Part 2

CHALLENGES AND APPROACHES FOR INCLUSIVE VALUE-CHAIN DEVELOPMENT: INTRODUCTION

Jason Donovan, Dietmar Stoian, and Mark Lundy

Summary

Growing demand for higher-value agricultural products presents new opportunities for smallholders and market agents in developing countries. However, responding to these opportunities can require significant investment for enhancing productive capacities, business skills, and infrastructure. Nongovernmental organizations (NGOs), government agencies, and food processors recognize the opportunity—and need—to support the integration of smallholders and small and medium-sized enterprises (SMEs) into value chains. Chapters in this part shed light on critical issues for the design, implementation, and assessment of programs that support value-chain development (VCD). Chapter 1 (Donovan et al.) identifies the strengths and limitations of widely used methodological guides for designing value-chain interventions. Chapter 2 (Stoian et al.) stresses the importance of adopting a livelihoods perspective when engaging smallholders in VCD and advocates an asset-based, multi-chain approach toward this end. Chapter 3 (Donovan and Poole) applies an asset-based approach to assess smallholder capacity-building interventions for participation in certified-coffee markets. Chapter 4 (Minot and Sawyer) reviews experiences with contract farming—a specific private-sector-initiated intervention in value chains, the inclusive nature of which has been questioned in the literature. These chapters provide guidance on the design of future value-chain interventions and investments for smallholders and SMEs.

Introduction

Growing demand for higher-value agricultural products, abroad and increasingly at home, presents smallholders and agriculture-based SMEs in developing countries with new opportunities to add value to their primary production. However, responding to the opportunities can require significant investment for enhancing productive capacities, business skills, and infrastructure. Government agencies, NGOs, and the private sector have recognized the opportunity, as well as the need, to support smallholders and local enterprises to effectively participate in agrifood value chains. In some cases, government agencies and NGOs target their interventions at smallholders, with the aim of building smallholders' capacity to respond to the growing demand for high-value agricultural products and services in international markets. In other cases, they seek out options for enhancing the policy and institutional environment in which smallholders and their business partners operate, with emphasis on removing political–legal barriers and institutional bottlenecks to increased productivity and profitability. Agrifood companies may support smallholders and SMEs in their efforts to obtain better access to raw materials and semi-finished products, and to enhance their social and environmental credentials ("sustainable sourcing"). While poverty reduction may not be the primary goal when companies invest in their smallholder suppliers, such engagement may have important implications for pathways out of poverty and overall rural development (Humphrey and Memedovic 2006; Barrett et al. 2011). From a bi- and multilateral donor perspective, the promotion of VCD is explicitly geared toward poverty reduction, and related investments are made across a range of subsectors, developing regions, and actors (e.g. government agencies, NGOs, cooperatives, large-scale buyers, and processors) (DFID and SDC 2008; Humphrey and Navas-Alemán 2010).

Behind development organizations' interventions in value chains lies a desire to stimulate economic growth and, in some cases, enhance the environmental and social performance of value chains. Organizations have put particular emphasis on inclusion of the rural poor and expanded business opportunities for women, often in combination with incentives for environmentally friendly production technologies (UNIDO 2011). The term "inclusive value-chain development," frequently used by organizations working in VCD, denotes the expanded set of expectations surrounding such value-chain interventions. Building inclusive value chains is an inherently complex process. It involves value-chain actors with different and often divergent interests, entrepreneurs and businesses of different sizes, farmers with a variety of assets and productive capacities, and an array of input and service providers, all operating in a dynamic business environment with severe limitations in terms of infrastructure and services. Despite anecdotal evidence regarding progress in VCD to extend benefits to the rural poor, the inclusive value-chain approach is fairly new, rigorous impact assessments are scant, and learning is still emerging (Garloch 2012). Critical questions remain regarding the potential for poor farmers—including women, youth, and indigenous communities—to benefit from their participation in value chains: (1) How are interventions designed to meet the needs of the poor and advance business along the chain? (2) Who is excluded from participating in and benefitting from more demanding value chains? and (3) What are the underlying reasons for such exclusion, including those related to poverty, age, sex, and ethnicity?

