Inclusive Business in Agrifood Markets: Evidence and Action
International Conference, Beijing, March 5-6, 2008

Background to the Regoverning Markets Programme
Conference Issues Paper 1

Rapid changes are taking place in national and regional agrifood markets in developing countries, with implications for the ability of agriculture to contribute to economic growth, poverty reduction and sustainable rural development. Small-scale agriculture, which supports the livelihoods of the majority of the rural poor, is potentially under-prepared for these changes. In recognition of this challenge, an intensive programme of collaborative research and policy support was undertaken between 2005 and 2008 to understand the keys to inclusion in agrifood systems under different degrees of restructuring. It aimed to deepen the research on implications and opportunities for small-scale producers and SMEs, to understand what is best practice in connecting small-scale producers with dynamic markets, and to bring these findings into the wider policy arena. This conference background document describes the design of the programme and presents evidence of the changes underway, as context for a series of recommendations in the subsequent Issues Papers.

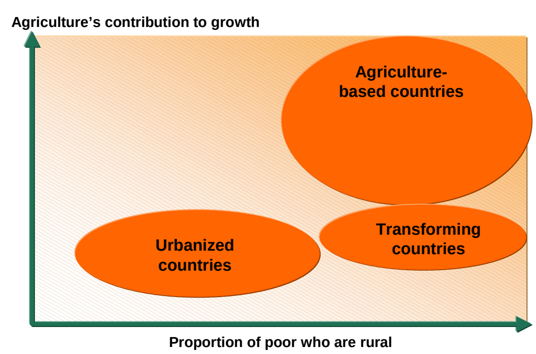
Key messages

- **Eighty per cent of the rural poor live in 'transforming' countries, where agriculture contributes less to growth, but poverty remains overwhelmingly rural.**
- **Transforming countries are also where domestic markets are undergoing rapid but uneven modernization, with the number of large supermarket chains and food processing companies growing alongside the informal and traditional markets.**
- **Modernization and restructuring in agrifood markets needs to work for broad-based growth in agriculture and the rural non-farm economy to narrow the urban-rural divide and reduce the potential for political tension.**
- **The Regoverning Markets programme is a global consortium of researchers and development practitioners from 15 organizations that set out to address the questions of small-scale farmer participation in dynamic national markets.**
- **The programme draws together evidence from empirical research, case studies and multi-stakeholder dialogues, which together are the basis for a call for action.**
- **Research shows that agrifood market restructuring is occurring rapidly in most countries, and also reaches midstream, to wholesale.**
- **This is not always matched by farm-level restructuring. Restructuring and modernization does, however, come with requirements for some threshold investments, such as irrigation, greenhouses and cooling tanks.**
- **The delay in significant farm-level impacts allows producers, policy makers, support agencies and business to develop new and innovative means to better secure market inclusion for small-scale producers over the long term.**

Who are the rural poor?

Of the world's 1.9 billion rural poor, around 280 million live in 'agriculture-based' countries, mostly in sub-Saharan Africa, where agriculture still contributes significantly to growth, and where the key policy challenge is to help agriculture play its role as an engine of growth and poverty reduction. But the majority of the rural poor – 1,500 million – live in 'transforming' countries, where agriculture contributes less to growth, yet poverty remains overwhelmingly rural.

The World Bank's latest World Development Report (WDR2008) paints a picture of a rising urban-rural income gap in transforming countries, accompanied by unfulfilled expectations which create political tensions: "Growth in agriculture and the rural non-farm economy is needed to reduce rural poverty and narrow the urban-rural divide."



Agriculture's three worlds (World Bank WDR2008)

It is in transforming countries, too, where domestic markets are undergoing rapid but uneven modernization, with large supermarket chains and branded manufacturers growing alongside the informal market.

