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EDITORIAL

Integrating Smallholder Producers into Institutional Markets through Collaborative Marketing Groups

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The seven papers contained within this special edition of *Banwa* were presented to an international symposium in July 2008, which sought to *Improve the Efficiency of Supply Chains in the Transitional Economies: Responding to the Challenge of Linking Smallholder Producers to Dynamic Markets*. Organized by Curtin University of Technology and the University of the Philippines Mindanao, this symposium was an integral component of the celebrations to mark the centenary of the University of the Philippines (1908–2008).

Introduction

Consumers today are placing greater demands on the food system to provide food that tastes good, is safe to eat, is safe for the environment, and is safe for the farmers who produced it. Furthermore, the food must be readily available and in a form that requires little to no preparation. With increasing personal disposable income, greater urbanization, and more women in the workforce, convenience is driving the demand for more prepared and semiprepared meals (OECD-FAO, 2005). Not only is this resulting in a greater institutional demand to supply food manufacturers and processors, restaurants, and the food service industry—for more meals are being consumed away from home—it is also influencing where and when consumers purchase the majority of their food. In most of the world's transitional economies, this is resulting in the expansion of modern retail formats, facilitated in part by the deregulation of markets (Reardon and Berdegúé, 2002) and in part by limited opportunities for expansion in traditional markets (Fearne and Hughes, 1999).

Irrespective of whether the farmers' produce is destined for processing, the food service market, or the modern retail market, industrial purchasing theory suggests that buyers will purchase from those suppliers who are best able to deliver a range of consistent quality product, reliably and consistently, at a competitive price (Cunningham and White, 1973; Lehmann and

O'Shaughnessy, 1974; Dempsey, 1978; Wilson, 1994). While quality does not always mean best, in business-to-business markets it is widely accepted that quality means "fitness for the intended purpose" (Feigenbaum, 1991). Buyers typically consider product and supplier attributes in a manner that seeks to minimize the various costs associated with purchase and use. Costs include not only the purchase price of the product itself but also such variables as transport, handling, product packaging, and the various costs associated with the failure of the product due to poor or inconsistent quality and unreliable delivery (Wilson, 1994). Furthermore, there are the various costs associated with the damage to personal reputations or brands as a result of customer complaints arising from inferior-quality products. Consequently, this requires the buyer to not only have some knowledge as to who produced the product, where, when, and how, but to be assured that the produce will meet their expectations.

Most institutional buyers find it necessary to adopt procurement strategies that bypass the traditional marketing system where there is much variation in both the quality and the quantity of the fresh produce offered for sale and prices are inherently variable (Folley, 1973). Anonymous arm's-length transactions are giving way to enduring long-term relationships with preferred suppliers (Batt, 2007).

For the buyers, engaging in long-term relationships with preferred suppliers may result in various economies of scale and improvements in both supply and demand (Wilson, 1996). There are obvious economies of information arising from the reduced amount of time spent in price negotiation and monitoring the quality of the products consigned to the buyer. Buyers can anticipate improved access to a more reliable supply, improved product quality and performance, and a higher level of technical interaction in the form of developing and launching new products. However, the greatest benefit to arise from a long-term relationship is the reduction in risk and uncertainty (Arndt, 1979; Dwyer, Schurr, and Oh, 1987; Noordewier, John, and Nevin, 1990).

While most smallholder producers are readily able to transact with the traditional wholesale market, their experiences in selling to the institutional market are vastly different. Unable to maintain a consistent supply of good quality product and unable to perform many of the value-added activities demanded by their customers, smallholder producers may often find that they are excluded from participating in the institutional market. While there are numerous impediments including the lack of infrastructure, appropriate inputs, knowledge and technical advice, microfinance, and market information (Chen, Shepherd, and da Silva, 2005), one of the mechanisms most often advocated to facilitate their inclusion into these high-value markets is the formation of collaborative marketing groups (CMGs). In the papers that follow, various authors explore the benefits and pitfalls associated with the establishment of collaborative marketing groups and the enabling environment that is necessary to facilitate their development.