Part 2 of this book, presented in four chapters, sheds light on some of these questions by exploring the conceptualization and implementation of VCD and its contribution to rural poverty reduction. Chapter 1 (Donovan et al.) compares VCD tools geared toward development agencies and the private sector with emphasis on methodological guides for designing value-chain interventions. Chapter 2 (Stoian et al.) questions the assumptions underlying VCD interventions in terms of smallholders' access to livelihood assets, their investment in value-chain activities, and the associated risks of specialization for livelihood resilience, particularly as regards market shocks, natural disasters, and crop losses due to pests and diseases. Chapter 3 (Donovan and Poole) explores how differences in asset endowments and livelihood strategies influence the outcomes of external interventions to build the capacity of smallholders in Nicaragua to participate in value chains for certified coffee. Chapter 4 (Minot and Sawyer) shifts the focus to private-sector-driven VCD in the form of contract farming, drawing lessons on the conditions under which private companies organizing smallholder production contribute to income and other benefits for smallholders.

Opportunities and Challenges for Developing Inclusive Value Chains

Chapter 1 (Donovan et al.) reviews the concepts and methods embraced by 11 value-chain guides, and assesses their strengths and limitations for designing value chain interventions. The review is timely, as in recent years there has been a proliferation of guides to support the design of VCD. Guides differ in their developmental goals (for example, poverty reduction, economic growth, or "decent work"), their approach to achieving those goals (for example, a focus on better market links versus improved business environment), and their targeted users (government agencies, NGOs, or private sector). All of the guides place strong emphasis on institutions for the production and marketing of agricultural products and achieving sustainability of interventions through a strong demand orientation. The scale of intervention varies: some guides focusing on the national level (with an orientation toward economic development or more affordable food for urban populations), while others zoom in on a particular group of smallholders and businesses (with an orientation toward improving commercial relations among the actors). The review sheds light on certain gaps and limitations in the guides for achieving rural poverty goals. First, greater attention must be given to understanding poor households and their capacity to engage in new market-oriented endeavors. Important questions need to be addressed regarding households' access to sufficient productive resources, potential for substantial trade-offs when using these resources, and their ability to take on higher risks when investing their capital and labor. Second, the guides should provide deeper guidance for dealing with variations in the context. Most guides assume that users will identify critical elements of the context, understand their relevance for VCD, and make the necessary adjustments in data collection and analysis. These contextual differences may relate to scale in shipping and processing (and the related need for smallholder organization), the pre-existing asset endowments of smallholders and local businesses (and the related need for investments in asset building prior to VCD), and the overall business environment (and the related need for advocacy as part of the VCD). Finally, more attention should be given to the capacities of those who implement the guides. Greater discussion on how to deal with complex research design and implementation issues, such as variability in returns, may help to improve the overall rigor of assessment and usefulness of VCD strategies. New debates and interactions among tool designers and users are needed to identify the costs and benefits of additional tools and their rigor, and to promote learning for improved design and implementation of VCD guides.[1]

Chapter 2 (Stoian et al.) draws attention to the link between VCD and smallholder livelihood strategies that comprise a complex mix of subsistence and market-oriented activities and that are diversified to meet multiple livelihood goals and mitigate risks;[2] and the authors address the related impli-

---

1 Recent experiences by the Central American Learning Alliance (Lundy and Gottret 2007; Faminow, Carter, and Lundy 2009; Lundy, Gottret, and Best 2012) provide insights into the opportunities for collective learning around VCD. This collaboration between researchers and development practitioners has enabled them to collectively address critical questions and knowledge gaps, develop and test tools to fill those gaps, and document outcomes and collective learning about what works and why. After a decade of practice, evidence has shown that VCD practices and knowledge management have improved, as shown by increased effectiveness in existing projects and more strategic new projects.