Market modernization offers increased economic opportunities for small-scale producers and small and medium-sized enterprises (SMEs), consumers, and other actors in the food chain. New buyers in the countryside are competing for farmers' produce. But there are also risks of domestic businesses being bypassed, and of costly market entry requirements that favour the better-resourced. If the Millennium Development Goals (MDGs) are to even be partially met by 2015, then agriculture and SMEs in transforming as well as agriculture-based countries must deliver equitable growth. Market modernization and restructuring challenges the expectation of a growth and equity 'win-win' derived from agricultural development.

WDR2008 calls for action in response to the modernization of procurement systems in integrated, modern supply chains, whereby small-scale producers can share in these growth opportunities. The work of the Regoverning Markets programme responds directly to this challenge.

Markets are restructuring and modernizing

Agrifood markets are in an unprecedented state of flux, and are generating intense policy debate worldwide. Market liberalization, a reduced role of the state, a shift towards market-driven policy, changes in consumer preferences and purchasing power, and the modernization of food processing and retailing are primary drivers. It can take developing and emerging market economies as little as ten years to reach the levels of agrifood market restructuring that took five or more decades in Western Europe or North America.

Disproportionate attention has been paid to export markets, despite the far greater importance of domestic markets for the huge majority of small-scale farmers. The impacts of transformation of the processing sector on farmers has also been well studied, particularly around contract farming, where one could link a clear change (rise of big processors) with a clear participant group (milk or tomato producers in such and such a radius of the processing plant). The least researched area has been the impact of the rise of modern grocery retail on farmers.

The modernization of agrifood has been accompanied by intense policy debate, especially in India, where local traders – but also farmers – feel a threat to their livelihoods from the growth of modern organized retail. The food industry is assessing its 'realm of responsibility' in the supply chain; producer organizations are debating appropriate responses and strategies; governments devising new forms of market governance to promote private sector investments while ensuring social inclusion; public and private sector organizations joining forces in novel alliances; and donors revisiting their support to agriculture in the context of the MDGs.

Three key questions dominate the debate:

- Can small-scale producers and their organizations be partners in new business?
- Can the new agrifood business drivers be partners in development?
- Can anticipatory public policy make any difference?

Modern grocery retail calls for high and consistent product quality, Indonesia

The Regoverning Markets programme set out to address these questions through empirical study, case studies and practical experience in policy dialogue and outreach. Outputs from this work were reviewed by the international team in a workshop held in Morelia, Mexico, in September 2007. This document describes the work of the programme. It presents some of the emerging findings on the state of market restructuring, drawing in particular from the outcomes from eight intensive country studies. Three other Issues Papers address areas for innovation for industry, policy makers, and producers, and one addresses chain-wide learning.

Empirical studies

Country-based research studies undertaken by national institutions have examined the processes and impacts of restructuring through a comparative in-depth empirical analysis:

- China, Indonesia, South Africa and Turkey - vegetables
- India and Poland - dairy
- Mexico – strawberry, fresh and processed
- Zambia – red meat and poultry

They addressed the following questions:

- What restructuring is occurring? What distinct market channels do farmers face and how do they differ; how have they changed over time?
- What determines the participation of farmers in the different channels (farm size, non-land assets, policies, etc)?
- What are the impacts of their participation on technology and incomes?
- What are the policy implications?

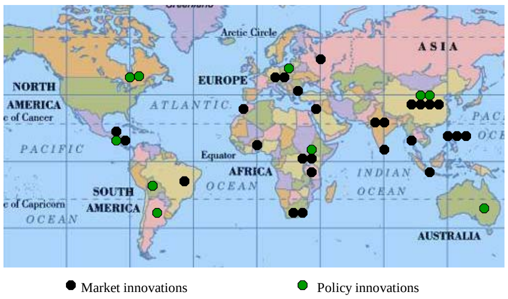
The results of these empirical studies are summarized in this Issues Paper.

Village-level market analysis in Shandong, China

Innovation and good practice

Over 40 case examples with a global coverage (see map) have been documented on connecting small-scale producers with modern markets.

