Innovation in Business Models and Chainwide Learning for Market Inclusion of Smallholder Producers

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The Regoverning Markets program (2005–2008) was a multipartner international research and outreach program funded by the UK Department for International Development (DFID), the International Development Research Centre (IDRC), the Canadian International Development Agency (CIDA), Interchurch Organisation for Development Co-operation (ICCO), Cordaid, and the US Agency for International Development (USAID). Web site: www.regoverningmarkets.org.

Abstract

The potential for modern agribusiness to promote broad-based economic growth in developing and emerging market economies is significant. Food retailers, wholesalers, and processors have the potential to link smallholder producers to dynamic domestic and regional markets. They can contribute technical and managerial capacity building and investment. However, this potential is often underutilized, and in many countries, smallholder producers and small- and medium-scale enterprises are relegated to lower-value markets. While agribusiness is not, nor should it be, driven primarily by a development imperative, the retail and processing stages rarely see the reach of their actions at the production level, including the implications for smallholder producers. Furthermore, many recent initiatives, often working with development partners, seldom result in any lasting economic empowerment or sustained market engagement of smallholder farmers or their organizations. In many countries, there is little policy dialogue between the private and public sectors and other key stakeholders, including farmers’ organizations and civil society. This paper explores the business challenge of and case for smallholder producers’ market inclusion. It looks at some of the evidences that demonstrates how business models and business processes can succeed in securing market inclusion. It includes producer- and buyer-driven business models, the development of new market intermediaries, changes in mainstream procurement policy, the development of domestic codes of good
business practice, and global initiatives. This paper draws largely on business models and policy innovation from empirical research, case studies, and country-level multistakeholder chainwide learning events undertaken through a global program entitled Regoverning Markets program.

**Keywords:** agribusiness development models; market inclusion; Regoverning Markets

**Abbreviations:**
- APMC - Agricultural Produce Marketing Committee
- BoP - base of the pyramid
- CAS - Cámara Argentina de Supermercados (Argentine Supermarkets Chamber)
- CGCSA - Consumer Goods Council in South Africa
- COPAL - Coordinadora de las Industrias de Productos Alimenticios (Food and Beverage Manufacturing Association)
- CSR - corporate social responsibility
- ESOP - Enterprise de Services et Organisations de Producteurs
- FDI - foreign direct investment
- IFAD - International Fund for Agricultural Development
- MPEG - Mpumalanga Economic Growth
- PAMA - Programa de Apoio aos Mercados Agrícolas (Mozambique Agricultural Markets program)
- SMEs - small- and medium-sized enterprises
- WTO - World Trade Organization

**Background and Approach**

The Regoverning Markets program set out to address three questions: (1) can smallholder producers and their organizations be partners in new business, (2) can the new agrifood drivers be partners in development, and (3) can anticipatory policy make any difference? Within the program, over forty case examples with global coverage were documented of policies and innovations which connected smallholder producers with modern markets (Berdegué et al., 2008). Some thirty cases explored innovations which sought to provide insights into the following: (1) what factors explain the smallholder producers’ market inclusion; (2) what technical, organizational, managerial, and financial changes did smallholder producers have to implement to be included in dynamic markets; (3) what are the costs and benefits of inclusion; and (4)
what are the implications of interventions which address the sustainability and the potential for upscaling and replication?

In addition, the program undertook empirical country-based research in eight countries, addressing the features of change in market channels, the determinants of farmer participation on different channels, and the household impacts (Reardon and Huang, 2008; Huang and Reardon, 2008), as well as providing support at the country level to multistakeholder chainwide learning (Proctor and Digal, 2008). This paper builds largely, but not exclusively, upon insights from this work.

The Business Challenge of Smallholder Producers’ Market Inclusion

Development is not the primary purpose of business. However, the transfer of agrifood business models from urbanized countries, where less than 2% of the workforce may be engaged in agricultural production, to investments in transforming agriculture-based economies overlooks the huge differences in the structure of the differing economies and thus the challenges posed by “international norms.” In China and India, the two most populous “transforming” countries, some 43% to 60% of the workforce is engaged in agriculture. The sheer numbers of people demand that agrifood investors in developing and transforming economies explore inclusive business structures and models. The challenge is to make inclusive market development work for mainstream business and contribute to meeting the Millennium Development Goals.

