

# ***Linking worlds: New Business Models for Sustainable Trading Relations between Smallholders and Formalized Markets***

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## **Acknowledgments**

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## **Introduction**

Consider the following scenario: A major branded food manufacturer takes a high-level decision to make its business more inclusive and more equitable for small-scale suppliers. In common with many of its competitors, the firm is starting to see sustainable development as a core business principle. In a number of countries where it operates, the company commits to working with local smallholder farmers. The company is taking on this approach for both business and social reasons, primarily to improve the quality and security of its supply of raw materials, but also to contribute to the Millennium Development Goals (MDGs) and improve its reputation in the country and communities where it works. Involving smallholders as suppliers may also help the company get greater support from investors or customers who seek to support ethically based trade.

In partnership with its main supplier, the company looks for smallholders who can meet its stringent standards for quality and consistency. It develops a small community fund to insure farmers against crop failure and invest in essential local service improvements.

After a successful pilot, procuring directly from a limited number of suppliers and with positive interest from governments and NGOs, the programme begins to run into problems. Quality and quantity of supply are variable and difficult to match with market requirements. Farmers start to complain that the company is failing to keep its commitments on orders and prices, and that pricing methods are not transparent.

Rising procurement costs associated with collecting, grading and bulking product from dispersed suppliers, along with problems of farmers 'side selling' to traders, make plans for scaling up the project less attractive. A newspaper article in Europe accuses the company of compromising food security in the communities where it is running its smallholder programme. The management starts to lose heart, and to regret getting involved in the 'development' business.

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<sup>1</sup> Wilson, E et al. (2009). Business models for sustainable development: a new value proposition. IIED

What can we learn from this scenario? Could the company have done better? Are there principles which the company and its supply chain could have applied to improve the chances of success? Should the company have undertaken a more comprehensive review of its overall business model? Similarly, what was the responsibility of the farmers? What market considerations, skills and business linkages were needed to improve farmer engagement and performance?

These questions are typical for firms which are progressively defining corporate social responsibility (CSR) in terms of their core business and value chain activities rather than as discrete philanthropy or a checklist to help reduce reputational risk. The questions are also typical for support agencies, especially NGOs, who are shifting to market approaches in their development projects. Both are seeking to design and modify business models to respond to specific sustainable development challenges in low- and middle-income regions globally. Those challenges include the need to:

- stimulate access to markets and global supply chains for local small-scale suppliers;
- deliver affordable goods and services to low-income communities;
- respond to the demands of climate change mitigation and adaptation; and
- ensure environmentally sound production and service delivery.

The goal of this paper is to provide a set of workable principles and processes for companies and support agencies around the first of these challenges: improving the market performance of smallholder farmers and fostering longer term business relations along the value chain. While the focus in this paper is on agrifood products, the principles can equally be applied to new markets for environmental services, such as carbon markets.

Incorporating these principles will not prevent all the problems described in the introductory scenario, but applying the approaches may help companies and support agencies consider the most appropriate questions when designing a market linkage programme. This framework builds on the work done to date on food company purchasing practices, especially by Traidcraft.<sup>2</sup>

This paper first defines business models and their link to sustainable development then sets out six principles, with brief supporting case material. Lastly the application of these principles is discussed from the perspective of the real world of agribusiness. This first paper on the principles will be followed by a future paper that shares experiences from the New Business Model for Sustainable Trading Relationships project and beyond on the process of operationalizing these principles in existing and new supply chains.

## **From value chains to new business models**

Over the past 10 years, the international community has placed increasing emphasis on developing more active partnerships with businesses, using the power of the marketplace to support new opportunities for the rural poor. Many firms also see emerging economies as a critical area of future commercial growth, with new markets to be found even in the poorest communities 'at the Base of the Pyramid'.<sup>3</sup>

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<sup>2</sup> See 'Buying Matters' Traidcraft, 2006 and 'A fresh perspective: sourcing vegetables from developing countries' Traidcraft, 2007  
[http://www.traidcraft.co.uk/international\\_development/policy\\_work/policy\\_resources/policy\\_reports.htm](http://www.traidcraft.co.uk/international_development/policy_work/policy_resources/policy_reports.htm)

<sup>3</sup> Prahalad C.K. and Stuart L. Hart (2002). 'The Fortune at the Bottom of the Pyramid'. *Strategy and Business*, Vol.26 pp54–67.

The NGO sector is no exception, investing resources and prestige in market linkage projects, in the expectation of rural income and asset growth and, where possible, greater commercialisation for smallholders.

This trend has been accompanied by the development of a range of market facilitation and linkage tools around the *value chain* theme. Market linkage projects typically involve identifying particular bottlenecks at the supply side of the value chain and then investing in discreet interventions, such as new technology, organising farmer groups, or establishing new collection points that enable smallholders to penetrate new markets. The lead firm will look to its suppliers rather than its own business to implement its strategy.

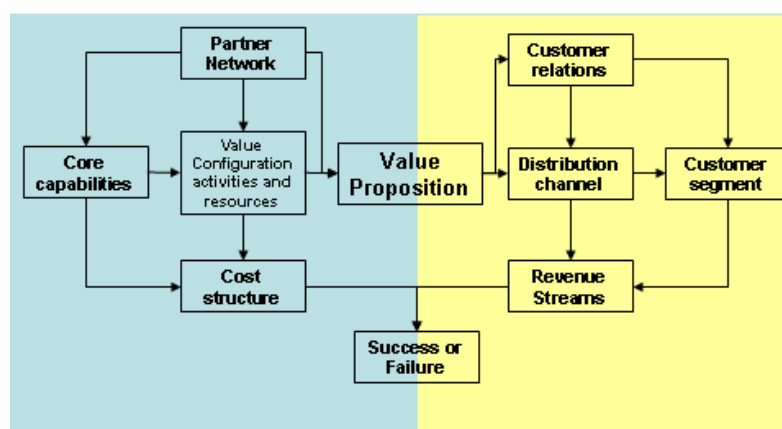
These single point interventions can be highly effective in short-term chain gains, or whilst the facilitating agency continues to invest in technical support. But value chain interventions without attention to the *core business model* of the chain actors may result in problems with durability or in taking new market linkages to a larger scale. Projects to link the worlds of small-scale production and modern agribusinesses, and to upgrade the position of smallholders in those markets, can remain as small “corporate responsibility” (CR) cases for the Annual Report or can be limited to speciality niches, peripheral to the core business.