Thirty of these case studies, conducted by national institutions, including through a competitive grants programme, focused on innovations by chain actors that support greater inclusion of small-scale producers at domestic or regional levels. ‘Innovation’ refers to the actions and policies of private companies, public institutions, farmer organizations or non-governmental organizations that resulted in enhanced market participation of small-scale producers.



Case studies of initiatives and policy innovations

Each case study sought to generate the following insights:

The drivers of inclusion: What factors explain that the small-scale producers in the case study are included in dynamic markets, and others not?
The elements of inclusion: What technical, organizational, managerial and financial changes did the small-scale producers have to implement to be included in dynamic markets?
The costs and benefits of inclusion: What financial and non-financial costs and benefits do the small-scale producers obtain from their inclusion in dynamic markets?
The sustainability of inclusion: What type and level of direct/indirect subsidies have contributed to the innovation? What implications does this have on sustainability?
Up-scaling and replication: What public and private policies contribute to the up-scaling of the innovation? What lessons can be derived for public and private policies to promote market inclusion of small-scale producers elsewhere?

Nyabyumba United Farmers Group, Uganda

Studies were also carried out on specific policies and/or institutional changes that have contributed to inclusive market development. These were drawn from both developed and developing country experiences and include codes of practice on supplier-retailer trading relations, the functioning of agricultural broker associations, and an example of the legal framework that supports the functioning of producer groups.

A research principle was that it is as important to study outliers as indicators of major change, as it is to study the mainstream.

Policy outreach and learning

Regoverning Markets is designed so that evidence-based research should go hand-in-hand with policy outreach, with mechanisms for dialogue and exchange between interested parties in place from the outset. Country-level Reference Groups including representatives from the public sector, the business community and producers and their organizations have enabled key stakeholders to inform the direction of the empirical research study and be informed by the outputs.

The programme has included the development and application of a set of activities, undertaken with multiple stakeholders, designed to map the policy and institutional factors along the market chain that impact upon the shape of the chain and market inclusion. These country-level processes sought to anticipate future change and assess options and entry points whereby small-scale producers and SMEs can secure their place in these dynamic markets.

Chain-wide and multi-stakeholder learning workshops have been held in Turkey, South Africa, Indonesia, Morocco, the Philippines, Bangladesh, Pakistan and Vietnam. A guide on the approach has been published.

At regional and international levels, partnerships with key programmes and associations are made. This includes partnerships with the Food and Agriculture Organization of the United Nations (FAO), Global Forum on Agricultural Research (GFAR), International Food and Agribusiness Management Association (IAMA), International Federation of Agricultural Producers (IFAP), New Partnership for Africa's Development (NEPAD), Forum on African Research in Agriculture (FARA), the International Society of Horticultural Science (with inputs into meetings in Vietnam and Thailand), International Agricultural Trades Research Consortium (China), and International Association of Agricultural Economists (IAAE).

Outputs from the programme have fed into WDR2008.

A multi-stakeholder chain mapping exercise in Turkey

How are markets being restructured?

There are large differences in the observed market restructuring among developing and emerging market economy countries. Relatively more food market restructuring has occurred in North America (Mexico), followed by Eastern Europe transitional economies (Turkey and Poland), South Africa, South East Asia (Indonesia), East Asia (China), and South Asia (India). It is less developed in sub- Saharan African countries (Zambia).

There are also large differences in observed market restructuring among commodities. Generally, market restructuring has been more rapid in the dairy and livestock sector (e.g., poultry and meat) than for fruit and vegetables.

All of the eight study countries had a set of policies that occurred during the market liberalization period, in the 1980s to 2000s, with full or partial privatization of the public sector retail and processing segments. Most of them liberalized foreign direct investment (FDI) in retail and processing in the late 1980s or early 1990s. This was followed by a wave of retail FDI into all of the study countries, except South Africa - where retail FDI is permitted but the retail boom was fuelled by domestic capital - and India - where retail FDI is mainly not yet permitted, but has nevertheless taken off in the 2000s, fuelled by domestic capital.