Any business model within the agrifood sector is generally built upon a set of assumptions or business propositions. These align to consumer assurance, standards of food safety and quality, low prices, and reliability of supply. Key features of the business case for and against smallholder producers and small- and medium-scale entrepreneurs’ market inclusion are presented in Table 1.

Smallholder producers can have a comparative advantage in terms of quality, innovation, costs, and farm management. Where there is a scarcity of alternative suppliers due to the characteristics of the product (seasonality, labor requirements, locality), a shortage of land for large-scale domestic or own-business production, a lack of a medium- to large-scale supply base (for example, the dairy sector in India or Poland), or where demand is called for in remote areas away from main distribution channels, there can be a specific business case for linking with smallholder producers and SMEs.
Securing Supply in Remote Regions

**Tanzania:** Given the remoteness of hotels, local supply from smallholder producers is much less costly, especially during the rainy season where road transport from outside the area is not always possible. Such local supply also has a promotional value in the tourist trade: a support to local communities coupled with the encouragement of environmentally sound production.

**South Africa:** In contrast to the centralized fresh produce procurement systems of South African retailers which rely on preferred commercial suppliers, there is also innovation in procurement schemes. Two rural-based supermarket chain stores in the Limpopo Province source fresh vegetables locally from smallholder farmers. By 2004, the Thohoyandou SPAR was procuring approximately 30% of its vegetables from about 27 smallholder farmers. These farmers are supported by interest-free loans, a guaranteed market, farm visits, and training on required quality standards. The remoteness of the supermarkets from the central distribution centers, the store’s operation in rural areas, reduced transportation costs, and meeting freshness requirements as well as contributing to community development are the drivers for supporting the development of this local procurement scheme from smallholder farmers.

**Sources:** Mafuru et al. (2008); Biénabe and Vermeulen (2007)
Securing supply is especially important in the current market where global supply is shifting markets from a buyer’s market to a seller’s market. Retail buyers and processors may also seek to work around markets where large traders have a hold. This was the situation in Pakistan where a milk processor, Haleeb Foods Limited, worked around the large and well-established milk traders by securing a small-farmer supply base (Tanvir, 2007). Smallholder and artisan producers are also sources of produce for niche markets for alternative markets.

Both the producer and the buyer usually want to “cut out the middleman” and shift from being dependent on traditional wholesale markets to the pursuit of greater value, improved quality, and product assurance. Direct procurement is often presented as a win-win-win for customers, business, and producers.

Another reason for business to organize their own supply base is where there is a lack of collective producer action, often because of suspicion of cooperatives or laws that insulate producers from the market.

Smallholder producers are themselves a new business opportunity. In India, now that retailers can buy directly from farmers rather than operating through government-controlled Agricultural Produce Marketing Committee (APMC) markets, new retail models are emerging—such as the DCM Hariyali Kisaan Bazaar, which applies a “bottom of the pyramid” approach. This is an extension of the approach advocated by Prahalad and Hart (2002), which argues that corporations can make considerable profits by designing new business models and products to target the poorest 4 billion people who make up the base of the economic pyramid.

Working with smallholder farmers is also a means of building community goodwill. The political importance of supporting national development goals cannot be understated within the context of a company’s “license to operate.” This goes beyond the debates such as those around liberalization of retail FDI in India or the quest for black economic empowerment in South Africa. A political backlash against organized foreign-owned retail is possible anywhere and can translate into restrictive legislation.

The modernization of retail has been accompanied in some cases by political turmoil, especially in India, where local traders—and also farmers—feel a threat to their livelihood. This reflects a perception that the growth benefits from globalization are patchy and are, according to the Indian minister of finance, Palaniappan Chidambaram, “not reaching to the bottom of the pyramid.” Here, as in many other countries, it becomes a political imperative to explore inclusive business models. Indeed, pressures brought to bear by both producers and consumers in Argentina encouraged the agribusiness sector to set business codes of practice.
Best Commercial Practices Code in Argentina

Rapid investment by global and regional retail players in Argentina in the late 1990s created fierce competition between players including local retail investors. The trading environment became unsatisfactory for small companies who suffered from a poor bargaining position at all levels. The choices faced by the sector were either to develop a private code or submit to government legislation. The Food and Beverages Manufacturing Association (COPAL) and the Argentine Supermarkets Chamber (CAS) worked together, informed by evidence and experience from across the globe, to develop a private code of practice which was signed in June 2000. Since then, supplementary rules have been added and the approach shared with many countries in the region and indeed worldwide. Similar private sector codes have, for example, been developed and adopted in Colombia and Mexico. Seven years on, there has been significant improvement in both free and fair practice and thus competitiveness. The culture and way of doing business has changed with a dramatic decline in cases submitted for mediation or arbitration.

