

The power of agricultural investment to generate public goods, such as poverty reduction, food security, local economic development, respect for the environment, as well as private profit is conditioned by the levers of both public and private strategy. While many market failures, such as business operating procedures, imposition of grades and standards, transfer of risk, that inhibit sustainable trade between small-scale farmers and agribusiness can be overcome through changes within the company, the underlying legislative and policy environment often has a dominant impact.

Some countries have adopted policies to guide decision making in strategic areas affecting agriculture. Many of these policies support both small and large scale farming, including a competitiveness agenda that includes objectives to modernize and transform peasant agriculture to commercial models. However policy implementation may prioritize one aspect over the other. Relevant to inclusive value chains we find two sets of policies that are strongly linked: policies that support inclusive investment and policies that support inclusive market development. But introducing the governance dimension, requires one step back to look at the rationale for our systems to deploy public sectors' and corporates' rules and policies to guide value chain value delivery.

**Why we need governance mechanisms** that are able to drive inclusive and sustainable policies? The answer is partly provided by **The Future of Food and Farming (2011)**, a major conclusion of this Report is the critical importance of interconnected policy-making. Other studies have stated that policy in all areas of the food system should consider the implications for volatility, sustainability, climate change and hunger. Here it is argued that policy in other sectors outside the food system also needs to be developed in much closer conjunction with that for food. These areas include energy, water supply, land use, the sea, ecosystem services and biodiversity. Achieving much closer coordination with all of these wider areas is a major challenge for policy-makers.

There are three reasons why broad coordination is needed. First, these other areas will crucially affect the food system and therefore food security. Secondly, food is such a critical necessity for human existence, with broad implications for poverty, physical and mental development, wellbeing, economic migration and conflict, that if supply is threatened, it will come to dominate policy agendas and prevent progress in other areas. And, thirdly, as the food system grows, it will place increasing demands on areas such as energy, water supply and land – which in turn are closely linked with economic development and global sustainability. Progress in such areas would be made much more difficult or impossible if food security were to be threatened. Substantial changes will be required throughout the different elements of the food system and beyond if food security is to be provided for a predicted nine billion people. Action has to occur on all of the following four fronts simultaneously:

1. More food must be produced sustainably through the spread and implementation of existing knowledge, technology and best practice, and by investment in new science and innovation and the social infrastructure that enables food producers to benefit from all of these.
2. Demand for the most resource-intensive types of food must be contained.
3. Waste in all areas of the food system must be minimised.
4. The political and economic governance of the food system must be improved to increase food system productivity and sustainability. The solution is not just to produce more food, or change diets, or eliminate waste. The potential threats are so great that they cannot be met by making changes piecemeal to parts of the food system. It is essential that policy-makers address all areas at the same time.

### Chains and smallholders

Moving back to the smallholder sphere, it is important to acknowledge that the governance dimension goes beyond the public sector sphere. The understanding of the governance type and framework of the value chain is extremely important when analyzing and intervening with small-scale producers from developing countries linked to a global, often captive or hierarchical value chain. The definition of the power and influencing capacity should be understood in order to install the dialogue among the value chain actors around margins and benefits along the chain.

Table – Types of governance in value chains

Type	Description
<b>Markets</b>	Market linkages do not have to be completely transitory, as is typical of spot markets; they can persist over time, with repeated transaction. The essential point is that the cost of switching to new parties is low for both parties.
<b>Modular value chains</b>	Typically, suppliers in modular value chains make products to customer's specifications, which may be more or less detailed. However, when providing "turnkey-services", suppliers take full responsibility for competencies surrounding process technology, use generic machinery that limits transaction-specific investments, and make capital outlays for components and materials on behalf on customers.
<b>Relations value chains</b>	In these networks we see complex interactions between buyers and sellers, which often cerates mutual dependence and high levels of asset specificity. This may be managed through reputations, or family and ethnic ties. Many authors have highlighted the role for spatial proximity in supporting relational value chain linkages, but trust and reputation might well function in spatially dispersed networks where relationships are built-up over time or are based on dispersed family and social groups
<b>Captive value chains</b>	In these networks, small suppliers are transactionally dependent on much larger buyers. Suppliers face significant switching costs and are, therefore, "captive". Such networks are frequently characterized by a high degree of monitoring and control by lead firms.
<b>Hierarchy</b>	This governance form is characterized by vertical integration. The dominant form of governance is managerial control, flowing from managers to subordinates, or from headquarters to subsidiaries and affiliates.

