Building Back from Business

Introduction

As Jim said yesterday, most resources now going into agriculture and agribusiness development are from the private sector.
But the private sector perspective as we heard at IAMA is still a far distance from the reality on the ground in many if not most lower income countries.
On the other hand, it is not fully clear to me that the new generation of donor funded value chain projects, such as we are seeing here at the workshop, are pursuing approaches that are likely to be sustainable, replicable and up-scalable.

Reflecting on this, what I intend to do will be to give some personal views on practical strategies and actions for public sector and NGO driven agribusiness initiatives. Are there emerging lessons on good programme practices that can contribute to success and sustainability?

Frankly, the suggestions given by Jag this morning were so excellent that my remarks could be to simply repeat what you already heard. I'll try though to hit on a few points that might complement.

Agricultural Management, Marketing and Finance Service

To give a bit of background on my perspective, I will start by describing my unit in FAO and what we have been working on.

There two fundamental factors that determine the way that we do business in FAO, which are different compared to industry, academia, or donor projects. These are:

a) As inter-governmental agency, we must be responsive to government interests and demand for support services – although in many cases the people in our governing bodies do not themselves have a good idea of industry trends
b) We do not operate primarily through project mode; and so we have high concern for good practices and capacity building for sustainable progress in the absence of substantial extra-budgetary resources.

Our mission as AGS is to help develop efficient and client responsive agricultural enterprises and support services

Core competencies of the unit that I lead - AGSF:

- marketing of farm produce and agro-industrial products
- rural financial services
- farm business management
- agribusiness development

There is a second service in our division that focuses on agricultural engineering technologies, particularly post-production.

Building on our joint core competencies, we are focusing on a few key priorities for accelerating agricultural growth:

- Reinforce entrepreneurial and managerial capacity
- Identify new enterprises and technologies for value addition in supply chains
- Ensure provision of client responsive agricultural services
- Strengthen agrifood distribution systems

Role in FAO: Mainstreaming lessons about business and market driven development

Our role as an external service provider includes:

- Clarifying good practices through field appraisals and case studies
- Preparing guidelines and training materials for public sector and public-private partnerships
- Facilitating multi-stakeholder awareness raising, consensus building and action planning
- Developing and technically supporting field action programmes

Our Focus through 2000

Build capacity to participate in local markets

- Market infrastructure planning - improve communications and transport infrastructure
- Market information and extension - poor marketing knowledge and selling skills

- Farm business management – planning for markets; skills for enterprise diversification and product development, managing finances
- Rural finance – expanding outreach of rural financial systems; microbanking software, some micro finance

<u>Over the past five years</u>

We have focused heavily on strategies and mechanisms for building linkages to help producers acquire the services, markets, finance, expertise and economies of scale needed to be competitive and hence achieve food and livelihood security.

Contract farming (2001).

> Pre-conditions for success, types of contract farming, contract specifications, managing the contracts

Farm-agribusiness linkages

> three region comparative appraisal. Pointed to differences but also some commonalities: lack of reliable supplies especially off- season; low capacity utilization; meet standards of relevance to desired markets and processing technologies; mobilize services and investment/working capital.

Livelihoods diversification and enterprise development

> demand driven mini-grants, draw lessons. Main issues have been linking market appraisals with livelihoods strategies, and then moving on to practical business action-planning. Concerns were moving away from the initial entry points and engagement of stakeholder organizations to support initiatives.

Services provision by and through NGOs, FOs.

> Still on-going. Producer organizations and linkages – reduce transactions costs, better contract negotiation and compliance, alternative services provision

<u>Recent shifts</u>

As with everyone else, shifted 3-4 years ago toward value chain and agrifood system. Some issues working on now:

- Institutions and technologies to assure quality and safety along value chains
- Bank linkages with front line development financial service providers
- Changes in retailing systems and related procurements practices
- Trader finance and associations
- Term finance - lack of capital for expansion of production or upgrading of equipment
- Cost reduction (out-sourcing) schemes for compliance and certification for organic and food industry standards
- Capacity building for Good Agricultural Practices

Information about any of these or interest in collaborating, please contact me. I also put out some materials, and would be happy to have copies sent to anyone interested.

Political risks of business initiatives

As you might imagine with the orientation and focus of the unit that I lead in FAO, I am a firm believer in the role and importance of agribusiness and value chain development:
- Embedded services
- Better control of product quality and safety
- Value addition – from commodities to differentiated products

At the same time, I believe that it is important to recognize that agribusiness and value chain initiatives face high political risk.

> In fact, I often feel like small agribusiness is like a mouse among elephants. On the one side is the big multinational firms that are moving to consolidate their sourcing and retailing in emerging markets. On the other side are the governments and donors with their ideas of pro-poor growth.

There are two distinct sources of risk.

<u>One</u> is that many governments are leery of agribusiness, or as many business managers say – simply do not understand business.
Also, for now there is a preoccupation, with many donors as well, with MDGs. Despite all the talk of win-win situations, most are aware that there will be losers – maybe many losers.