Source: Brom (2007)

Organizing supply

The biggest challenge for modern agrifood business to work with smallholder farmers and small- to medium-sized enterprises (SMEs) is organizing supply. There are perceived to be high transaction costs and higher risks associated with purchasing from large numbers of fragmented smallholder farmers and SMEs. Modern food processing and retail is positioned in the market with high standards for safety. Assuring standards of quality and food safety is built on principles of traceability and bookkeeping. Demands for consistent quantity and continuity of supply, packaging, and bar coding are all elements of meeting modern agrifood requirements. Standards may extend to labor and environment, with certification costs proportionately much higher for smallholder producers. Such farmers are also perceived to be less reliable in honoring trading agreements.

Given these demands, it is not surprising that buyers seek out large suppliers and also seek out areas which are already favored by agribusiness—for example, those already engaged in export production. This is easier in countries with a dualistic farm structure such as South Africa.

Producers and SMEs also face competition from high-quality, low-price imports, ushered in by structural adjustment and the demands of WTO membership. There is a close link between chain modernization and liberalization. Supermarket chains, in particular the multinationals, are important importers of foods.
**Carrefour’s Quality Line in China**

With the rising consciousness of consumers on food safety, the demand for high quality and safe food has increased. In 1999, Carrefour started to sell the “green” food under its own brand with the “Quality Food Carrefour” logo. These lines represent an innovation in purchasing systems within China, where Carrefour integrates management of the entire supply chain, with full traceability. To date, cooperators of the Carrefour quality line are all larger-scale, rather than smallholder, farmers. The latter account for more than 90% of the rural population in China, demonstrating the challenge of connecting smallholder farmers with the demand for “safe food.”

*Source:* Dinghuan and Dandan (2007)

**From Wholesale to Preferred Supplier: Shoprite**

Shoprite, a leading South African retailer, relied on sourcing 70% of its fresh produce from wholesale markets in 1992. In 1992, Freshmark, their wholly owned specialized and dedicated wholesaler, started to form “preferred supplier” relationships with large commercial farmers (from whom it sources the majority of its produce), as well as some large wholesalers and some medium- and smaller-scale farmers. By 2006, it had 700 such preferred suppliers (a few for each product) and sourced 90% of its produce from them, with only 10% from the wholesale market. The shift towards using preferred suppliers was facilitated in South Africa by the sharply dualistic farm sector structure. Freshmark “follows” Shoprite into other African countries, still sourcing much of its produce from South Africa.

*Source:* Biénabe and Vermeulen (2007)

**How Business Models and Business Processes Can Succeed in Securing Market Inclusion**

Options on how business models and processes can succeed in securing market inclusion range from global to local and from within business to interbusiness, including working with other partners such as the public sector.
Corporate social responsibility including pan-industry initiatives

Corporate social responsibility (CSR) is about how businesses align their values and behavior with the expectations and needs of stakeholders—not just customers and investors, but also employees, suppliers, communities, regulators, special interest groups, and society as a whole. Key CSR issues include governance, environmental management, stakeholder engagement, labor standards, employee and community relations, social equity, responsible sourcing, and human rights.

CSR has been poor at addressing issues of market inclusion. Although there are numerous good stories of community engagement, such innovations seldom influence business processes. Change requires senior management to buy-in and widen the scope. A key driver of CSR is the UN Global Compact which, while it has wide membership, illustrates how marginal CSR remains in the agribusiness sector and specifically primary agriculture producers.

UN Global Compact

Human Rights
1. Businesses should support and respect the protection of internationally proclaimed human rights within their sphere of influence
2. Make sure that they are not complicit in human rights abuses

Labor Standards
3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining
4. The elimination of all forms of forced and compulsory labour
5. The effective abolition of child labour
6. Eliminate discrimination in respect of employment and occupation

Environment
7. Businesses should support a precautionary approach to environmental challenges
8. Undertake initiatives to promote greater environmental responsibility
9. Encourage the development and diffusion of environmentally friendly technologies

Source: http://www.unglobalcompact.org/

Upgrade mainstream procurement

Much can be done by business to ensure that their procurement practices work to the benefit rather than the detriment of smallholder producers—often
with little change to structure. These include securing coherence between corporate policies including CSR and procurement practices and through related adjustment of reward systems and senior management buy-in.