The combination of retail restructuring policies and rising urbanization and incomes (in most of the countries), led to the rapid rise of modern food retailing during the 1990s and/or the 2000s typically at a rate three-to-five times faster than the growth of GDP per capita. For example, in urban Mexico, supermarkets and hypermarkets had 52 per cent of overall food retail in 2006, up from around 5 per cent in 1990, and the share of supermarkets in fresh produce was 25 per cent by 2006, up from near zero in 1990. In China, the number grew from one supermarket in 1990 to 53,000 by 2002. In Indonesia, the market share of supermarkets has grown from around 5 per cent to 30 per cent of food retail between 1995 and 2005, and access is spreading within the middle class and is starting in the markets of the lower-middle and working classes.

The penetration by supermarkets of the fresh produce retail significantly lags that of the overall penetration. For example, in Mexico, supermarkets have 55 per cent of overall food, but only 25 per cent of fresh produce; in Indonesia, 30 per cent and 10 per cent; in Turkey, 35 per cent and 20 per cent.

In all the study countries (except China, where processing was not examined), the food processing sector started to restructure before the retail sector, though there is evidence from all the studies that there has been mutual benefit between the large processing sector and the supermarket sectors. There has been rapid consolidation in the processing sectors, in particular the second-stage processing, in all the study countries for the products studied. In India modern dairy processing is at most 16 per cent of the dairy sector, but this seems poised to accelerate, in particular in the form of the spread of modern retail.

The wholesale sector itself has not been public sector controlled, apart from the market premises, in most countries. But there were some exceptions, with India and Turkey both instituting state control (via licensing) of the wholesalers in the public wholesale markets in the 1990s. In both cases they were motivated by the idea that this would avoid chaos and speculation in the wholesale sector that would possibly endanger urban food security and farmer incomes.

Many of the studies show consolidation emerging over wholesale markets. For instance, in West Java, Indonesia in the mid 1990s, the sector was dominated by small brokers. By the mid 2000s the larger wholesalers predominated, and the smaller brokers were in the minority, and mainly operating in the more hinterland areas. There is evidence from the Mexico, Turkey, and Indonesia studies that wholesalers are buying more direct from farmers and the role of the small local broker is declining. Other types of restructuring are emerging in the wholesale sector, the most prominent of which are the ‘specialized’ or ‘dedicated’ wholesalers who sell-on to supermarkets and food services, and have preferred suppliers and quality selection.

What impact on procurement?

Supermarkets tend to source from the larger second-stage processors for reasons of food safety and quality, and to reduce transactions costs. Small-scale processors tend to be the main sources for traditional retailers (such as in the dairy sector in Poland), except where the processing sector is already consolidated (such as the processed potato sector in Indonesia).

Supermarket chains in Zambia source their beef from large first- and second-stage processors such as ZAMBEEF and medium/large third-stage processors. This contrasts with traditional retailers who buy from small first- and second-stage processors and from wholesalers.

In all the study countries examining fresh vegetables, all supermarket chains source the majority of these products from the wholesale markets, with the exception of South African leading chains, which source tomatoes mainly from large commercial farmers via preferred supplier relationships. The shift by South African supermarkets away from the wholesale markets to using preferred suppliers was greatly facilitated by the sharply dualistic farm sector structure. The major supermarket chains were found to source the great majority of their tomatoes from large commercial farmers, and revert to the small farmer areas only to meet gaps in the supply from their main suppliers. Only a small share comes from commercializing small-scale farmers, and with only a few exceptions among retailers, very little from the “emerging farmers.” This compares with China, where small farmers dominate, and where no evidence was found of such farmers being excluded from vegetable production.

Large processors sometimes (such as for tomato processors in South Africa and Turkey, dairy processors in Poland, potato processors in Indonesia, private and cooperative processors in India, and for some larger beef processors in Zambia) work in preferred supplier relationships with small-scale farmers on a semi-contract farming basis. In these relationships, sometimes credit, seed, inputs, and technical assistance are offered, and the product is collected at or near farm gate. In other cases (such as most of the first-stage processors of strawberry in Mexico, and smaller processors of beef in Zambia) the relationship is merely that of the spot market. The larger processing sector and export sectors in Zambia source beef mainly from the huge ranches that dominate one side of the very dualistic Zambian beef industry.