## What is a business model?

A “business model” describes how an individual firm organises itself and its relationships in order to create and capture value. It tells us how the building blocks of production, marketing, costs and revenues come together to provide a value proposition in the marketplace that differentiates the firm from its competitors. The business model concept is linked to business *strategy* (the process of business model design) and business *operations* (the implementation of a company's business model into organizational structures and systems).<sup>4</sup>

There are two broad areas of possible adaptation and innovation in business models: the production side and the marketing side (Figure 1). The production side comprises the set of activities, mechanisms and relationships for providing a good or service, in other words for creating value. The *partner network* -- the supply chain and its coordination -- is a vitally

Figure 1. Template of a business model (adapted from Osterwalder, 2008)



<sup>4</sup> Osterwalder, A. (2008) *The Business Model Canvas* <http://business-model-design.blogspot.com/>

important source of competitive advantage. The marketing side comprises the set of activities, mechanisms and relationships for selling that good or service, or in other words for capturing value. Broadly speaking, the production side is associated with costs while the marketing side generates revenues, though marketing also entails costs.

The business model template in Figure 1 demonstrates the importance of attention to the value proposition and cost management structures which underpin the success of any business model. In the case of modern agrifood chains, almost all value propositions are built on consumer assurance, high standards for food quality and safety, year-round availability, and, sometimes, lower prices, communicated to consumers through brands. Agribusiness models are generally highly sensitive to any additional costs and risks. It is around this apex of consumer assurance and cost that the question of market inclusivity ultimately revolves.

## **Can new business models improve the inclusion of smallholders in formal trading?**

The business literature alerts companies to the need for *new* or 'disruptive' business model thinking in two situations.<sup>5</sup> In the first, a firm may seek to fend off a 'disruptor' which has brought a radically new customer value proposition to the market. Agrifood markets, though mature, are still regularly confronted with disruptors, in terms of products (examples include the fruit smoothie and chilled ready meals), and retail formats (the example of deep discounters with limited product range). A second situation is when a firm wants to reach a new group of customers. The 'Base of the Pyramid' concept is an extension of this scenario, serving a new group of underserved customers -- the poor four billion at the bottom of the global economic pyramid -- with adapted products and services.

There are far fewer new business models – disruptive or otherwise – built on serving a new group of *suppliers*, such as poor smallholders. An extraordinary exception is Fairtrade. Here the customer value proposition is *smallholder inclusion and development*. The products serve a customer segment that wants a fair deal for smallholders and their families. But even Fairtrade leaves the business models of most lead firms largely unaffected. These firms see Fairtrade as an extension of niche marketing, to be delivered by suppliers and sold alongside conventional products.

Are there alternative, more 'disruptive' business models that build sustainability (poverty reduction or environmental stewardship) into at the heart of the firm and its production and marketing networks? Where sustainability is a deliberate co-product of mainstream business performance? Is there a greater chance of impact?

The first answer is that many partner networks are already highly 'inclusive.' Some important agricultural commodities do not lend themselves to plantation-scale production. Cocoa, where 90% of all production is in the hands of small producers, is one such example.

This reinforces the point that it is not only market inclusion that is the goal, but fair and equitable inclusion, whereby smallholders can improve their economic opportunity through raising product quality and meeting or exceeding market standards. In short, smallholder biased models are designed to improve the efficiency of the chain with wider social objectives. One of the major differences between conventional and 'new' business models becomes clear: the need to capture value in different parts of the value network, most notably for smallholder suppliers and primary producers.

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<sup>5</sup> Clayton Christensen, Harvard Business School

*Inclusive* new business models designed to assist fair and equitable smallholder inclusion in formal markets therefore need to create arrangements that put the ‘partnership’ back in ‘partner network.’ This will be most effective if trading arrangements are (a)  **durable**: with long-term trading relationships; (b)  **equitable**: specifically increasing market access for smallholders with equitable balance of risk, responsibilities, and benefits among the chain actors; (c)  **efficient**: improving financial sustainability; (d)  **effective**: assisting in guaranteeing purchaser access to consistent supplies of agricultural products that meet or exceed market standards; (e)  **adaptable**: offering sufficiently flexible procurement standards that enable both buyers and sellers to respond to changing markets and social and environmental conditions; and (f)  **credible**: recognised as offering real benefits rather than serving interests of PR, and free of double standards.

Why are these models so rare? It is widely perceived in agribusiness that purchasing from partner networks which include large numbers of dispersed small-scale farmers will inevitably raise costs, lead to variations in product quality, integrity and traceability and therefore increase commercial risks. Small-scale farmers are often seen to be less reliable in honouring trading agreements and less likely to meet contractual product agreements than larger producers, because they do not have the cash flow, technical skills and technologies (such as irrigation for vegetable production, or cooling tanks for milk production) to produce the right products at the right time. Common business practice therefore sees buyers typically seeking out large-scale suppliers and areas favoured by agribusiness, such as zones involved in export production. This is particularly easy in a dualistic farm structure such as that found in South Africa.

An adaptation on the partner network to overcome these issues might involve novel ways of working with producers and suppliers. Successful innovations of this nature often combine both technical and organisational elements. For example the provision of services such as inputs to support product uniformity and specialised procurement hubs for sourcing from a large number of disparate small-scale suppliers. Any business model needs to be appropriate for the geography and structure of the supply chain. The choice of business model will depend on the nature of the partner networks, product (perishable, differentiated or branded product, or bulk commodity) and the nature of the end buyer (branded retailer, wholesaler, etc.) These same factors determine the nature of economic dependency between chain actors.

The next section outlines the principles that should be considered when building a new business model.

## **Principles of new business models**

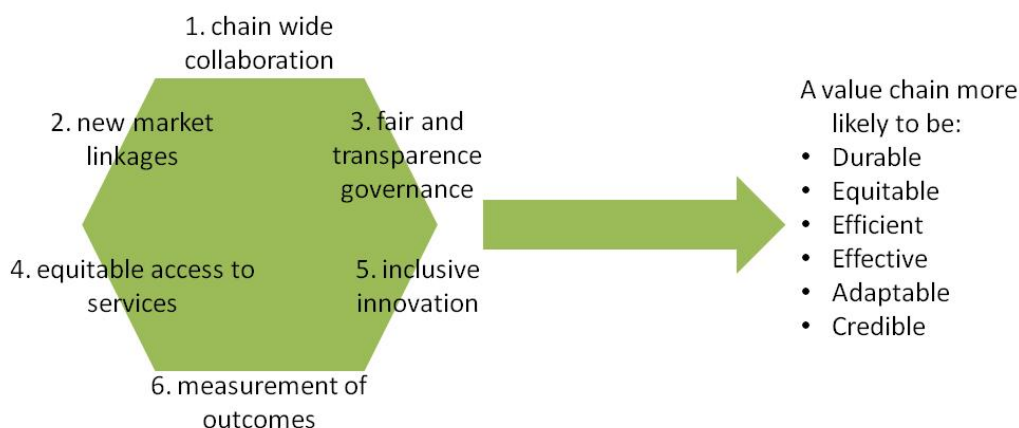
From examining the literature on value chains and following discussions with private sector, NGO partners, and drawing on our own experience through pilot business model projects, we have identified a set of principles that can serve as a framework for diagnosing and improving trading relationships when moving to a scalable business model. This framework will evolve as our understanding advances globally about how to best engage smallholders in dynamic markets. We have seen consistent patterns in the cases examined that supply chains are most robust for smallholders over time where there is a structure in the value chain for:

1.  **chain wide collaboration** on shared goals and identified champions for those goals;
2. new  **market linkages**;
3.  **fair and transparent chain governance**;
4.  **equitable access to services**;
5. Inclusive  **innovations** in the chain; and
6.  **Measurement of outcomes** throughout the chain, with those measures shared between

chain actors and used for continual improvement of commercial and social performance on a regular basis (Figure 2).