Where modern retail operates through preferred supplier schemes, understanding and benchmarking these suppliers on key aspects of their business operation can help to identify trends in sourcing profiles and thus hot spots. Market information and technology can be shared with producers and SMEs. Standards and certification systems can and should be adapted to the reality of smallholder producers. Payment practices are of critical importance, especially prompt and transparent payment as seen in the Madzarov case.

**Dimitar Madzarov in Bulgaria**

The private dairy processing firm, Dimitar Madzarov Ltd. in Bulgaria, has increased by a factor of twenty, its daily processing of milk, which it sources from over 1,000 small farms, half of whom have less than five cows. The firm has met all the requirements to continue selling its dairy products in the demanding and highly competitive European market. Part of its success is the result of the high frequency with which it pays its smallholder 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 finance is considered by the smallholder farmers to be of greater importance than the price received for their milk.

**Source:** Bachev and Manolov (2008)

Attention can be given to the upstream impacts of chainwide business practice including slotting fees, retrospective discounts, and avoiding playing one supplier off against another.

**Codes of best practice and self-regulation**

Cross-industry codes of conduct established by the business sector and regulated by them can provide much-needed oversight of trading relationships at the domestic level, increasing transparency, and strengthening trust between chain actors.

**Affirmative procurement**

There are also models of inclusive procurement, built on preferential sourcing from smallholder producers and family farmers, their organizations and SMEs. For example, Carrefour Indonesia has established a dialogue with SME suppliers of fresh food (vegetables and fish), household equipment, and textiles to improve product quality and packaging and improve their shelf access, in part by waiving the listing fee. Similarly, Wal-Mart Honduras has
established the “Una Mano para Crecer” (“Help to Grow”) program for SMEs.

**Carrefour in Indonesia**

**Special relationships with the SMEs**
Carrefour Indonesia has established an ongoing dialogue with SME suppliers to improve product quality and packaging. The banner has also created the “best supplier prize” and the “most promising supplier prize” (with a jury composed of a member of the government, the president of the Association for Modern Commerce, and a university personality), and it takes part in events organized by the government to promote SMEs. Carrefour Indonesia made this the theme of its 2006 advertising campaign and thus uses this policy to enable the group to contribute to the country’s economic and social growth.

**Supporting and training microentrepreneurs**
Indonesia has more than 42 million microbusinesses. To help 1,000 of them grow, in December 2006, Carrefour Indonesia, the Carrefour International Foundation, and the Bina Swadaya NGO launched a one-year microfinance program. A grant of €112,000 from the foundation was distributed in the form of loans to 1,000 microentrepreneurs in Jakarta and Surabaya by the Bina Swadaya NGO. Carrefour Indonesia’s involvement in the program consists of training in hygiene, merchandising, packaging, management, and marketing.

**Source:** Carrefour 2006 Sustainability Report

A number of affirmative models exist where agribusiness chains have partnered with producer organizations and groups of smallholder farmers to work with funding agencies for example through an IFAD grant aligned to the Mozambique Agricultural Markets Support program (PAMA), where smallholder vegetable growers now supply a significant proportion of the fresh vegetable requirements of a large supermarket chain—Shoprite.

**New market intermediaries and alternative trade models**
Chain intermediaries are vital in linking smallholder producers to dynamic markets and are of particular importance to producers located further away from the markets and main roads. The existence of these intermediaries often makes the difference between successful and sustainable smallholder farmer inclusion and failure. Their legitimate and useful role in the value chain needs to be acknowledged, and they need to be supported in order to streamline the value chain.
When the market is dominated by small traders, there is a specific challenge to meet demands for food safety. Agrifood processors and modern retail have to work with, and arguably foster, a new generation of intermediaries to ensure traceability and due diligence. Some of the successful “double-specialized intermediaries” are both business oriented and development motivated. An example is the Bimandiri Company, Indonesia, which is private sector driven and independent from support from government or NGOs.