How can one follow the trends in EU and USA and turn to developing region governments and be convincing in arguing for win-win?

Concerns about losers and market barriers have been flamed by the “supermarkets are coming” movement. This has created a near hysteria in development community that is being fed into governments. The research dialogue is nuanced but the communication is not.

Positioning of NGOs and many governments on trade restrictions and subsidies further contributes to a distrust of big business.
Growing awareness of private sector standards setting by retail and manufacturers is contributing to general fear of market barriers.
This has been one of the most persistent issues raised in FAO governing bodies over past 3-4 years.

Particular fears have been expressed even over our efforts to advise and assist member countries in their own efforts to harmonize standards and to build capacity for EUREPGAP – which is being accepted as a benchmark in many countries.

Core policy risk is that governments will interfere with value creation as they become preoccupied with value capture by suppliers.

> This might be a legitimate public interest, but there needs to be a realism about the value creation of the suppliers and their role in overall value chain competitiveness.

<u>The second risk</u> is that many governments are gearing up for greater interventionism and activism. Uneven but see some of this in all regions. There is growing interest in taking action to support enterprise development to improve trade competitiveness, accelerate growth – but with pro-poor outcomes.

Several problems have been arising when public sector over steps “public interest” into:

- driving the choice of target enterprises or products – creating asset specificity and vulnerability
- services provision that leads to under-mining of commercial service providers; including services provision through the value chain
- cost absorption that results in farmer <u>and</u> business dependency syndrome

Due to both risk factors, the success and sustainability of much <u>private</u> sector activity is in many cases being negatively affected by the support activities and/or “public-private” partnerships developed in the context of special projects.

The result is disincentives for private investors and competitor firms.
As many of the agribusiness people that we have talked to say, they have even more fear about public sector undermining than they do cost increases due to poor institutional frameworks and bad policies.

My fear is that this is likely to lead to entire countries being left behind – particularly when many are not particularly attractive for investment to start.

We’ve heard a lot about Brazil. Kenya, Uganda, Vietnam, etc. are also popular. How much do we hear about Cameroon, Nigeria?

So what are some of the things that we need to be thinking about, and doing in public sector supported agribusiness and value chain initiatives.

I’ll now turn to some lessons learned – or hypotheses if you will – on practical strategies and actions to improve likelihood of success.

Supportive policies, institutions, services

The first is that more attention needs to be given to support institutions, services and institutions for creating enabling environments.

- Most countries do not have the required institutions and infrastructure to facilitate and allow the private sector to develop new products and enter new markets
- Institutions that stimulate supply chain development are essential but in many countries these institutions do not exist or are very weak.

This is now an old story but still is surprisingly missing from many projects.

This need not and should not be rocket science. Agribusiness enterprise managers can quickly come up with a litany of inefficiencies introduced by public sector:

- One stop licensing – charcoal story in Kenya
- Lack of inter-professional organizations
- Legal frameworks covering contracts
- National identification so defaulters can be traced
- Trade fairs to promote contacts and spread information

The list can go on. Future issues things like are dealing with supply chain leadership and governance. This level of action is perhaps more important as we move out of area based project mode.
For your information there will be conference on BEE in Cairo in November.

Second - Pragmatic about Business Models

Second, for near future, it will be important to be sensitive to the political risk by carefully choosing the business model.
Examples: pineapple in Vietnam – not get political capital in most countries
Not sure about Care model in Kenya
FARMAPINE in Ghana (until failed) was good

Third - Build Back from Business

The third proposition is a mantra that I often use; this is "build back from business, not out from farmers". This obviously is not an absolute, but it is neglected as a rule of thumb.

In FAO and from what I have seen here, I believe that there is a continuing idealism about small farmer empowerment and participatory community level development.

I believe though that in many cases, even market oriented small farmers face difficulties in successfully entering higher end market segments – unless of course provided with special support to field projects.
- Limited skill sets
- Not attractive to banks
- Too little access to information / market intelligence
- Not have clear basis for distinguishing themselves and their products – commoditization almost inevitable

Conversely, small and medium agribusiness firms are better placed to be mini-leaders at the early end of value chains, even if bigger organizations are the overall leaders. Can play several key roles:

- Create effective demand; not really an exclusion story; rather new market segments created
- Provision of embedded services. Emerging story after structural adjustment
- Possibility of attracting private investment; entrepreneurs
- Lowest level on the "feeding chain" where realistic possibility of market intelligence

Of course there are many examples in which projects have built out from farmers. I don't want to make too big of an issue of this - but suggest that project formulators should consider the question,

> Who can sustainably develop the market intelligence, develop the downstream contracts, add unique value, attract private sector investment capital?

Fourth - Core Competencies

Whether or not the center focus is on building back from business or out from farmers, I suggest as a fourth hypothesis that it is important not to encourage farmers and farmer organizations to go well beyond their core competencies.