Principle 1, chain wide collaboration, ensures that all chain actors are pulling in a similar direction. Principles 2-5 represent a highly interconnected set of principles structuring how those actors will work together. Principle 6 is about measuring progress to ensure continuous improvement. We have come to understand that where mechanisms in value chains are adopted that embed these principles into the trading relationships, there is a greater chance of longer term, stable participation for smallholders, plus improved ability to adapt to changing market conditions, and greater economic and non-economic benefits from participation.

**Figure 2. Business Model Principles that can achieve positive outcomes for small-scale producers**



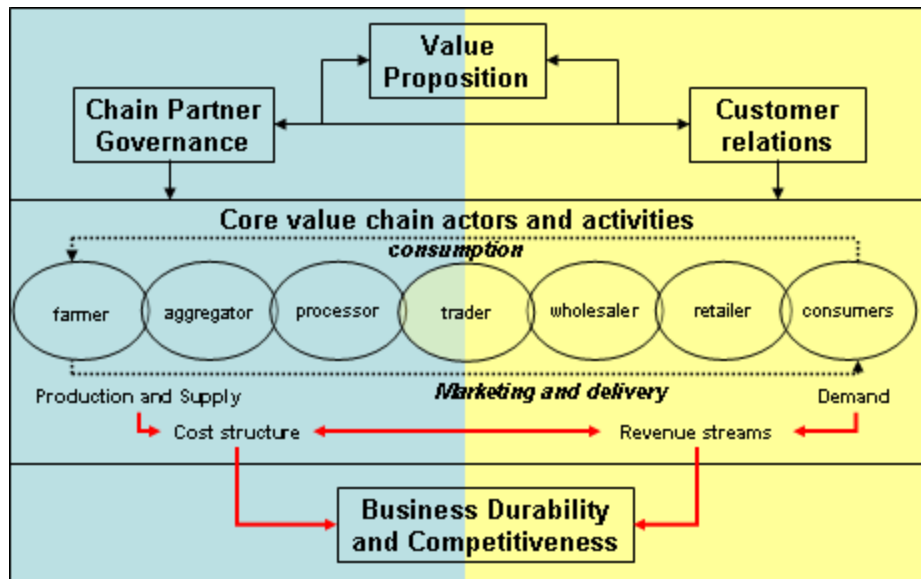
These six principles are now discussed in more detail, with short supporting case examples from both export and domestic markets. Note that these principles have considerable overlap, and that it is self-evident that most successful case studies incorporate more than one of these principles.

**Principle 1: Chain-wide collaboration with shared goals and identified champions**

A common theme of new business models is one where all or most chain actors *set shared goals for collaboration*, to facilitate the identification and resolution of problems, in terms of both commercial and social performance.

Businesses are experimenting with much more integrated ways of working challenging the clear-cut traditional boundaries between the role of the firm and the roles of its partners and clients. The development of a *systemic view* of the chain recognizes and values the interdependence of the actors. It significantly stretches the usual boundaries of the business model, which has focused on the individual firm and its internal processes, to one of chain-wide processes involving multiple actors (Figure 3). A collaborative partner network is vital for perishable commodities such as fresh vegetables, dairy and meat, which require traceability and have higher food safety risk profiles. But collaboration is also key to upgrading, in terms of quality or sustainability, in the commodity trade. This is increasingly visible in the growing number of certified products, such as organics, Rainforest Alliance, Fairtrade and other certification-based systems. Where critical elements of the supply chain add strong incentives for participation, such as food safety or quality, this creates an even stronger collaboration vehicle for identification and resolution of problems.

**Figure 3: Chain-wide new business model**



The term ‘collaboration’ should not be used to gloss over the fact that chain stakeholders may not have an interest in increasing transparency and collaboration, or that the interests of smallholders differ from those of intermediaries and lead firms. Reaching and implementing agreement often involves identifying a driver or a champion to lead the process. This champion may be from the lead firm, from a dedicated wholesaler, from a facilitating NGO, or a motivated farmer, or co-operative manager and might be a single individual or a group of people.

**Principle 2: New market linkages**

Market linkages are typically the weakest point in improving the participation of small-scale farmers in formal markets. For farmers and their organisations, these linkages should provide a stable market with clear quality, volume and price signals as well as access to production support (Principle 4) and contribution to improved livelihoods. For buyers, these linkages must provide a consistent supply of safe, quality products at a competitive price and with low transaction costs. For the stability between supply and demand, direct communication must exist between the producer, supplier and buyer.

Partner networks, with co-investment and knowledge-sharing between producers, suppliers, processors and retailers, are usually built around a small number of large-scale preferred suppliers. New business models must therefore build in market linkages that put small-scale suppliers on par with, or above, the competitiveness of large scale suppliers.

At its simplest, chain linkage can comprise direct market trade between end customer and primary producer, as practised in coffee by Intelligentsia Direct Trade.<sup>6</sup> But the high level of transaction costs in direct market linkages can be justified only for the most exclusive ‘boutique’ brands.

Where direct collaboration is not feasible or scalable, adapted business models are called for. From the producer side, group organization increases farmers’ incentives to *cooperate to*

<sup>6</sup> <http://www.intelligentsiacoffee.com/origin/directtrade>

*compete* as one single supplier, by restricting their opportunistic behaviour and by mutual control. This type of collective action saves costs for quality and quantity verification and testing. Business models can comprise new marketing arms of producer organizations, such as NorminCorp (see case study below), which is responsible for product branding, technical upgrading, broadening the supply base, etc.

At the level of food manufacturers and retailers, this principle could include a commitment to seek out these organisations of small-scale producers – or for market-oriented NGOs, a commitment to assist in facilitating farmers to develop organisations where none currently exist. Our findings have shown however, that farmer organisations should be considered as only one way of establishing an attractive and ethical source of supply from farmers. Where there is distrust of producer organisations, or where investments in producer organisation will not result in a stable procurement system, the ability to meet minimum volume requirements, homogeneity in quality of the shipped produce, and meeting terms of payments, then specialized intermediary enterprises or lead farmer models may be the solution.