**Partnership between Farmers and Supermarket via a Specialized Wholesaler—the Bimandiri Company**

As a specialized wholesaler, the Bimandiri Company guarantees the product quality and continuity of mangoes required by Carrefour in Indonesia. The wholesaler provides services to mango farmer groups such as technical assistance and capital. There is no product transaction: the intermediary receives a transparent 5% commission on the sales made between the farmers and retailer. The benefits for the farmers are manifold. The intermediary has encouraged the farmers to change from working individually to work in a group and transformed their relationship with the market from spot-market to contract-based negotiation. The farmers gain higher prices, faster payment, better access to market information, and inclusion in a dynamic market.

**Source:** Natawidjaja et al. (2008)

Strategic public sector support to intermediaries, such as the Tongzhou Agricultural Broker Association in China, is an area that appears to offer the potential for enhanced market participation by smallholder producers. The Tongzhou Agricultural Broker Association was organized in 2001 with the support of Administration for Industry and Commerce. The administration issued special policies for the association, such as subsidies and taxation relief. It provided the association with initial funds for their operation and working office, technical instruction, and printed materials. The outcome has been better skilled and regulated intermediaries, able to service many hundred smallholder farmers (Shudon, 2008).

**Base of pyramid business models**

Base of the pyramid (BoP) models provide a platform for multiple service provision of input and output sides of the farm-to-consumer value chain with a particular focus on poorer households. India is leading in BoP innovation in the agrifood sector.

The DCM Hariyali Kisaan Bazaar chain in India seeks to empower the farmer by setting up centers which provide all encompassing solutions
to farmers under one roof. Individual centers operate a catchment radius of approximately 25 km, each covering 30,000 to 40,000 ha and impacting on some 15,000 farmers. They aim to (1) improve the quality of agriculture products through a team of qualified agronomists; (2) source quality agricultural inputs at fair prices; (3) provide financial services including access to modern retail banking and farm credit through simplified and transparent processes, insurance, etc.; (4) provide farm output services including warehousing and access to new markets and output related services—IT market services; and (5) provide other products and services—fuels, consumer goods and durables, apparels, etc.

Under the system inspired by the DCM Hariyali Kisaan Bazaar chain, the public and private sectors collaborate and create, respectively, an enabling environment for the efficient delivery of services. The private sector needs to create multiple revenue streams based on transparent and effective participation in both input and output value chains. Only commercially sustainable business models will have any long-term impact on the rural economy (Gupta, 2008).

**Alternative models including Fairtrade**

There are a number of trade-based initiatives such as the Ethical Trading Initiative which gives attention to worker welfare. While poverty reduction is at the core, these initiatives fail to address the issue of smallholder farmer and SME market inclusion or exclusion. Codes and standards are seen as a cost to suppliers and a barrier to market entry for smallholder producers. Other alternative trade models including Fairtrade initiatives, emphasize long-term trading relationships built on trust, transparency and accountability, enhanced producer and SME voice in supply chain management decisions, capacity building of producers and SMEs including strengthening producer organizations and support for diversification, and ensuring equal access to women and men to contracts and leadership positions.

**Shared equity**

Enabling smallholder producers to acquire a share in the business offers an alternative business model for inclusive development. Two examples serve to illustrate this. The Thandi winery combines co-ownership of vineyards by workers (land redistribution beneficiaries) with the economies of scale and managerial and business skills needed in export-oriented markets (Ewert et al., 2007). The Enterprise de Services et Organisations de Producteurs (ESOP), Togo, is an innovative shareholding structure with participation from a farmer organization, a private entrepreneur, and a support agency. Better performing farmers within the organization can progressively become shareholders of the company (du Breuil and de Romémont, 2008).
Producer-driven models

Producer-driven models such as farmer-owned businesses, producer organizations, and cooperatives have had mixed success in providing members with economic benefits in terms of access to dynamic markets. Research in eight countries found that membership of farmers’ organizations was correlated with participation in modern markets in only half the countries; in the rest, the correlation was not significant or was negative. This reflects the very diverse role played by farmers’ organizations from the provision of inputs and other services through to marketing outputs. The case studies show that collective action remains an important strategy, lowering transaction costs, offering greater transfer of capacity, and increasing bargaining power. However, the cases also show that collective action is not always through formalized farmers’ organizations. Some organizations have developed innovative and different forms of membership such as quasi-members and top-up suppliers to reduce risks and enhance competitiveness.