The studies note only a relatively low degree of procurement restructuring among wholesalers – regardless of whether they are large on-market wholesalers, or off-market specialized wholesalers.

Traditional retail

It is often assumed that "traditional retail" is static. However, the large public markets like the bazaars, wet markets and street markets, are restructuring and upgrading. They are focusing on offering higher quality to compete with the supermarkets on quality and service and to reduce the gap in terms of market infrastructure and hygiene. This means wholesalers and farmers will increasingly face both retail segments (modern and traditional-now-modernizing) that demand quality and reduced transaction costs.

Informal market, South Africa

Yet traditional markets are resilient and can co-exist for significant periods of time with restructured markets. In fact, the restructuring process often includes interactions and spillover effects between 'old' and 'new' markets. There are instances of 'partially restructured' markets, with faster and deeper changes downstream and continuity of traditional patterns upstream. Small-scale farmers usually operate in multiple market channels, new and traditional, displaying diversified marketing strategies in order to meet different economic needs (e.g., access to credit or improved cash flow, controlled risk levels) or social needs (e.g., inclusion in the social networks that are interlinked with the marketing networks).

What is happening at the farm level?

In all the countries where empirical research was undertaken, at least for the study products, there was a complete or near-complete dominance of small farms on the production side. Large farms existed in many of the countries, but usually in enclave sectors focused on exports.

Intensive field research shows that there has been much less observed market restructuring at the upstream level than at downstream level. Penetration from downstream changes or the modern retail revolution to other segments of the food marketing chain has often been stopped at midstream by wholesale operations, processing firms and other intermediaries. The China study concluded that this is an indication of a very competitive wholesale market, small wholesalers who are efficient in linking downstream and upstream, and high transaction costs of modern retailers and exporters with millions of small producers. Supermarkets were found to procure a third of their vegetable supplies from large specialized/dedicated wholesalers or directly in the production zones, with a small proportion own-produced (on their own land or contracted). For all of these except own-production, the buying is done in spot relations from the farmers, so that the brokers or wholesalers who interact with the farmers are indistinguishable from the viewpoint of the farmer.

There is evidence of penetration from downstream to midstream (e.g., processors and wholesalers) and there is also rising evidence of the responses of midstream to the changes in downstream. The typical pattern is for supermarket chains to source via specialized/dedicated wholesalers.

When restructuring does reach as far as the farm – driven by business needs for traceability, for example – and farm income from modern markets increases, then exclusion of smaller, less well capitalized producers becomes a reality. Exclusion of whole regions that are not endowed with the characteristics demanded by downstream agents in the chain can also arise.

Restructuring and modernization comes with requirements for quality, quantity, consistency, and traceability, with a large fixed cost element that favours farmers with assets and capacities to access the necessary finance, information, and technology. This requires some threshold investments from producers. Research in Indonesia showed that potato farmers who supply modern market channels use better technology, use chemicals more intensively, have higher capital investment and use less family labour. For tomatoes in Indonesia, irrigation capital is a determinant of inclusion, with this investment key for meeting requirements of quality and consistency to modern channels. In Mexico, modern strawberry buyers (large wholesalers and processors) also require consistency and quality, which in turn translates into requisite equipment, technology uptake and also a minimum land size. In the Poland dairy sector, the key non-land assets were dairy herd sizes and cooling tanks. In the South African tomato sector, the key non-land asset variable is whether they can produce under greenhouses, thus attaining the multiple seasons and the quality required by the modern local channel. In India, there was no evidence of non-land assets-based exclusion.