2 Other authors have also stressed the need to integrate a livelihoods framework with a value-chain framework (Dorward et al. 2003; Neilson and Shonk 2014). It is the focus on asset building at the level of both smallholder households and their businesses, as well as the direct link to development practice—design, implementation, and monitoring of VCD, and learning around its outcomes and impact—that sets Chapter 2 apart.

cations for the design and assessment of value-chain interventions. They question some of the underlying assumptions of NGOs, government agencies, and private-sector agents seeking to link smallholders to higher-value markets, namely: (1) smallholder households have sufficient resources to participate effectively in more demanding markets; (2) they do not face substantial trade-offs when aggregating these resources in a given value chain; and (3) they are able to assume higher risks when reinvesting their assets and labor in such a way. In reality, however, smallholder households carefully balance subsistence and market-oriented agriculture with off-farm labor and other nonagricultural income-generating activities, and highly constrained assets for many of these households. The crux of the authors' argument is that most strategies for VCD, with their focus on a single chain, steer smallholders to adopt specialization strategies, with higher investments of capital, labor, and other resources directed toward activities in a specific value chain. Such strategies may lead to higher returns, but they also imply greater risk and potentially higher trade-offs between economic growth and livelihood security.[3] The authors also argue that smallholders need to be endowed with a minimum amount of livelihood assets to participate successfully in value chains, and that smallholders below minimum asset thresholds require specific, nonmarket interventions to become "value chain ready." They advocate an asset-based, multi-chain approach to VCD in response to the shortcomings of conventional VCD interventions focused on a single value chain. Such an approach would take into account diverse options across a portfolio of value chains in a given territory, and intervention strategies would be adjusted to diverse asset endowments among smallholder households. Multi-chain VCD would also allow for access to and control over household assets to be differentiated by gender and age across a number of subsistence and market-oriented livelihood activities. This would imply greater coordination among those engaged in VCD in a given area to ensure complementarity among VCD

3 The capacity of smallholders to participate in higher-value markets has been discussed at length in the debate on nontraditional agricultural exports (NTAE). Between the late 1980s and late 1990s, agricultural development strategies prioritized the promotion of NTAE. Multilateral and bilateral donors helped identify lucrative markets and provided technical assistance and the means for meeting market requirements (for example, training, subsidized credit, farming inputs, and infrastructure development). In Latin America, NTAE promotion involved fresh fruits and vegetables (for example, in Chile, Costa Rica, Guatemala, and Honduras), fresh cut flowers (for example, in Colombia and Ecuador), and processed products such as frozen concentrate organic juice (for example, in Belize and Brazil). However, researchers have strongly criticized these programs for their perceived lack of sustainability, inattention to poverty and the environment, and negative effects on gender relations (Stonich 1991; Carter et al. 1996; Donovan and Poole 2008).

interventions—investments that could deliver more sustainable outcomes and impacts over the long term.

Chapter 3 (Donovan and Poole) analyzes the accumulation of livelihood assets among smallholders producing certified coffee in Nicaragua. The authors are particularly interested in the capacity of resource-poor smallholders who pursue diversified livelihood strategies and operate in adverse conditions to significantly increase their income and build their asset base through engagement with more demanding markets. There is growing consensus that asset accumulation plays a critical role in providing a pathway out of poverty (Carter and Barrett 2004). However, the authors' case underscores that smallholder endowments with critical livelihood assets are overall limited and often imbalanced. They also show the implications of the fact that access to these assets is differentiated by gender and age. Results among the coffee-growing households in Nicaragua suggest a pattern of significant, but incomplete, asset building across critical livelihood assets. In terms of human capital, for example, most households acquired new skills that improved coffee quality, but few households developed more complex skills for improved plantation management—a critical determinant of coffee productivity through plant-disease control. The ability to intensify production practices was linked to endowments of human and financial capitals that were severely constrained in many cases. The results also highlighted the considerable heterogeneity in smallholders' capacity to build assets through new market linkages. Households with relatively low asset endowments prior to engaging in certified-coffee markets were the least likely to achieve major advances in asset building. These households benefitted from certified-coffee markets mainly through access to safety nets that helped reduce vulnerability to external shocks (through membership of a cooperative). The work reported in Chapter 3 suggests that much remains to be learned about how interventions for VCD that involve poor farmers can deliver lasting change in production systems and marketing options that positively impact rural livelihoods.