At the level of trading, new models can comprise the upgrading of existing formal or informal intermediaries, or the establishment of new trading organizations such as Hortifruti, to new ‘double specialized business intermediaries’ with an integrated development mission in addition to a clear business objective such as Hariyali Kisaan Bazaar (see case example in Principle 4), and even a ‘franchisable’ social trader model.

Seeking out and working with this new generation of intermediaries is for many in agribusiness and CSR counterintuitive, but will be absolutely essential to take inclusive procurement to scale.

#### Case Example: **NorminCorp**<sup>7</sup>

Farmers of the Northern Mindanao Vegetable Producers’ Association, NorminVeggies, are able to successfully participate in dynamic vegetable chains primarily because of the organizational structure they chose in order to respond to the market challenges. This involves a marketing corporation, Normincorp, which gives them the capacity needed for each development in the supply chain. Normincorp’s formation signified a new development in marketing for small farmers. While established as a stock corporation, Normincorp functions more like a cooperative and has a social enterprise character. It was a set up and operated with keen business sense but also with full empathy for the small farmers. As market facilitator, Normincorp saw to it that production was programmed by farmer clusters with their respective cluster leaders, according to marketing plans, that quality farm and postharvest management could be done by each farmer in the cluster, and that coordination could be provided for the sequence of activities that include order taking, outshipment logistics, billing/charging, and collection and remittance to the farmers. Normincorp supplies multiple market outlets – exports, supermarkets, hotels, wholesale and local markets – spreading risks and ensuring an outlet for all products. For these services, Normincorp earns a market facilitation fee based on the value of the sale and uses the income to cover the marketing management overhead.

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<sup>7</sup> Source: Sylvia D. Concepcion, Larry Digal, Joan C. Uy (2007). Innovative Practice Philippines: The case of NorminVeggies in the Philippines.

[http://www.regoverningmarkets.org/en/resources/se\\_asia/innovative\\_practice\\_philippines\\_the\\_case\\_of\\_norminveggies\\_in\\_the\\_philippines](http://www.regoverningmarkets.org/en/resources/se_asia/innovative_practice_philippines_the_case_of_norminveggies_in_the_philippines)

### Case Example: **Lead farmer networks with Hortifruti Honduras**<sup>8</sup>

Hortifruti is the specialized wholesaler for fresh fruit and vegetable for Wal-Mart in Central America. The company works with a variety of suppliers for vegetables in Honduras and Nicaragua, often purchasing product from existing farmer cooperatives. However, it has experienced significant difficulties with these farmer organizations in terms of lengthy decision-making processes. As a result, Hortifruti Honduras has developed and promoted a 'lead farmer' model of organization through which it identifies and builds the capacity of farmers who can meet its quality needs in a consistent fashion. After demonstrating such capacity, lead farmers receive larger and larger orders for product or new products and are invited to work with neighbouring farmers to meet this demand. Lead farmers provide access to technology, technical assistance and market access to their network of neighbours as part of a bundle of production and marketing services. The cost of these services is recouped via the sales margin to Hortifruti. The expansion of this model depends on the identification of new lead farmers. Early results indicate that it is low-cost, scalable and sustainable.

### **Principle 3: Transparent chain governance**

Governance refers to the setting, monitoring and enforcement of formal and informal rules along the chain. Rules pertain to the *terms of trading*, including price setting, grades and standards and regularity of delivery, often referred to as buying conditions. Specifically, fair and transparent governance refers to the establishment and enforcement of *clear and consistent grades and standards*, *clear commitments to buy and sell* certain volumes of certain grade products at certain times, and equitable processes of *risk management*.

A new business model seeks to make these processes fair and transparent to all members of the chain. Mutually recognised interdependency between chain actors appears key. Shared commercial risk and insurance against failure are frequently cited at all levels as the cement of successful relationships. This can be achieved formally or informally, but the guarantees must be transparent in ways that enable the chain to be regularly monitored and rules enforced through an agreed facilitator, chain self-regulation or other mechanisms down and up the chain. Producers need to have access to mechanisms that allow their buyers to be held accountable, and vice versa. Examples from different models include the co-development, management and consistent application of *standards*, use of *contracts* to enhance predictability and transparency for producers, improved *forecasting and planning*, clear, consistent and known guidelines for *pricing* (such as quality grades), and so forth.

Fairtrade certification, which includes an emphasis on fair minimum prices, price premiums, and democratic decision-making, has emerged as the dominant public advocate for fair chain governance. The Fairtrade model is grounded in the historic experience of small-scale producers being vulnerable to sustained periods of low prices (often below cost of production) because they have few alternative options, limited negotiation leverage or bargaining power, and are dependent on traders for essential credit and inputs. While mechanisms such as minimum

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<sup>8</sup> Sources:

Agropyme (2006). Innovaciones Organizacionales de Pequeños Productores de Vegetales para Participar en Canales de Comercialización Dinámicos en Honduras' Report prepared for the Regoverning Markets Consortium. Agropyme, Agencia Suiza para el Desarrollo y la Cooperación (COSUDE) and Swisscontact, Tegucigalpa, Honduras.

Lundy, M. (2007). New Forms of Collective Action by Small-Scale Growers. Input for the World Development Report 2008. Santiago, Chile: Rimisp. (<http://www.rimisp.org/getdoc.php?docid=9855>).

prices and price premiums can be important strategies in the right market situation, there are other ways to improve the fairness and transparency of supply chains for all market situations. For example:

- A clear and accessible production standard enables the farmer to know what is required to get the top quality prices.
- Standards that are developed with participatory voices of the producers rather than unilaterally by buyers are more likely to avoid unintentional exclusion of some producer groups (see also Principle 5).
- Transparency of prices through the chain empowers more effective and grounded negotiation even without needing transparency of margins.
- Transparency about the impact of changes in pricing and policy through the whole value chain enables decisions makers to consider the sustainability of the whole chain.

In terms of incentives, new business models also seek to make incentives transparent and assist in their accrual to actors responsible for positive change. Examples from different models include incentives for meeting or exceeding quality and quantity goals, contracts that leverage access to credit, access to reasonably priced inputs, etc. The key issue here is the need to align incentives with outcomes. A new business model would link incentives for upgrading to improved market conditions under a profit sharing agreement, i.e. the farmers improve quality which allows the product to be sold to more exacting consumers at a higher price, with part of that price premium returned to farmers and the remaining covering marketing expenses.

While it is not constructive to try to over-regulate chain activities and/or governance, it is important to have a minimum level of common understanding on which to base decision making. Standards setting, regular monitoring of processes, and enforcement are examples of areas profiting from common understanding. A common framework reduces the risk associated with uncertainty and provides an incentive for compliance for both buyers and sellers, especially in systems where repeat transactions are the norm.