Source: elaboration of the author based on Gereffi, Humphrey, Sturgeon, 2005, p.5; Altenburg, 2007, p.12

At the same time the lead actor, for its power based on brand, technology or information capture, acts as a system integrator (Altenburg, 2007), strengthening the value chain.

### From farming to new agricultural economy, from government-led marketing to regoverning markets

From many developing countries small farmers are supplying global value chains, with an important degree of complexity and high quality and safety standard products, responding mainly to the need of industrialized countries' and urban areas' consumers. New forms of aggregations or clusters are being developed to generate services that are functional to working in a value chain (i.e.: capturing the benefits coming from purchasing inputs at scale, lowering production cost; being able to claim VAT credits through a commercial branch, getting better prices, internalizing the production of inputs such as seedlings and fertilizer), and transaction between farmers and buyers are becoming more formalized on

both produce and inputs markets, as well as contractual arrangements with international actors of the value chain. *“These changes, referred to as the new agricultural economy”* (Cavatassi et al., 2009) generating at the same time a risk and an opportunity for many small-scale farmers, that, so far, have remained left out of the benefit of the this new agricultural economy. For some authors the process *“may even exacerbate poverty levels through marginalization of small farmers and the rural poor who are disadvantaged as compared to the larger and better endowed commercial farmers”* (Johnson and Berdegúe, 2004; Berdegúe et al., 2003; Reardon et al., 2003; Little and Watts, 1994 in Cavatassi et al, 2009).

**BOX 1 - Trade-offs due to shifting from local retailers to supermarkets (from Altenburg 2007)**

One of the main trade-offs seen so far in many market-based approaches is the one between local markets and structured (mainly international supply chains). While synergies can be identified within a market system approach, when looking at the targeting and programmatic approaches, many questions on substitution effects, risks and benefit sharing remain open. The table below presents some of the main trade-offs between the two approaches from a socio-economic impact perspective.

<b>Box 2: Socio-economic impacts of a transition from traditional retail organization to supermarket supply chains (hypothetical)</b>		
<b>Area of impact</b>	<b>Expected development impact</b>	<b>Assessment (pos./ neg.)</b>
Direct employment in retailing	Decreasing due to concentration, crowding out of mom-and-pop stores	-
Indirect employment effects in supplier firms	Decreasing due to concentration	-
Employment effect on competitors	Crowding out of mom-and-pop stores	-
Wage levels of employees	Increasing due to higher productivity	+
Income level of suppliers	Decreasing margins as oligopolistic buyers exert pressure on prices, but higher income for <u>some</u> suppliers due to increasing turnover and productivity gains	- / +
Income disparities	Increasing concentration among retailers and suppliers, crowding out effects	-
Stability of supplier's income	more stable sourcing patterns (for those remaining)	+
Learning opportunities	Different, partly new opportunities for suppliers with regard to quality, logistics, franchises etc., partly deskilling of workforce	+ / -
Labour standards	more formalized, but increasing pressure to increase labour productivity	+ / -
Equality of opportunities for women	Depends on labour market; concentration processes likely to crowd out informal producers which are more often female-headed	- (?)
Environmental standards	Better enforcement of standards throughout the chain	+
International competitiveness of domestic retail sector	Increasing	+
Foreign exchange balance	Increasing imports of luxury goods or even basic products if local suppliers lack economies of scale	-
Consumer prices	Lower retail margins and higher productivity lead to declining consumer prices	+
Own compilation		

