in touch via their contact person at Grow Africa or IDH.
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