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# **New Trends in Supermarkets Procurement System in South Africa: The Case of Local Procurement Schemes from Small-Scale Farmers by Rural-Based Retail Chain Stores**

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***"New trends in supermarkets procurement system in South Africa: the case of local procurement schemes from small-scale farmers by rural-based retail chain stores"***

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**Abstract**

In contrast to the centralised fresh produce procurement systems of South African retailers relying on preferred commercial suppliers, this paper draws on an in-depth analysis of the innovative procurement schemes of two rural-based supermarket chain stores in the Limpopo Province to source fresh vegetables locally from small-scale farmers. The objective is to derive lessons to guide public and private sector actors in promoting greater participation of small-scale producers in dynamic supply chains, through the exposure of the key drivers and success factors affecting the inclusion of small-scale vegetable farmers.

The critical factors affecting the up-scaling and / or replication of this type of procurement relates to operation in a remote, emerging market, franchise stores with flexible procurement options, small-scale farmers with potential and land in close proximity to the supermarket, good communication and coordination, long term commitment, technical support, interest-free farm loans and diversity in product supply among farmers.

Key indicators of mutually beneficial engagement are consolidated farming systems, improved farming income, low cost procurement of fresh vegetables (short supply chain), as well as fostering of the stores' broader community involvement strategy. Up-scaling/replicating the scheme would probably require the involvement of external actors and the definition and establishment of public private partnerships. These should be tailored to the specific local conditions and capacities of the different stakeholders. Specific emphasis should be put on support towards the development of critical skills at local community level to empower small-scale farmers to sustain beneficial participation in the market.

## ***"New trends in supermarkets procurement system in South Africa: the case of local procurement schemes from small-scale farmers by rural-based retail chain stores"***

### **1. Introduction**

As in many other parts of the world, the consolidation of supermarkets in South Africa was accompanied by the development of centralised procurement and preferred suppliers' schemes (Weatherspoon and Reardon, 2003a and b). The dominance of large-scale farmers in the South African agricultural commercial sector facilitated these processes. These factors contributed strongly to the exclusion of small-scale farmers from access to formal markets (Louw et al., 2004).

With the political and social changes underway (e.g. AgriBEE) as well as the spreading of supermarkets in rural areas, new innovative strategies towards including small-scale farmers into supermarket procurement system are observed in South Africa. Interestingly, innovative private retail strategies are developing especially in remote rural areas where competition among supermarkets is intensifying and small farmers' communities are important, making local procurement a major asset. Striking examples of this are the initiatives of the rural-based SPAR supermarket chain stores in Thohoyandou and Giyani in the Limpopo Province to source fresh vegetables locally from small-scale farmers.

This paper draws on an in-depth analysis of the innovative fresh produce procurement schemes of these two stores, in order to derive lessons to guide public and private sector actors in promoting greater participation of small-scale producers in dynamic supply chains. Qualitative case studies were developed in order to understand the main drivers and success factors of small-scale farmers' inclusion. Data collection was based on semi-structured personal interviews with the main role players of the schemes, including retail store owners and managers as well as a sample of small-scale vegetable farmers in Thohoyandou and Giyani with current or previous involvement with the SPAR retailers.

### **2. Background**

#### **2.1 Overview of the South African retail sector**

The uniqueness of the fresh produce procurement initiative described in the case study will be better understood after comparing the innovation against the conventional behaviour of South African retailers. As pointed out in the literature (See among others Reardon et al. (2001), Reardon and Berdegue (2002), Balsevich et al. (2003), Dries et al.(2004), the rise of supermarkets resulted in most countries in the establishment of centralized buying and distribution centers<sup>1</sup>, with: (i) concomitant shifts from traditional brokers to new specialized/dedicated wholesalers<sup>2</sup> and (ii) a decline of traditional wholesale systems. The reliance on specialized/dedicated wholesalers usually results in a shift towards preferred suppliers' systems to select producers capable of meeting supermarket standards in terms of quality and safety standards, quantities and consistency. Agri-food industries and supermarkets have been setting their own standards, based on their understanding of consumer demand and existing regulations. These private standards often substitute for missing or

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<sup>1</sup> Dries, Reardon and Swinnen (2004), among others, explain this change as follows: "*This is done in order to reduce coordination costs, generate economies of scale buying in larger volumes, work with fewer wholesalers and suppliers per unit merchandized, and have tighter control over product consistency in meeting standards. Typically chains make this move when they reach a certain volume threshold.*" Having a larger supplier pool from which to choose also helps in getting the cheapest and best quality products.

<sup>2</sup> As pointed out by Dries, Reardon and Swinnen (2004), these dedicated wholesalers are "*more responsive to quality, safety and consistency requirements of supermarkets than are traditional wholesalers who aggregate products over many producers and qualities with little capacity for segregation.*"

inadequate public enforcement of safety norms, and are used in the competition with the informal sector, to claim superior food product quality. Supermarkets promote standard product quality and appearance, at the lowest price. They also require “durability”, an essential product characteristic for supermarkets to increase their geographical coverage and sell on distant markets (Friedmann, 1993).

These global retail trends are clearly reflected in the South African context. The South African food retail sector is highly concentrated and dominated by four retailers as shown in Table 1 with the prospect of further concentration in line with the global trend (AC Nielsen, 2006a). Furthermore, all the larger retailers in South Africa have been expanding their activities within South Africa. According to ACNielsen, the number of retail stores in South African increased by 77% to a total of 2 125 stores from 1994 to 2005 while the South African population increased by 16%, and the number of households by 26% (ACNielsen, 2006b). Growth in the retail sector is also sustained and stimulated by the good performance of the South African economy with growth supported by stable monetary and fiscal policy, a relatively stable world economy and the emergence of a strong black middle socio-economic class (BFAP, 2006).