Empowering Smallholder Farmers through Collaborative Marketing Groups

While the concentration of food manufacturing and food retail operations is often attributed to trade liberalization, Murray-Prior (this issue) notes how globalization has also exposed smallholder producers to greater competition. With inherent diseconomies of scale, higher transaction costs, and poor and highly variable quality, smallholder farmers in the transitional economies are often unable to compete against imports. Even though the price is often higher, imports offer institutional buyers a more reliable supply of consistent quality product with a commensurate reduction in transaction costs. However, while imports seldom provide more than a short-term solution, the capacity of smallholder producers to compete is often constrained by poor transport and logistics and the lack of appropriate production inputs, technology and technical advice, and credit and market information. Poverty, illiteracy, and a poor bargaining position further constrain the capacity of smallholder farmers acting alone to participate in the institutional market.

Murray-Prior (2007) defines a collaborative marketing group as a group of farmers who have organized to collectively market their produce. This definition includes structures such as cooperatives, grower associations, cluster marketing groups, and bargaining cooperatives. Historically, collaborative marketing groups have been formed for three main reasons: (1) to increase bargaining power; (2) in response to government policy; and (3) as an entrepreneurial activity to enhance the efficiency of production, processing, and marketing activities.

However, CMGs, irrespective of the way in which they are structured, usually fail. Failure is attributed to a great many reasons including corruption and mismanagement, insufficient capital, the lack of infrastructure, the inability to enforce contracts, and the inability to reward farmers for producing high-quality products.

To succeed, CMGs must not only serve their patrons (the smallholder farmers) but also their downstream customers. This inevitably means that the prices paid to farmers must be at least as good as those offered by existing market intermediaries and the prices at which the product is sold must be comparable to those offered by alternative suppliers, while providing a sufficient margin to recover the costs of the group's processing and marketing activities. Murray-Prior notes that the long-term sustainability of CMGs is contingent upon two key variables: a comparative advantage and a reasonable level of trust among the members of the group and their community.

The key success factors in linking smallholder producers to the institutional market require the organization to overcome the poor infrastructure, diseconomies of scale, lack of appropriate market signals for quality, high transaction costs, and poor quality. Access to markets must be assured and

property rights sufficiently defined to ensure that supply and demand are balanced. Success is unlikely if the main reason for the formation of the CMG is the often misguided belief that the group can perform the marketing activities more efficiently than the existing market intermediaries.

Conversely, Proctor and Vorley (this issue) contend that smallholder producers often have a comparative advantage in terms of product quality, innovation, and low cost. Where there are few alternative suppliers, a shortage of suitable land for large-scale production, or an unmet demand in remote areas, there can be a compelling case for linking smallholder producers to institutional markets. Working with smallholder producers can also provide a means of building community goodwill. Issues such as governance, environmental management, social equity and human rights, and procurement are important in aligning business values and behavior with community expectations.

For smallholder producers, the procurement strategies practiced by institutional buyers can be particularly troublesome. Not only are the transaction costs higher in purchasing from a large number of fragmented smallholders, but modern food processors and retailers have high expectations for product quality and food safety. This requires smallholder producers to introduce and implement quality assurance systems that often extend to both the environment and farm labor. For smallholder producers, the costs of certification are proportionately higher, thereby presenting a major impediment for the entry of smallholder producers into institutional markets. While certification standards can and should be adapted to the reality of smallholder producers, it is equally important to review the prevailing practices of slotting fees, promotional allowances, retrospective discounts and penalties, and the inordinate delay in facilitating payment to producers, which may be anything from 14 to 90 days. For small, semi-subsistence producers, such delays in payment have a direct negative impact on the farm household and the capacity of the farmer to provide sufficient inputs for the farm itself. It is also readily apparent that in many of the transitional economies, some review of public policy is required to provide an enabling environment to facilitate, either directly or indirectly, the entry of smallholder producers into modern institutional markets. Public investments in infrastructure, trade and commerce, market regulation, science and technology, and education and training are required in parallel with a suite of incentives to encourage and support the private sector.