In the more advanced cases, equitable governance and voice of the supply chain is imbedded in the structure of the chain. An example is the AgroFair joint ownership structure.<sup>9</sup>

**Case Example: Shared risk management between Los Angeles Salad and Cuatro Pinos cooperative<sup>10</sup>**

The business of export vegetables is inherently risky. Losses due to damaged product from shipping or other factors are commonplace and often the result of errors or difficulties beyond the control of chain members. In recognition of this fact, the exporter (Cuatro Pinos cooperative) and wholesaler (LA Salad) for a smallholder French bean chain developed a novel way to manage this risk. Through an informal agreement, 10% of the value of each box of French beans sold is placed into a settlement account. This account is jointly managed by the cooperative and the wholesaler in the US. Funds in this account are used to write off damaged product, invest in technical assistance on food safety and new product development, and for unforeseen circumstances. Both parties have agreed that first use of these funds is to guarantee payment to farmers, with other expenses taking secondary consideration. In the 2005-2006 production

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<sup>9</sup> Agrofair website, <http://www.agrofair.nl>

<sup>10</sup> Source: Lundy, M. 2006. *Assessing smallholder participation in the French bean chain in Guatemala: The Juan Francisco Project*. Supply chain assessment carried out under the umbrella of the Rural Livelihoods Program of the Sustainable Food Laboratory (<http://www.sustainablefoodlab.org>).

season, nearly US \$230,000 were used to write off loans issued to farmers who lost their crops in Hurricane Stan. This fund is a novel way to plan for, and respond to, risks inherent to the export of fresh produce and is a good example of shared risk management.

Related to the theme of transparent chain governance is the issue of internal contradictions and double standards. For example, if a firm's buying policy and incentive structures make it impossible for buyers to enter into longer term relationships of trust, then the trading environment may be completely hostile to new business model principles, whatever the stated ambitions of the business.

#### **Principle 4: Equitable access to services**

One of the special challenges faced by small-scale producers that often prevents successful participation in more formal (and potentially profitable) markets is the lack of access to services such as finance, market information, and best practices that could improve quality, yields, food safety, and environment performance. The need for service providers that can meet the rigorous food safety demands of formal buyers and also meet the service needs of farmers (a doubly specialised function), has led to the development of a new generation of private sector intermediaries that can bridge the two worlds of smallholder farmers and formal companies.

These double specialised intermediaries can use their skills to improve or build supply chains that enable smallholders to access credit, knowledge, technology, and develop incentives that encourage producers to invest in their own production based on market needs. This ability to extend the service frontier to those actors who are normally denied such access is a key ingredient in a relationship through which producers can sustain their participation by evolving with the market.

Finance, information and technology can be provided by the 'downstream' buyer, or by an agent of the buyer, by an NGO or NGO-business partnership, or by a commercial arm of a producer organisation, or by the producer organisation itself. There is no single recipe for success, but recent evidence suggests that the provision of services through a chain intermediary may be more cost efficient than services provided by actors at the ends of the chain, i.e., the primary producers or the end buyer. Due to the combination of commercial and social goals, new business models that seek sustainable development frequently require additional inputs of non-chain actors such as NGOs or external facilitation. To support the position of less endowed chain actors, the NGO often plays a catalytic or convening role, identifying opportunities for smallholders and making investments in bringing chain actors together to discuss and agree on common commercial and social goals.<sup>11</sup>

New business models therefore seek configurations which place more emphasis on a greater role for intermediary service providers that share risk and are financially matched with the product value and type of supply chain. For farmers with small landholdings, a contract can be used as guarantee for loans; there are a growing number of finance providers, such as Root Capital<sup>12</sup>, who are prepared to provide cash flow credit to smallholders who have secure contracts in place.

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<sup>11</sup> The type of methods and multi-stakeholder processes used to achieve such agreements are discussed further in the to-be-published Practitioner's Guide to New Business Models.

<sup>12</sup> Root Capital is active in 29 countries in Latin America, Eastern and Western Africa and Asia ([http://www.rootcapital.org/where\\_we\\_work.php](http://www.rootcapital.org/where_we_work.php))

### Case Example: Hariyali Kisaan Bazaar<sup>13</sup>

A new generation of commercial intermediary in India is demonstrating that service provision can itself be a profitable part of a business model focused on inclusive growth. The rural retailer, Hariyali Kisaan Bazaar, which is part of the DSCL conglomerate, sells agri-inputs and consumer goods through its chain of centres, which also serve as a common platform for providers of financial services, health services, etc. The Hariyali centres are procurement hubs for farm outputs, providing buyback and warehousing, and thus creating multiple revenue streams based on transparent and effective participation in input as well as output value chains. Each Hariyali store has a catchment radius of 20 to 25 km, comprising about 15-20,000 farming families. They aim to provide producers with 'urban amenities in rural areas,' easy availability of quality products at 'city-like' fair prices and, through IT, provide commodity prices and commodity futures, as well as ATM access and weather forecasts. On the procurement side, they create linkages between producers and processors, exporters and retailers.

### **Principle 5: Inclusive innovation**

New business models promote *innovation by multiple actors* along the chain in products and services as well as the processes that underpin both. While equitable access to technical and market knowledge creates a more level playing field for small scale producers to participate in more stringent markets, more inclusive access to innovation provides a means to remain competitive in dynamic markets, which builds business durability. Important innovations in supply chains range from new product ideas, development of best practices, development of standards, to development of new supply chain organizational structures.

Too many development interventions are done 'for' smallholder farmers, rather than 'with' them, failing to consult and incorporate perspectives and needs throughout the chain. By way of example, it is one of the enduring ironies of sustainable development that compliance with some certification schemes introduced into the market in the name of 'sustainability' are proportionately much more costly for smallholders, thus magnifying existing inequalities in the rural economy.<sup>14</sup> This trend is likely to be perpetuated in the development of new carbon markets.

A systemic approach to innovation allows greater understanding of the interdependencies between actors as well as shared access to the potential returns on coordination and joint activities. The end result is an improvement in the competitive position of the chain as a whole rather than the accrual of additional value to one member or subset of members in the chain.

Innovation is important because it links directly to differentiation in the marketplace which is a prime driver for maintaining a competitive position by retail firms and, indirectly, the entire supply chain. A focus on intrinsic quality requires innovation throughout the chain to evolve with the market. Traditionally, however, product and process innovation has occurred in-house with the lead firm dominating the process and reaping the benefits. However, the entire chain can be

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<sup>13</sup> Sources: Bell, D.E., Sanghavi, N., Fuller, V. and Shelman, M. (2007). *Hariyali Kisaan Bazaar: A Rural Business Initiative*. Harvard Business School Case Study, November 2007.

Gupta, R. (2008). *New Models and Innovation in India: The Hariyali experience*. Presentation to the conference 'Inclusive Business in Agrifood Markets: Evidence and Action' Beijing, March 5-6, 2008. [www.regoverningmarkets.org/en/filemanager/active?fid=828](http://www.regoverningmarkets.org/en/filemanager/active?fid=828)

<sup>14</sup> A current example of this is to encourage very poor farmers to take on organic production systems, even though they are farming in very marginal highland areas requiring them to invest heavily in the system even when their yields are far lower than would be obtained from sustainable but inorganic production systems.

engaged to achieve even greater gains in product and process innovation than those available to the lead firm in the chain.