The recognition of the rapid changes taking place at global level in agricultural markets, reshaping the global agri-food system requires practitioners, academicians, industry managers, public sector managers, civil society leaders to be equipped to read and understand the new network of risks and opportunities. In this context it is relevant to introduce the concept of regoverning markets, first introduced by IIED in the early 2000, with its *“regoverning markets”* programme (Vorley and Proctor, 2004), funded by many international development agencies. The objective of the programme has been to produce evidence to support policy dialogue and interventions, recognizing that small-scale agriculture supports the livelihoods of the majority of the rural poors and that many actors were not prepared for the new agricultural economy. The regoverning markets programme aim was to: a) *“understand the keys to inclusion into these restructured agri-food markets, in order to address implications and opportunities for small-scale producers and enterprises”*, and more specifically to; *“Understand what is better practice in connecting small-scale producers with dynamic markets”*; b) *“Bring these findings into the wider policy arena and thereby inform, with facts and recommendations, practical action, public sector policy and private”*; and c) *“Bring these findings into the wider policy arena and thereby inform, with facts and recommendations, practical action, public sector policy and private sector strategies”*<sup>1</sup>

The challenge is to stimulate policy change to overcome the barriers that smallholder farmers face in accessing markets. As Coles (2010) highlights there is a basic difference between systems that are focused on positive social and environmental impact and the ones that are driven by price incentives regardless of the consequences: *“When income is relatively stable and the market is more reliable, producers are more likely to be able to invest to increase productivity or improve product quality and sustainability. In contrast, incentives to buy or sell for the cheapest price, whatever the consequences encourage short-term thinking and perpetuate environmentally and socially damaging practices”*. The body of work presented so far, is generating increasing consensus across organizations that are profoundly different in nature, corporate objectives, constituency and history, can represent a turning point in reconciling different theoretical approaches to agri-food systems.

### Policy and Approaches Challenges

- Caution against viewing market-based approaches as a panacea
- Market-based approaches can fail to reach the most marginalized populations, who often face social exclusion beyond mere exclusion from markets. For example, social safety nets and labor rights protections will still be critical in many contexts.
- The most conspicuous of these challenges is a need to address power imbalances between smallholders and larger businesses, as well as between women and men.
- Landscape impacts not taken into account by most market-based development and, only in limited cases, only through payment for environmental services
- Risk analysis and risk mitigation still weak, especially the one on Climate Change impacts that will affect multiple baselines for actors participating in one initiative (production suitability and quality, prices, infrastructures, workers' welfare to mention some)

Investment in agriculture and particularly in smallholder agriculture can generate public goods, such as poverty reduction and resilience to climate change, but new models for generating shared value are needed. These models should be based on a collaborative approach to build value chains responding to the needs of a resource constraint world, a growing population and rapidly changing consumption patterns. The reshaping of the social contract licensing agri-food companies to operate and thrive will have to bring at the center of the value definition the needs and expectations of both smallholders and

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<sup>1</sup>From: <http://www.regoverningmarkets.org>

consumers. Only through this value shift, the industry, policy-makers and society at large will be able to undergo the transformation needed to respond to the challenges that lie ahead, such as climate change, population growth, increasing urbanization, new consumption patterns and land degradation among others.

How inclusive business models might be operationalized in a manner satisfactory for smallholders, for industry shareholders, and for consumers, in a time when global recession seems to generate more castling strategies, than spaces for exploring transformative opportunities is still an open question.

In the context of high variability of quality and quantity of produce and power imbalances determining restricted competition, it is essential to look at both the policy and the investment dimension for a more equitable inclusion of smallholders, in markets identifying dimension of investment readiness for smallholders.

Producers' business models used by farmers to organize their production and link to markets are based on the both market and social dynamics and are not neutral in determining the amount of public goods that can be generated by smallholder agriculture.

### **Policies and Investment**

Land – In a context where the global response to future food challenges is the transformation of land in a commodity, used by sovereign investment funds to guarantee future financial and physical stocks, under the concept of large scale estates, irrespective of local dwellers rights, livelihoods and sovereignty, land policies and codes should influence and regulate land investment and access. Land policies in favouring smallholders should: (i) set-up financial mechanisms for smallholder to obtain landownership; (ii) protect local land rights, especially by generating mechanisms of oversight and guarantee of farming contracts where land is often used as a collateral; (iii) encourage inclusive investment in land, ensuring consultation and information of population; and (iv) support a landscape or watershed -based land-use planning ensuring diversity and quality of soils is fostered.