Chain intermediaries are vital in linking smallholder producers to institutional markets. As the existence of these intermediaries often makes the difference between successful inclusion or failure, their legitimate role in the value chain needs to be acknowledged and supported. While it is often necessary to work with and foster a new generation of market intermediaries, producer organizations and cooperatives have had mixed success in providing members with economic benefits. At the farm input level, CMGs can facilitate the provision of lower cost inputs, competent and timely agronomic advice,

access to microfinance, and improved farm services such as insurance, consumer goods, and durables. At the farm output level, CMGs can provide numerous value-added services including storage and warehousing, grading and packing, processing, and access to new markets and market information.

In one of the few studies that seek to evaluate the socio-economic benefits of CMGs for smallholder producers, Montiflor, Batt, and Murray-Prior (this issue) report on the differences between producers' qualitative and quantitative assessments. While gap analysis shows that the smallholder farmers' expectations of receiving a higher price for their produce and a commensurate increase in their household income are largely unfulfilled, most smallholder producers reported that they were financially better off as a result of collaborative marketing. This apparent anomaly can be explained, in part, by the greater market knowledge farmers had accrued through their participation in CMGs. Farmers had a much greater understanding of the institutional market, the buyers' demands, and the role that market intermediaries performed. Through CMGs, producers had much better access to inputs, technical information, and financial support which enabled them to improve productivity per unit area. However, given that there is continuous downward pressure on food prices and that prices for fresh produce in much of tropical Asia are highly volatile, evaluating the success of CMGs purely on the basis of price enhancements may not be entirely appropriate.

Given that the success of CMGs is very much dependent on effective leadership and the active participation of farmers, Montiflor et al. identify the importance of social capital and the improved interaction and collaboration between cluster members. Participants reported that through their membership in a CMG, their social status had improved and they had gained more friends. However, these social benefits were more important to those semi-subsistence clusters that were primarily area based, where the producers were generally less well educated and cultivated smaller areas of land.

George, Broadley, and Nissen (this issue) conclude that smallholder producers will be excluded from the institutional market unless they organize themselves into CMGs. However, given the increasing concentration and aggregation of companies in both the food processing and the retail sectors, they foresee the need for smallholder producers to establish global, regional-based food marketing companies. This will not only increase smallholders' collective ability to negotiate more effectively with downstream buyers, to control supply and to develop an internationally recognized brand name but also to share the costs of the prerequisite investments in technology, processes, and infrastructure. At the farm level, investments in new technology are required to improve productivity per unit area and to reduce wastage. At both the farm level and subsequent downstream processing level, investments in appropriate quality assurance systems are required to ensure the product meets customers' quality specifications and food safety requirements.

Even then, smallholder producers remain vulnerable to the exercise of coercive market power by market intermediaries. To overcome this final constraint, George et al. advocate the formation of global marketing companies that, while farmer owned, are managed by professional employees. Ideally, to achieve maximum leverage in the market, these global marketing companies need to market through a single desk. However, the key constraints are the lack of finance, trust, effective industry leadership, entrepreneurship, and inertia.

While Van Damme (this issue) supports the formation of CMGs as a means for overcoming the diseconomies of scale, he concludes that contract farming is the best way to organize and to assist smallholder farmer groups. Contract farming not only facilitates institutional development and capacity building at the grassroot level, but it is, as a result of investment by the private sector, more market oriented and more sustainable. While private sector involvement is the most appropriate way of linking smallholder producers to markets, where markets are absent or poorly developed, one of the major constraints to commercialization and market development is the lack of infrastructure, both on-farm and off-farm. Despite the increasing predominance of public-private partnerships, there is an ongoing need for government to provide the enabling environment through facilitating market access, land transfer and agrarian reform, investing in extension and advisory services, transport and social infrastructure, financial and legal services, and to address the persistent underinvestment in agricultural research and development.