Case example: ***Gestores de Innovación en Agroindustria***

In Colombia, the Centro Internacional de Agriculture Tropical, (CIAT) has worked to develop chain-wide innovation methods that work with representatives along a chain. The process entitled GIAR, *Gestores de Innovación en Agroindustria Rural* or 'Leaders in Rural Agro-Industrial Innovation,' is a toolbox designed to build a team of partners who focus on unmet market opportunities in a specific chain and then work to identify and provide solutions to critical bottlenecks in the market chain to take advantage of the identified opportunities. The team is responsible for providing innovation and solutions that market chain partners can use to upgrade their position in the market. Success in this area is critical where market forces tend to favor procurement towards those who can afford to innovate.

Case Example: **Farmer-led innovation in the Allenblackia chain in West Africa**

Unilever has been developing a commercial supply chain for seeds from the Allenblackia tree in West Africa since 2001. One of the major limitations to scaling up the supply base had been the time needed for seed germination. As the Financial Times reported in September 2008, a surprising source of innovation helped resolve this problem.<sup>15</sup>

Scientists from Ghana's Forestry Research Institute had been working to find a faster method of germination for the seeds of the Allenblackia tree. But it was not until the team met a farmer who was using plastic bags for seed germination that part of the solution emerged. Meanwhile, another farmer had found that removing the husks of the seeds also hastened germination.

"We combined the two and, within three weeks, the roots were growing," says Samuel Henneh, operations manager at Novel Development, which is developing the new oil supply chain. "That success story was caused by two farmers. So now we don't joke with the farmers - we behave as if we know nothing and we ask them to tell us their stories."

The source of this breakthrough reveals the importance of learning from all partners including the beneficiaries for companies involved in pro-poor commercial initiatives.

**Principle 6: Measurement of outcomes and acting on them**

The business axiom states that you cannot manage what you do not measure. Our sixth new business model principle is to incorporate tailored indicators and monitoring plans to *assess the effects* of the trading relationship as a for-profit business and also as a vehicle for community development. These measures of impact on household and community development help avoid companies making unsupported claims of supporting development, and can also assist business and chain partners to build-in continuous improvement. While these measures need to be robust and defensible, they should strive to be as simple and cost-neutral as possible. Striking an appropriate balance requires shared design and testing by chain actors as well as a pragmatic

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<sup>15</sup> Source: Murray, S. 2008. Hard-nosed benefits for a different kind of investor. Business and Development section. The Financial Times. September 25. <http://www.ft.com/reports/busanddev2008>

focus on absolute minimum information requirements and a clear identification of the end user and purpose of the information.

The simplest measure, the number of farmers linked to a new market, is only part of the story. Linking small-scale producers to markets does not automatically lead to development and improved livelihoods, although many claims in CSR and business development reports would suggest otherwise.

A slightly more complete level of measurement is simple cost-benefit analysis to assure that participation in the chain is profitable for all involved, including small-scale producers. But measurement of 'sustainable trading relationships' would most effectively probe a step further. Improvements in producer income from specialization for high-value markets may be obtained at the expense of the resilience of the household economy, long-term food security, the position of women in the household, or environmental resilience. So, measures of food security, gender relations and environmental aspects are additional dimensions for measurement in areas where these are important issues. This information, especially well-documented evidence that shows developmental impact, has a market value for the buyers (i.e. CSR reports).

It is advisable that chain participants have a role in guiding what information is collected. It is further essential that the information generated is shared and discussed widely along the chain, and used to support inclusive chain-wide management decisions. An inclusive process of measurement that involves chain actors can itself be a driver of much closer collaboration and *chain-wide learning* as in the previous Cuatro Pinos case. Examples of inclusive process include regular, joint review of market trends and strategies to maintain or improve market position and joint development of plans to upgrade product quality and quantities based on market conditions. This inclusive process helps to achieve better alignment between business and development outcomes. Business does not necessarily aim to achieve development results; but it is both beneficial and verifiable to show that it can and to state the principles that are required for it to be so. Particular attention is paid to minimizing trade-offs between income gains and broader development goals including food security, sustainable environmental practices, and gender and labour issues.

It is insufficient however to only measure what is happening in the chain. Rather, a new business model requires both *measurement and action* on what is found by those measurements. Actions may be positive – i.e. scaling up good experiences – or more focused on problem solving – how can practices improve – but the critical factor is that the effects of the chain are measured, the results shared openly with chain actors and decisions on how to improve taken in a collective fashion. A 'perfect' chain probably will never exist. Business is messy and nearly always subject to refinement. While new business models moving towards a triple bottom line optimize outcomes, perhaps equally important is the existence of an on-going process that engages a range of actors in this direction.

#### Case Example: **SABMiller Smallholder Agriculture Programme**<sup>16</sup>

The brewery company SABMiller has made a commitment to supporting local farming communities in a number of countries where it operates: South Africa, India, Uganda, Zambia and Tanzania, using in-sourcing and out-sourcing models and hybrid 'partnership' models. A hybrid partnership is defined as specific activities outsourced to suppliers under close control and supervision. SABMiller also appreciated the need to evaluate socio-economic benefits of its smallholder programmes, if scaling up was to be successful. Through external reviews it could measure the income benefits to farmers producing sorghum in Eagle Lager's value chain and

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<sup>16</sup> Sources: Business Linkages: Lessons, Opportunities, and Challenges. IFC [insert full references]

measure the number of farming families and dependents. Participating farmers reported more stable prices and a more stable, long-term market compared to other local crops. But external evaluation also could show where SABMiller could improve performance; where payments to farmers were delayed, or there were mismatches in supply and demand leading to stockpiling and big variations in orders from year to year (especially where lack of irrigation leads to big variation in harvests), or where the outsourcing company was reverting to supply from large commercial farms.

#### Case Example: **Cuatro Pinos, Guatemala**<sup>17</sup>

Beyond the specific decisions made to-date regarding the French bean chain in Guatemala, the process of **working with supply chain actors to assess the sustainability of their systems** shows promise on several fronts. First, increasing the visibility to all actors of their interdependence and need for collective action has been a positive outcome. Greater knowledge of the reach of each actor's decisions, while not in itself a guarantee of better decisions, helps generate more informed dialogue about options and highlights the tradeoffs between short-term pressures and long-term business sustainability. Second, increased access to shared information supports more creative problem solving. Again while not a cure for all ills, this information permits actors to better understand the causes of difficulties and work together to identify solutions. Finally, a process through which actors are shown their own system but not provided with ready made solutions – of which few exist – seems effective in promoting generative learning at the individual and collective level and thus not only better solutions but better relationships and, finally, a stronger supply chain.