Investment – Targeted public and private sector investment are needed towards smallholder agriculture. Investment in agriculture should be informed by a new relation between State and markets, where clear roles, responsibilities and options are defined. Small farmers should be considered as recipients of financial investment, to upgrade their inputs, production and processing capacities and as recipients of public sector investment in hard and soft infrastructures. Today there a wide spread vacuum of investment between 50,000 and 250,000 USD towards agriculture, called "*the missing middle*" (Doran et al, 2009) between microfinance, and banking sector investments, in which a high-level of collateral assets or highly sophisticated business plans are needed. Investment in small-scale agriculture should have the goal of breaching inequalities and asymmetries, targeting specifically women and non-farm services. More specifically, investments should be prioritized whether they contribute to: (i) adaptive diversification of farm economic structure with a specific focus on women; (ii) capturing more benefit from producing or purchasing inputs at scale; (iii) lowering production costs, without affecting rights, (iv) extending tax breaks today available to exporters to smallholders, (v) attract or reduce the transactional cost of investment. This latter dimensions can be linked together to tackle the specific constraints that women face, enabling the generation of new, women-led businesses around agriculture, increasing the density and quality of services, while allowing women to make decision on how to plan for their assets and time. Gender injustice and the social and cultural norms and practices defining it should be imbedded into policies around small-scale agriculture, recognizing the need of moving beyond policies targeting only specific aspects of women's life in agriculture.

Climate Change Adaptation – The increasing incidence of climate change impacts, both in terms of frequency of extreme weather events, and long term changes in precipitation and temperature patterns,



is generating more and more unpredictability, increasing the already high risk in agriculture. This risk is even higher for smallholders who have a really thin asset base, coupled with lack of knowledge, new skills and technologies to mitigate risks and adapt to changing conditions. Both public and private sector will gradually face the need for intervention, to generate incentives to manage the uncertainty within a production system. There is enough ground to start planning for inclusive value chains, with a climate change risk management, because the modifications of the climate could compromise not only the agricultural performance of a single location, but they could threaten simultaneously several different complimentary locations within the same global value chain, increasing the aggregated risk for all actors. A call for action on smallholder agriculture and climate change should aim at: (i) Increasing the coverage of meteorological data, using ICTs to both collect more data, as well as to model and register weather events, allowing a better development of weather indexed insurance schemes and better long term planning, projecting solutions for the future, starting early pilots of new agricultural technologies, and crops; (ii) Generating solutions relevant throughout a value chain, with the engagement of multiple actors, to invest in adaptive solutions tackling infrastructure, technology, capacity and knowledge.

Reducing market asymmetries - Shared value, sustainability and social inclusion in global value chains can be achieved only if companies will move away from a facial and advertising oriented CSR and integrate their public commitment with their core operations. Firms purchasing from smallholders should make sure that smallholders are considered strategic long-term partners, and investments should be made accordingly. Processors and traders should reduce the time to payment for smallholders, because the implied financial exposure is not bearable given the thin asset base. These changes should be led by global lead firms, which, similarly to what have done with their preferred suppliers, reviewing their procurement policies, moving away from price speculation and integrating vertically through joint investment, should push with their suppliers for a more inclusive engagement of smallholders along value chains. To achieve this first set of changes within lead firms, there is the need of a change in the corporate culture, moving away from a competitive mindset and embracing a partnership, collaboration oriented manner of looking at operations and purchasing, creating an internal set of incentives to make it possible for buyers to achieve their performance indicators, while generating shared value for the company and between the company and the society actors enabling the creation of value.

More in detail, the balancing of risks and rewards along value chains should be a mix of publicly regulated norms and privately enforced processes.

- a. The first ones can be oriented at: (i) Guaranteeing the presence of a diversity of market outlets, such as local and national markets, that complement the export ones, recognizing the value of the diversification vis-a-vis environmental externalities, a portfolio management of risks and the value to local consumers; (ii) Protecting traditional local retailers and market from the penetration of modern global ones, through specific and locally relevant regulations. This is particularly relevant where traditional direct or semi-direct relationships exist between smallholders and urban consumers and where there is a relevant cultural heritage related to the markets; (iii) Last, but not least, implementing a sound agricultural market governance, able to reduce price volatility, to regulate and enforce viable standards for contracts between smallholders and buyers, and to increase relevant price information transparency.
- b. Lead firms and other companies along international value chains can act on two main points to reduce the market asymmetries with smallholders. (i) Increase the transparency of crops cost structure with farmers to increase trust between actors. Most processors and farmers share the same geography, language, and culture and an aggregated increase of social and human capital of the processor with the farmers would potentially increase local margins, by diversifying, changing cost structure via innovation, or generating joint advocacy for public investment.