Although strong farmer organizations are the key to agricultural development, some agribusiness firms have expressed disillusionment in working with farmers' groups. Many believe that it is a waste of effort, for it is forcing something onto rural communities that is inconsistent with their level of development. Thus, the promotion of such groups should only be undertaken where they are felt necessary by the farmers themselves and in a way that farmers feel comfortable.

Gagalyuk and Hanf (this issue) describe the challenges of vertical coordination in the Ukraine. While the customer's primary concern is the need for efficiency and the elimination of all unnecessary costs and activities, their efforts are hampered by the lack of infrastructure and inappropriate business practices, where exchange partners often engage in opportunistic trading and property rights are poorly defined. Contract enforcement is made all the more difficult by the absence of effective legislation and corruption.

In the final paper, Shepherd and Cadilhon (this issue) describe the role of commodity associations and their part in supply chain development. Such associations play a particularly important role as a focal point for policy dialogue with government, but they may also assist in setting grades and standards, promoting products in both domestic and export markets, and providing support for research, education, and training and information and statistics. Because they draw membership from the entire supply chain,

commodity associations have much greater strength when advocating policy or regulatory changes than associations that represent just one sector of industry. However, if they are to be successful: (1) they must draw their membership from organizations that are fully representative of the stage(s) in the chain they represent, (2) all sectors must be treated equally and have the same vote, and (3) the association must speak for and act on behalf of all members.

While other less formal arrangements bring actors together from different sectors of a commodity chain for ad hoc meetings to identify the advantages of working together, some concern has been expressed that membership of commodity associations is often open to organizations that are peripheral to the commodity chain. Such participation may reflect outside intervention in the establishment of the association, where membership is effectively decided by a donor or government agency rather than the chain participants themselves. Conversely, other commodity associations actively welcome the participation of actors who indirectly support the industry such as input suppliers, bankers, and transport and logistic companies. Where farmers associations are weak, some commodity associations actively support and encourage individual membership, but there is always the risk that they may become dominated by the larger commercial farmers, effectively disenfranchising the smallholder farmers. Other associations run the risk of becoming too dependent on government and of sacrificing their independence. While government can provide a wealth of expertise and analytical skills, government representation at the decision-making level is likely to inhibit discussion and policy dialogue. Generally speaking, commodity associations established by government do not provide an alternative to associations promoted by the supply chain participants themselves, even if they draw much of their membership from the same organizations.

Concluding Comments

In the agricultural sector, if smallholder farmers are to become more competitive in domestic and international markets, their supply chains need to become more efficient and more effective (Murray-Prior et al., 2005). Theoretically, the adoption of a supply chain framework enables farmers to better meet the needs of their downstream customers. However, just as important is the need for downstream customers to satisfy the farmers' needs. Failure by either party in the transaction to satisfy the needs of their preferred trading partner will potentially introduce conflict into the exchange, thereby increasing transaction costs and reducing the efficiency of the market.

As each of the papers above has demonstrated, one way to improve the competitiveness of supply chains in the transitional economies is to facilitate the formation of collaborative marketing groups. Acting collectively, smallholder farmers have the potential to significantly improve the quality of their product

offer by delivering a larger volume of consistent quality product to downstream customers, more reliably. Collective marketing also has the potential to greatly improve smallholder farmers' access to more reliable technical information and market information and, in some instances, to access credit. However, if there is to be any sustainable long-term improvement, a more holistic approach is required to address all aspects of the chain including input suppliers, production, processing, handling, distribution, and marketing. The role of government is to provide the enabling environment to facilitate the linkage between smallholder farmers and the institutional market.

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