“Going into this project I really did not know what to expect. Being a buyer, we usually are just concerned with finding great quality products that we can sell at a value. By working with everyone, I have come to appreciate that with our increased volume in beans, many people in Guatemala are finding ways to improve their lives. Today I see a bag of French Beans are more than just French Beans in a bag. It is about a quality of life we are offering.” Dale Hollingsworth – Buyer, Fresh Foods.

### **Applying new business model principles to a supply chain**

Our goal with this short paper has been to bring attention to critical areas in business relationships where innovations can contribute to better business and better development outcomes. Much work remains to be done in terms of further honing and testing these principles and developing useful operational guidance. Our hope is that widespread use and improvement of these ideas can help reduce the frequency of well-meaning commercial firms and dedicated NGOs confronting the scenario described in the introduction section of this document.

The heart of the challenge is in bridging the world of small-scale production (numerous and widely dispersed producers with diversified livelihoods, operating in the informal economy, with low access to services, finance and information, with fragile market relationships) and modern ‘downstream’ agribusinesses (operating in a concentrated, formal economy, with large-scale, standardized procedures, highly risk-averse).

The new business model principles are presented as a framework for identifying opportunities to improve the way trading relationships function for smallholders while achieving key commercial

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<sup>17</sup> Source: Lundy, 2007; Sustainable Food Lab Innovations for Healthy Value Chains

goals around efficiency, product quality, consistency and integrity. The reason for developing this framework is to stimulate the development of a new generation of business models that are attractive to both smallholder and large formal buyers, many of whom have shied away from the inflexibility or limited markets offered in the traditional Fairtrade approach.

Successfully working to change how a value chain functions requires careful time and attention. Champions driving this change, investing time and motivation beyond the daily operation of the supply chain, are essential for success. While this requires more upfront investment in time and attention, the experience from the field suggests strongly that upfront time investment is likely to reduce expensive and discouraging future problems that may come from simply trying to incorporate smallholder suppliers into more traditional supply chains and formal markets.

The specifics of particular products and value chains structures are very important when moving from principles to developing appropriate supply chain specific models. The application of new business model principles requires a process of adaptation and co-development undertaken by the chain actors themselves. In working with chain actors to implement these principles, it is important to start from where a firm, its suppliers, and smallholder growers are. It will not be possible to implement all principles from the start. In that sense, the development of new business models is akin to process innovation among business partners.

These principles should therefore be considered as a framework to be used in several circumstances: to improve an existing supply chain, to develop a new value chain bringing products to market, or to implement new systems such as third party certification. The principles are issues for discussion amongst chain participants interested in building mechanisms along the supply chain that will improve the sustainability of the overall system, improve the capacity to evolve, and improve the benefits of participation. Table 1 shares some general questions for such discussion, and illustrates how the new business model principles can help guide part of the process of assessing and improving value chains.

**Table 1. Some critical New Business Model assessment questions**

Principle	Critical questions
1. Chain-wide goals and champions	<ul style="list-style-type: none"> <li>– Have clear goals been discussed by different actors in the chain and consensus reached on targets?</li> <li>– Is there evidence of co-investment and shared decision-making in the chain or parts of it? If so, which actors participate and how does it work?</li> <li>– Is there evidence of shared problem solving among chain actors? If so, which actors participate and how does it work?</li> <li>– Are there any existing structures for collaboration, such as food safety committees, that could be expanded vehicles for problem identification and resolution?</li> <li>– Are there one or more champions, who will lead the process of co-innovation?</li> </ul>
2. Transparent governance	<ul style="list-style-type: none"> <li>– Are there clear and consistent grades and standards in the chain? How are they established and enforced?</li> <li>– Is there evidence of formal and informal contract adherence by members of the chain? If so, why? If not, under what conditions do the contracts break down?</li> <li>– How are different types of risk – production risk, commercial risk, financial risk – shared along the chain? Do these risks fall</li> </ul>

	<p>disproportionately on one actor or set of actors?</p> <ul style="list-style-type: none"> <li>– Are there mechanisms to ensure that there won't be sustained prices below cost of production for producers?</li> </ul>
3. Equitable access to services and associated incentives	<ul style="list-style-type: none"> <li>– Do all actors have timely access to market information</li> <li>– Do all actors have access to information on quality standards?</li> <li>– Who has access to financial and non-financial support services in the chain? Is this access available for all participants? Why or why not?</li> <li>– Do all, some or no members of the chain perceive additional benefits when they improve their activities? Why or why not?</li> </ul>
4. Inclusive product and process innovation	<ul style="list-style-type: none"> <li>– Is there evidence of product or process innovation in the chain? If so, who participates and why?</li> <li>– Are process and product innovations negotiated among chain actors?</li> </ul>
5. Investment in market linkages	<ul style="list-style-type: none"> <li>– How easy or difficult is it to buy (find product) and sell (find a buyer) products in this chain?</li> <li>– How are sellers currently linked to buyers? How do both buyers and sellers see this relationship?</li> <li>– Do buyers know where their product comes from? Do farmers know where their product is finally consumed?</li> <li>– Are business linkages along the chain stable or constantly changing?</li> <li>– Is there evidence of formal or informal linkage agents that provide both business and social development value?</li> </ul>
6. Measurement of outcomes and acting on them	<ul style="list-style-type: none"> <li>– Are key economic and developmental indicators known and shared along the chain?</li> <li>– What key trade-offs, if any, is the chain dealing with? (food security, environment, gender relations?)</li> </ul>

## Annex 1. Further case studies

## Principle 2. New market linkages

### Case Example: **Narlödere Cooperative and Migros supermarket, Turkey**<sup>18</sup>

The rapid growth of the supermarket sector in Turkey in recent years could offer new marketing opportunities for small-scale producers. The case study of the Narlödere village development cooperative and Migros supermarket chain in Turkey reveals the potential win-wins of long-term collaboration between a modern agribusiness and small-scale producers. In 1995, the Narlödere cooperative became a producers union and refocused their activities on fresh produce marketing, and particularly on creating a regular supply for its main client, the supermarket Migros. There was no written contract between the Narlödere cooperative and Migros but their oral agreement was based on mutual benefits arising from their transactions. The fact that this trade bypasses the traditional wholesale commissioner helped to raise the value that the producers received for their fresh produce. For Migros, the advantages to working with the cooperatives of the region lead to the development of shared goals such as (1) Migros only deal with one supplier in terms of negotiating – especially important in the context of small-scale farming and the farmers only need to meet the buying requirements of one buyer; (2) Migros receive regular deliveries of produce of sufficient volume and homogeneous quality; and the farmers can use this bulk buy to organise their production and quality systems, and (3) Migros has one fixed place for deliveries and likewise, the farmers have one supply point. Migros has invested in building the capacity of its local staff in production management by working within the cooperative, thus going far beyond the mere incentives contained within formal contracts. It is clear that the number of dynamic and proactive cooperatives of this kind in Turkey is very small. In the case, as in the majority of such business relationships, the personal involvement of the manager of the Migros supplier was the most important driver in setting goals and achieving agreements with the particular producers union. The role of the champion in many similar arrangements is a critical catalyst to change.