Incentives for collaborative behaviors can be generated by lead firms and transmitted along the chain through the production and purchasing codes. (ii) The other highly relevant dimension in which procurement with smallholders should be substantially different is around the time to payment and refusal rate. In many cases, especially at tropical and equatorial latitudes, this implies for the farmers to access high interest rate informal credit, to pay upfront for the operations cost of the following planting season, while waiting for the payment for the harvest of the previous one. This highly unjust mechanism is one of the major financial constraints to allowing profit (when any) reinvestment in small-scale agriculture. The other really important dimension is the negotiation and destiny of the refusal. For marginal rural communities, vegetable products not graded for the export market could be an important source of calories, of income through local markets, or of organic matter to be reintegrated in the soil. Nevertheless, very frequently the whole harvest is taken by the buyer's trucks, and the farmers are informed, a few months after, that up to 25 percent of the total volume is discounted as refusal. Where joint mechanisms of oversight of the refusal between farmers and processing companies have been established, the farmers have improved their performance or have started to sell the refusal to secondary markets, while the companies have reduced their transportation cost.

### **Public-private partnership (PPP)**

**Public-private partnership (PPP) describes a government service or private business venture which is funded and operated through a partnership of government and one or more private sector companies.**

These schemes are sometimes referred to as PPP, P3 or P3.

PPP **involves a contract** between a public sector authority and a private party, **in which the private party** provides a public service or project and **assumes substantial** financial, technical and operational **risk** in the project. In some types of PPP, the cost of using the service is borne exclusively by the users of the service and not by the taxpayer. In other types (notably the private finance initiative), **capital investment is made by the private sector on the basis of a contract with government** to provide agreed services and the cost of providing the service is borne wholly or in part by the government. **Government contributions to a PPP may also be in kind** (notably the transfer of existing assets). In projects that are aimed at creating public goods like in the infrastructure sector, the government may provide a capital subsidy in the form of a one-time grant, so as to make it more attractive to the private investors. In some other cases, the government may support the project by providing revenue subsidies, including tax breaks or by removing guaranteed annual revenues for a fixed time period. While in the last 20 years every latitude has seen the emergence of small and medium scale PPPs, in the last few years, there is an emerging trend of incredibly large PPPs in agriculture with the objective of generating public goods, while managed by a fairly restricted group of organizations.

### **"MEGA" PUBLIC PRIVATE PARTNERSHIPS IN DETAIL**

This are the PPPs recently launched through WEF, G8 and other multilateral spaces, mainly with a focus on Africa and the aim of reaching an investment scale of several billion dollars per year before 2015. Around this PPPs, often seen as a market-led panacea, there is a broad and increasing concern about how they can deliver participation, transparency and accountability on the real public goods value. Protection of rights, and sustainability of interventions for future generations are a clear dimension for more in depth analysis for the upcoming years for many of these. The main three are:

1. **NEW VISION** - The New Vision for Agriculture has the highest profile of the three PPP initiatives mentioned. Launched by the World Economic Forum

2. **GROW AFRICA** - Grow Africa is implicitly anchored in the New Vision, but we higher involvement of African leaders.
3. **NEW ALLIANCE FOR FOOD SECURITY AND NUTRITION** - The New Alliance was set-up at the G8 in 2012 and tries to raise over 5bn USD investments in African Agriculture

**Key questions:**

1. Under which conditions PPPs are accountable to deliver public goods?
2. Which safeguards should be implemented and monitored in PPPs involving land deals?
3. Do synergies or trade-offs exist between PPPs funding and public expenditure in sustainable agriculture in Africa?
4. Who should these global PPPs be accountable to?
5. In the context of an increasingly globalized economy, what are the models of public and private sector governance that can foster local economic development around agricultural value chains?
6. Can small-scale farmers organize to meet the demand of corporate giants? Can distribution systems be adapted to make markets work better for the poor? (Vorley, 2007).