The review of existing studies on the impact of contract farming and smallholder access to contract farming (Chapter 4) sheds light on the role of the private sector in supporting smallholder access to lucrative value chains. Contract farming schemes typically involve a contractor company that provides producers with technical assistance, seeds, fertilizer, and other inputs on credit, and offers a guaranteed price in exchange for agricultural products that meet specified quality and volume requirements. The debate around contract farming and its potential to advance rural development goals is extensive, with strong proponents of contract farming as a facilitator of development outcomes and a fair number of skeptics. Chapter 4 (Minot and Sawyer) provides clarity on the opportunities and limitations of contract farming as an institution that facilitates agricultural intensification by smallholders. They find that contract farming is more viable in value chains of fruits and vegetables for quality-sensitive markets, commercial dairy and poultry production, and certain cash crops (for example, tea, tobacco, sugarcane, and cotton). In terms of income benefits for smallholders, most case studies found considerable increases in income, in the range 25–75 percent. On the question of whether companies were willing to invest in building commercial relations with smallholders, the evidence was inconclusive. In general, however, larger companies seem to be willing to work with smallholders, but some crops benefit from economies of scale and other characteristics that tend to favor medium- to large-scale farmers. The literature points to contract breach by contractor companies, "side-selling" by producing households, and the high costs of working with large numbers of smallholders as major limitations to the growth of contract farming. This chapter stresses that contract farming, as a private-sector-led approach to linking smallholders with value chains, is not a broad-based solution to rural development, as only a small fraction of poor farmers in developing countries have access to contracts.

Conclusion

The chapters in Part 2 of this book shed light on some important challenges facing efforts to encourage smallholder participation in higher-value markets. Chapter 1 identifies the gaps in a set of methodological guides for the design of VCD interventions that include the rural poor. These include scant attention to the needs and circumstances of diverse types of smallholders to be involved in VCD, and limited guidance on how to handle variations in the context that influence the activities, investments, and strategies of value-chain actors. Chapter 2 stresses the poverty conditions in which many smallholders realize their livelihoods and seek to mitigate risks, and the resulting need for broader interventions for rural development that go beyond VCD interventions addressing production, processing, and marketing issues for a single crop. Chapter 3 highlights the importance of pre-intervention asset endowments for VCD-related asset building, with the lowest levels of asset building observed among those farmers who were least endowed with assets prior to the interventions in the value chain of certified coffee. Participating in and benefitting from interventions for VCD pose considerable challenges to resource-poor farmers when certain preconditions for success are not met.

Preconditions relate to asset endowments, access to sufficient and effective services and affordable inputs, and minimum degrees of smallholder business organization. Chapter 4 provides a persuasive argument that contract farming is not a solution to broad-based rural development as it only involves a small fraction of smallholder households. This, in turn, can be seen as a consequence of high transaction costs resulting from poor infrastructure and services, underdeveloped grading and standards systems, and inconsistent volumes and quality of raw materials provided by smallholders and their businesses. From a private-sector perspective, these costs are often prohibitive and limit active engagement in VCD, either in the form of "embedded services" or, particularly, in the spread of contract farming. Even in those cases where these costs are manageable, the private sector has very limited capacity to address the needs of most resource-poor populations, including landless people, and smallholders with minimum landholdings and other assets.

On the whole, the chapters in this part suggest an urgent need for deeper coordination and collaboration among those who intervene in value chains in support of smallholders and rural development. Intensive collaboration between researchers and VCD stakeholders will open the door to more innovative approaches, methods, and tools that respond to the various realities and needs of smallholders and other resource-poor people. Evidence-based learning provides the best chance for expanding the options for inclusive VCD and achieving higher impact on poverty reduction and rural development in less time with fewer resources. Better investments in VCD will emerge from deeper links between development agencies, governments, and those engaged on the ground in support of VCD building based on shared objectives, joint learning, and mutual accountability. Finally, the farmers, buyers, processors, and input and service providers engaged in value chains will benefit from improved collaboration among themselves. Identifying critical elements for forging such innovative alliances, crafting the underlying institutional arrangements, making joint investments, and developing related risk- and benefit-sharing mechanisms are critical areas for future research in direct collaboration with stakeholders inside and outside of the value chain. Critical reflection, innovation, and risk-taking will be required among these actors to enable the shift in focus from short-term outputs to long-term development processes, and from one-size-fits-all approaches to strategies designed around the particular realities and needs of smallholders and other weaker actors engaged in a value chain.