> Focusing on core competencies is Management 100, and is something that the biggest agribusiness firms now understand, and yet development agencies often are out there in small villages encouraging farmers to do storage, transport, agro-processing, long distance marketing, financial services, etc.

I am a firm believer in building competencies of farmer organizations, particularly to overcome scale problems and transactions costs. Strong groups also can help with governance problems.
But it is not clear that they should be taking on transport, marketing and other such tasks that can be done through value chain service providers or commercial providers.

Fifth - Adding Up Problem

If de facto taking over the value chain leader role of identifying the market segment and consumer requirements, then a fifth suggestion is to be very aware from the start of the adding up problem.

How many countries are trying or have tried to supply cut flowers to the EU?

When launching a programme, some key questions need to be asked:

Where is the evidence of a new consumer segment with effective demand for which can be a cost-efficient supplier?
What are sources of longer term comparative advantage?
How avoid commoditization and success replication?

I personally believe that it is more sound to find businesses that already have established the market intelligence, downstream contacts and contracts, etc. and then to assist in establishing building the capacities of farmers to be reliable suppliers. Or, to find the export and retail firms that know well their market segments and, again hopefully have financing and contracts lined up, and to tie them back to first stage agro-processors.

The firms then bear the risk and make the investments, and the public sector helps with the upstream linkages so smaller scale actors can join the value chain.

Sixth - Second Generation Problems

Even if all the right questions are asked and answered, I suggest as a sixth point that there is a need to anticipate what I call the “second generation problems.” Hamish introduced a similar idea with his call for continual innovation.

Second generation problems most often are due to industry consolidation and decline in value chain competitiveness, even after initial success, but can also be other problems. Let me give three examples of what I would characterize as second generation problems:

Vanilla in Papua New Guinea
Vegetable growing in Ghana

Sangrur District in the Punjab

These are all success stories but all have created vulnerabilities that need to be addressed.

One key lesson: provide advisory and technical support on a variety of farm and non farm activities rather than only on specific crops, animals and technologies.
Another is working on a diversity of options even from the start of projects.

Seventh - Direct Services Delivery

Another strong belief of mine is the desirability of avoiding direct services delivery.
Direct services delivery is a cornerstone of many projects in FAO, but also I believe in many USAID projects.
Provision of services is one of the main reasons why most initiatives launched under projects later collapse.

The seventh proposition is to accept some short run inefficiency, if necessary, in order to provide services by partnering with existing organisations that can provide the services in an ongoing manner.
Therefore - reinforce and support the competence and knowledge of local capable organisations for sustainable services provision normally might be a key project component.

Also, facilitate stakeholder engagement towards the end of encouraging a realigning of service providers to the needs of the business venture. We have several projects now that are working in this mode.

As to modality, I believe that projects can be very successful in catalyzing and facilitating change through small mini-grants.

Relying on local services provision is not always easy in practice, and more complete set of lessons is needed linked to specific commodities and value chain models. A couple of examples:

- While private processing firms in high value markets have been able to take over a quite comprehensive and professional role as agricultural

extension service provider, high processing margins are a prerequisite for the provision of such services.
- Creation of mutual asset specificity between growers and processors reduces uncertainty and raises the exit costs of both sets of partners – but can also increase vulnerability.

Eighth - Financial services

The handling of financial services can be particularly critical to sustainability.
General rule from rural finance is to avoid targeted, special-interest and subsidised micro-credit and revolving funds that tend to be untenable in the longer run and can also distort the market.

Some examples of emerging lessons:
- Give capital contributions to farmers' investments only on the basis of clear enterprise plans which include cash flow budgets to indicate sustainability and viability
- If there are to be any subsidies, these should support capacity building, economies of scale and marketing efficiencies which produce higher incomes and hence the ability to later pay market rates of interest

Ninth - NGO roles and responsibilities

The next to last practical suggestion that I will make is to be very careful in the handling of NGO linkages. Jag referred to the critical role of NGOs and I agree that linkages with NGOs are needed because private sector cannot always internalize cost of training and upgrading suppliers. Competitors will come if these costs are internalized, leading to contract jumping.

Have fear though that public sector and NGOs will get into commercial activities for value creation and then will slip into value capture. CARE in Kenya definitely has done this.

Tenth - Public roles and responsibilities

The final suggestion is another old story but one that requires, I believe, some more serious attention. This is the desirability of having public sector projects focus on public services – such as product certification, research and extension, transportation and communication infrastructure, property rights, fair processes for resolving contract disputes, availability of information and statistics.

The one point that I might note is that there is a real risk of dependency and distortion even when intervening at the business level. Chetah example in Zambia. Stick as much as possible to mitigation of risk transactions costs rather than services delivery.

Concluding Remarks

Before ending, I would like to draw your attention to a two key initiatives on which we would welcome comments and guidance.

Policy paper

Been a lot about supply or value chains, but not a lot about wider networks and the broader agri-food systems.

Linkages and value chains workshop