Membership of producer organizations was correlated with participation in modern markets in only half of the countries; in the rest the correlation was not significant or negative. This is indicative of the very mixed role of producer organizations, from political lobbying to channels for government subsidies. As in Turkey, marketing cooperatives are rare. Co-operative members typically remain oriented to the traditional markets. In the Poland case study, a significant negative impact was also found for cooperative membership on modern market inclusion, but this observation suggests that the costs of remaining in the traditional channel (e.g. lower price, higher risk of milk refusals, lower quality premiums etc.) may be outweighed by benefits created by cooperation.

Generally, better road and marketing infrastructure facilitates farmers' participation in modern market channels, though the impacts in some country studies are not statistically significant. Among eight countries studied, four of them found that the distance to road or markets or dairy collection points has significantly negative impacts on farmers selling products to modern channels.

There are various market structure and regulatory constraints that buffer small-scale farmers from substantial restructuring downstream. The responses from intermediates to retail market restructuring have softened the shocks of retail changes on farms. The extent to which this reduces the capacity of the small-scale farming community to build up resilience within demanding agrifood markets must, however, be open to question.

Concluding remark

The challenge of connecting small-scale producers to dynamic agrifood markets is still a new field with few proven and replicable models and methodologies. Evidence of limited penetration so far of downstream restructuring means that producers, policy makers, support agencies and business have time to work together to develop new and innovative ways to secure market inclusion for small-scale producers over the long term.

Consortium members

INTERNATIONAL COORDINATOR
International Institute for Environment and Development (IIED), UK (Bill Vorley)

REGIONAL COORDINATORS
Central and Eastern Europe: Corvinus University of Budapest, Hungary (Csaba Csaki)
China: Center for Chinese Agricultural Policy (CCAP), China (Jikun Huang)
East Africa: Tegemeo Institute of Egerton University, Kenya (James Nyoro)
Eastern Mediterranean and Middle East: Akdeniz University, Turkey (Ali Koç)
Latin America: Latin American Centre for Rural Development (RIMISP), Chile (Julio Berdegué)
North and West Africa: Targa-Aide, Morocco and Institut Agronomique et Vétérinaire Hassan II, Morocco (Abdelaziz Sbai)
South Asia: Sustainable Development Policy Institute (SDPI), Pakistan (Abid Suleri)
South East Asia: University of the Philippines Mindanao, the Philippines (Larry Digal)
Southern Africa: University of Pretoria, South Africa (Andre Louw)
Centre de Coopération Internationale en Recherche Agronomique pour le Développement (CIRAD), France (Estelle Biénabe)

COORDINATORS – EMPIRICAL RESEARCH
Center for Chinese Agricultural Policy (CCAP), China (Jikun Huang)
Michigan State University (MSU), USA (Thomas Reardon)

COORDINATORS – INNOVATION AND GOOD PRACTICE
Latin American Centre for Rural Development (RIMISP), Chile (Julio Berdegué)
Royal Tropical Institute (KIT), Netherlands (Lucian Peppelenbos)

COORDINATORS – POLICY PROCESSES
International Institute for Environment and Development (IIED) / Felicity Proctor Consulting Ltd, UK (Felicity Proctor)
University of the Philippines Mindanao, the Philippines (Larry Digal)

EMPIRICAL RESEARCH, TURKEY
UMR MOISA, Montpellier, France (Céline Bignebat)

Regoverning Markets is a multi-partner collaborative research programme analyzing the growing concentration in the processing and retail sectors of national and regional agrifood systems and its impacts on rural livelihoods and communities in middle- and low-income countries. The aim of the programme is to provide strategic advice and guidance to the public sector, agrifood chain actors, civil society organizations and development agencies on approaches that can anticipate and manage the impacts of the dynamic changes in local and regional markets. The programme is funded by the UK Department for International Development (DFID), the International Development Research Centre (IDRC), the Canadian International Development Agency (CIDA), ICCO, Cordaid, and the US Agency for International Development (USAID). The Beijing conference was further supported by DFID, IDRC, CIDA, and the Dutch Ministry of Foreign Affairs/Development Cooperation (DGIS). The views expressed are not necessarily those of the funding agencies. For further information see www.regoverningmarkets.org or contact RegoverningMarkets@iied.org