References

Barrett, C., M. Bachke, M. Bellemare, H. Michelson, S. Narayanan, and T. Walker. 2011. "Smallholder Participation in Contract Farming: Comparative Evidence from Five Countries." *World Development* 40 (4): 715–730.

Carter, M., and C. Barrett. 2004. *The Economics of Poverty Traps and Persistent Poverty: An Asset Based Approach*. Madison, WI, US: Department of Agricultural and Applied Economics, University of Wisconsin.

DFID (Department for International Development) and SDC (Swiss Agency for Development and Cooperation). 2008. *A Synthesis of the Making Markets Work for the Poor (M4P) Approach*. London and Berne, Switzerland.

Donovan, J., and N. Poole. 2008. *Strategies for Linking Smallholders to Markets for Non-Traditional Products: Review of Experiences in the Caribbean Basin*. AAACP (All ACP Agricultural Commodities Programme) Series, No. 2. Rome: Food and Agriculture Organization of the United Nations.

Donovan, J., and D. Stoian. 2012. *5Capitals: A Tool for Assessing the Poverty Impacts of Value Chain Development*. Technical Series, Rural Enterprise Development Collection 7. Turrialba, Costa Rica: Tropical Agricultural Research and Higher Education Center (CATIE).

Dorward, A., N. Poole, J. Morrison, J. Kydd, and I. Urey. 2003. "Markets, Institutions and Technology: Missing Links in Livelihood Analysis." *Development Policy Review* 31 (3): 319–332.

Faminow, M. D., S. E. Carter, and M. Lundy. 2009. "Social Entrepreneurship and Learning: The Case of the Central American Learning Alliance." *Journal of Developmental Entrepreneurship* 14 (4): 433–450.

Fowler, B., and M. Brand. 2011. *Pathways Out of Poverty: Applying Key Principles of the Value Chain Approach to Reach the Very Poor.* Discussion Paper/Microreport no. 173. Washington, DC: United States Agency for International Development.

Garloch, A. C. 2012. *Pushing the Poverty Frontiers of Inclusive Value Chain Development*. USAID Briefing Paper. Washington, DC: United States Agency for International Development.

Humphrey, J., and O. Memedovic. 2006. *Global Value Chains in the Agrifood Sector.* Vienna, Austria: United Nations Industrial Development Organization.

Humphrey, J., and L. Navas-Alemán. 2010. *Value Chains, Donor Interventions and Poverty Reduction: A Review of Donor Practice*. IDS Research Report 63. Brighton, UK: Institute of Development Studies.

Lundy, M., and M. V. Gottret. 2007. "Learning Alliances: An Approach for Building Multi-Stakeholder Innovation Systems." In *Learning Alliances: Scaling Up Innovations in Water, Sanitation and Hygiene Sector.* Technical Paper Series No. 47, edited by S. J. Smits, P. B. Moriarty, and C. Sijbesma. Delft, the Netherlands: IRC International Water and Sanitation Centre.

Lundy, M., M. V. Gottret, and R. Best. 2012. "Linking Research and Development Actors through Learning Alliances." In *Agricultural Innovation Systems: A Sourcebook*. Washington, DC: World Bank.

Neilson, J., and F. Shonk. 2014. "Chained to Development? Livelihoods and Global Value Chains in the Coffee-Producing Toraja Region of Indonesia." *Australian Geographer* 45 (3): 269–288.

Stonich, S. 1991. "The Promotion of Non-Traditional Agricultural Exports in Honduras: Issues of Equity, Environment and Natural Resource Management." *Development and Change* 22: 725–755

UNIDO (United Nations Industrial Development Organization). 2011. *Pro-Poor Value Chain Development: 25 Guiding Questions for Designing and Implementing Agroindustry Projects*. Vienna, Austria.