### Case example: **dairy processing firm, Dimitar Madzarov Ltd in Bulgaria**

The private Bulgarian dairy processing firm, Dimitar Madzarov Ltd., has grown by a factor of 20 its daily processing of milk, sourced from over 1,000 small farms, half of which have fewer than five cows. The firm has successfully met all the requirements to continue selling its dairy products in a demanding and highly competitive market. Part of the success of Madzarov in building a reliable milk procurement system has to do with the high frequency of payment to its small-scale farmer suppliers. In the case of the smallest farmers, the firm goes as far as advancing payment. Access to this source of timely and reliable financing is considered by the farmers to be of greater importance than the price received for their milk. An effective system for coordination, stimulation, and conflict resolution with individual farms has been developed by Dimitar Madzarov. A good reputation as a reliable partner has been built up by the dairy. This gives farmers a sense of security and increases their willingness to maintain trade relations. This is additionally enhanced by formal delivery contracts with individual suppliers. Not surprisingly more than half of farms are long term suppliers of the dairy. The high frequency of contacts between the same partners facilitates transactions, develops friendship and trust, stimulates cooperation and restricts individual opportunism. The dairy manager is personally responsible for communications with farmers, and she is available to discuss goals and problems with every supplier at any time. Twice a month regular group discussions are held for training of farmers on new company and institutional requirements, prospective standards, problem identification and resolution, opportunities for participation in public support programmes etc.

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<sup>18</sup> Source: Sylvaine Lemeilleur and Selma Tozanli (2007). A win-win relationship between a producers' union and a supermarket chain in the Turkish fresh fruit and vegetables sector. Regoverning Markets Innovative Practice series. <http://www.regoverningmarkets.org/en/filemanager/active?fid=966>

Source: Bachev and Manolov (2007). *Bulgaria: A case study from the Plovdiv region*.  
[http://www.regoverningmarkets.org/en/resources/c\\_e\\_europe/innovative\\_practice\\_bulgaria\\_a\\_case\\_study\\_from\\_the\\_plovdiv\\_region](http://www.regoverningmarkets.org/en/resources/c_e_europe/innovative_practice_bulgaria_a_case_study_from_the_plovdiv_region)

**Upland Marketing Foundation Inc. (UMFI)**, Philippines. Innovation in supply management, product branding and technical upgrading with support of intermediary. Broadening the supply base beyond the original farmers organisation enabled group to secure and expand market. Importance of professional marketers – or intermediaries to open new markets. Specialist market function. External support a prerequisite to broker linkages and build confidence between small-scale producer and markets. Doubly specialised intermediary.  
[http://www.regoverningmarkets.org/en/resources/se\\_asia/innovative\\_practice\\_philippines\\_keys\\_to\\_inclusion\\_of\\_small\\_scale\\_organic\\_rice\\_producers\\_in\\_supermarkets](http://www.regoverningmarkets.org/en/resources/se_asia/innovative_practice_philippines_keys_to_inclusion_of_small_scale_organic_rice_producers_in_supermarkets)

Case study of a successful supply-chain in **Uttarakhand**. Multi-actor collaboration: Innovation by an NGO to secure linkages between farmers and modern markets; building of trust between chain partners and modern retail market with intermediation by NGO. External support a prerequisite to broker linkages and build confidence between small-scale producer and markets. Doubly specialised intermediary. Multiple actors work as a team.  
[http://www.regoverningmarkets.org/resources/south\\_asia/india\\_connecting\\_small\\_scale\\_farmers\\_with\\_dynamic\\_markets\\_a\\_case\\_study\\_of\\_a\\_successful\\_supply\\_chain\\_in\\_uttarakhand](http://www.regoverningmarkets.org/resources/south_asia/india_connecting_small_scale_farmers_with_dynamic_markets_a_case_study_of_a_successful_supply_chain_in_uttarakhand)

#### **Principle 4. Equitable access to services**

**Opcion and Aj Ticonel in Guatemala** Alberto Monterroso, Aurelle de Romemont, Oscar de León and Federico Grajeda (2006). Innovative Practice in Guatemala: The experience of small producers in competitive markets – a case study of OPCION/Aj Ticonel.  
[http://www.regoverningmarkets.org/en/resources/global/innovative\\_practice\\_guatemala\\_the\\_experience\\_of\\_small\\_producers\\_in\\_competitive\\_markets\\_a\\_case\\_study\\_of\\_opcion\\_a](http://www.regoverningmarkets.org/en/resources/global/innovative_practice_guatemala_the_experience_of_small_producers_in_competitive_markets_a_case_study_of_opcion_a)

**MA's Tropical Food Processing (Pvt.) Limited in Sri Lanka** Samaratinga (2007) *Sri Lanka: Integrating small farmers into dynamic supply chains - case study of MA's tropical fruit company*.  
[www.regoverningmarkets.org/en/resources/global/innovative\\_practice\\_sri\\_lanka\\_integrating\\_small\\_farmers\\_into\\_dynamic\\_supply\\_chains\\_case\\_study\\_of\\_mas\\_tropical\\_f](http://www.regoverningmarkets.org/en/resources/global/innovative_practice_sri_lanka_integrating_small_farmers_into_dynamic_supply_chains_case_study_of_mas_tropical_f)

**Bimandiri**: Traditional intermediary transformed into modern intermediary – servicing the farmers needs of knowledge, planning and modern market needs of product assured quality. Fixed rate commission.  
[http://www.regoverningmarkets.org/en/resources/se\\_asia/innovative\\_practice\\_c2\\_rd\\_2\\_indonesia\\_the\\_transparent\\_margin\\_partnership\\_model\\_linking\\_mango\\_farmers\\_to\\_dynami](http://www.regoverningmarkets.org/en/resources/se_asia/innovative_practice_c2_rd_2_indonesia_the_transparent_margin_partnership_model_linking_mango_farmers_to_dynami)

**Haleeb Foods Ltd.** Innovative Practice Pakistan: A case study of milk production and marketing by small and medium scale contract farmers. By Tanvir Ali.  
[http://www.regoverningmarkets.org/en/resources/global/innovative\\_practice\\_pakistan\\_a\\_case\\_study\\_of\\_milk\\_production\\_and\\_marketing\\_by\\_small\\_and\\_medium\\_scale\\_contract\\_fa](http://www.regoverningmarkets.org/en/resources/global/innovative_practice_pakistan_a_case_study_of_milk_production_and_marketing_by_small_and_medium_scale_contract_fa)