Building policy dialogue between the private and public sectors

In many countries, a policy dialogue vacuum exists that limits the national capacity to explore future trends and drivers of change in the agrifood sector and to develop broad agreement on the implications and opportunities for agrifood modernization. The dynamics and implications of modern domestic agribusiness and changes in market chains have been largely overlooked by both public policy and private sector strategy with unanticipated and/or unintended consequences to smallholder producers and their market inclusion. Relevant government departments with responsibilities for direct aspects of the food chain from production through wholesale to retail are largely unconnected. Added to this are the indirect aspects of infrastructure, trade and commerce, market regulation, financial intermediation, science and technology, and education and training, which further dilutes coordination. The private sector has a key potential role to play in informing public policy and intervention and can, given an enabling environment, be a catalyst for change in inclusive procurement.

There are a number of examples where a partnership between the public and private sectors has been formalized and/or where space is created through public sector interaction with trade associations, commodity associations, or chambers of commerce to address the roles and responsibilities of the different interest groups for sustained market development through the formalization of joint structures such as the commodity committees in, for example, Mexico.
Vegetable Health Committees, Mexico: An Institutional Mechanism which Crosses Public and Private Sector Boundaries

Low quality standards and phytosanitary restrictions led producers to implement phytosanitary controls to access markets. The organization of producers came into existence under the framework of the Federal Law of Vegetable Safety in 1992. Through the technical work of the multi-stakeholder Vegetable Health Committee, by 1998, producers in a number of municipalities could make deliveries to the northeast of the United States. Due to this inclusion, the Vegetable Health Committees were strengthened and became the most important organizations in the avocado sector. Michoacán now has 11,400 avocado producers, providing 88% of national production, estimated at 1.40 million tonnes per annum, making it the world’s primary avocado producer. This institutional mechanism crosses the boundaries between public and private sectors, and voices the interests and capacities of producers, industry, and government.

Source: Medina and Aguirre (2007)

Chainwide learning which aims to enhance understanding of the institutional and policy dimensions can help to secure and enhance smallholder producers’ access to dynamic markets. By supporting both single and multistakeholder dialogues within a structured process, the dynamics of the change process that includes policies, institutions, actors, and their interactions can be captured and entry points for action agreed. The processes are based on a framework of understanding the context of smallholder producers’ market engagement that includes mapping the value chain as well as the institutional and policy environment. Key drivers and trends set the scene together with work on future scenarios for markets for determining opportunities and issues. From these, options to enhance the participation of smallholder producers and strategies to influence change towards greater inclusion of producers can be identified and developed (Vermeulen et al., 2008).

Work in eight countries (Proctor and Digal, 2008) has demonstrated a range of positive outcomes from such chainwide learning processes. This has contributed directly to the following: national policy processes and strategies (Philippines, Pakistan, Morocco, Turkey, and Vietnam); stimulated new alliances and structures such as the alliance formed in South Africa between the Consumer Goods Council in South Africa (CGCSA), Mpumalanga Economic Growth (MPEG), and national bodies; the formation of a standing Horticulture Committee under the Department of Horticulture, Indonesia; a new alliance between Padjadjaran University and a major retailer to strengthen education and skills development for modern markets in Indonesia; and the formation of a private sector task group in Bangladesh.
Conclusions

There is a business case for domestic and global agrifood business to explore innovation and support and reinforce the emergence of new business models and processes within the agrifood chain that can offer greater inclusion for smallholder producers and SMEs. In part, this may be undertaken with relatively small changes in business practice, including a deeper understanding of the implications of market transformation by both the private and the public sectors. However, a transition to mainstream inclusive markets will require greater innovation and the development of new business models, in particular, those at the level of market intermediation and at the level of farmer group mobilization. New intermediary models may benefit from direct and indirect support at the start-up stage from public intervention, with careful attention being given to the exit strategy for public funding.

Better sharing of new and validated models between countries and regions can act as a stimulus for wider uptake and generate interest in what is currently a relatively new field of work. Weak public and private sector dialogue, combined with inconsistent, overlapping, and incomplete public policies, acts to hinder the growth of effective and efficient markets.

Multistakeholder chainwide learning may be one step in supporting better public and private sector mechanisms to accompany agrifood market change in developing and emerging market economies.
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