**Table 1: The estimated market shares and target markets of the major retailers in South Africa**

<b>Retailer:</b>	<b>Estimated market share<sup>3</sup>:</b>
Pick ‘n Pay	33%
Shoprite/Checkers:	33%
SPAR	26%
Woolworths	8%

The four major chains have developed highly centralized fresh produce procurement systems, with distribution centers located in the major metropolitan areas spread throughout South Africa. Their main procurement source is based on preferred supplier schemes, which slightly vary from one supermarket chain to the other in terms of the contractual arrangement modalities but always include regular engagement with farmers based on technical advice, training and specification. Consistency of supply and adherence to food safety standards are important criteria to be included in these preferred supplier schemes. In addition to direct procurement from farmers, three of the four major chains are still procuring a small part of their fresh produce from the national wholesaler markets -National Fresh Produce Markets (NFPM’s). However, because of concerns related to lack of cold chain maintenance, inadequate traceability to the farm level and food safety issues, all retailers have significantly reduced their procurement from NFPM in the last decade currently representing as little as 10% of total procurement.

In terms of the procurement strategies of individual stores<sup>4</sup> within these retail groups, rules slightly differ from one major retailer group to the other and are different for corporate and franchise stores. Corporate stores have to procure all their fresh produce through the distribution centers. Some franchise stores should get at least 90% of the produce from the distribution centers but have more flexible in terms of external procurement. All Woolworths’ stores receive their fresh produce through the central

<sup>3</sup> Estimation based on discussions with procurement personnel of the various retailers during 2006

<sup>4</sup> Source: Discussions with key procurement personnel (at top-management level) from the various retail groups.

procurement system. The SPAR group central distribution system for fresh produce is mainly for their Freshline brand (a limited range of up-market, expensive, value-added, superior quality fresh produce). Stores are also allowed to arrange for fresh produce procurement through alternative channels, such as NFPM's, wholesalers and farmers directly. This is particularly applicable to stores operating in less affluent areas where the up-market fresh produce product range is not suitable for their target market.

Most of the major South African retailers require internationally recognized food quality and safety systems such as EurepGAP at farm level and HACCP at packhouse / processing level, from their fresh produce suppliers. Most produce delivered by the farmers to the distribution centers are packaged and ready for supermarket shelves. The implementation, maintenance and auditing of these systems are complex, time-consuming and costly, even for commercial farmers.

These centralized procurement schemes seriously hamper the capacity of small-scale farmers to participate in the supply to the central distribution systems due to a number of reasons including small-scale farmers' general inability to cope with quality, safety, consistent supply quantities and administrative requirements, retailers limited commitment, time and capacity to manage and monitor small-scale farmers, high transaction costs associated with dealing with a large number of small farmers, and relatively stable supplier bases of commercial farmers.

However, in the light of the South African legacy of apartheid, political programs are underway to eliminate the skewed participation and inequity in the agricultural sector, such as the framework for Black Economic Empowerment in Agriculture (AgriBEE). AgriBEE's goal is to ensure black people's improved access to productive resources and full participation in the agricultural sector as owners, managers, professionals, skilled employees and consumers<sup>5</sup>. It was launched during July 2004. Its setting is still under negotiation and the retail sector will probably not be subject to the comprehensive AgriBEE requirements. However, one of the issues taken into consideration is the retail procurement strategies.

According to the various retailers, the possible opportunities for inclusion of small-scale farmers into formal retail supply chains include the following:

- Strategic partnerships / mentorship programmes with commercial farmers to increase marketing volumes and use the established infrastructure of the commercial farmers (especially in terms of packhouse facilities). This option is the most popular among most of the various retailers.
- Dealing with franchise stores, with more flexible procurement options and, in many cases, less stringent food quality and safety requirements - especially in the case of SPAR and Pick 'n Pay.
- Procurement from groups of small-scale farmers (collective action, producer organisations).
- Project-based approach through which groups of farmers are developed to be able to supply to a specific retailer through a process where the retailer mobilizes external resources (such as NGO's, government support) to provide the farmer groups with training. This is mostly done by Woolworths and Pick 'n Pay.
- Involvement in niche markets like organic fresh produce.

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<sup>5</sup> 30% of commercial agricultural land should be owned by black by 2014, an additional 20% should be leased to them by the same time, 10% of existing farmland should be set aside for farm workers for their own production, farm workers should achieve a 10% ownership stake in all enterprises by 2008, and illiteracy among farm workers should be eliminated by 2010 (Hlengani, 2005).

## 1.2 Significance and role of agriculture in South Africa

South African agriculture is highly dualistic, with a large-scale commercial sector and a large group of small-scale semi subsistence farms mostly in the former homelands. About 60 000 commercial farmers represent 87% of the total agricultural area, and produce more than 95% of the marketed output. On the other hand, about 3 million small-scale farmers<sup>6</sup> of whom a majority is settled in the communal areas, make up about 13% of the agricultural land area (NDA, 2001). These are mostly subsistence oriented with generally low production levels due to dominant traditional land tenure system, lack of physical infrastructure, lack of credit facilities, low access to input markets and high level of urban emigration of the active population. Historically, the level of commercialisation of small-scale farmers has been limited and agricultural activities have tended to be small-scale with a restricted contribution towards household incomes (Lahiff and Cousins, 2005).

National agricultural policies of the last decades, both under the apartheid regime and in the current democracy, fostered the domination of the agricultural sector by large commercial farms. Furthermore, with the end of the apartheid system, almost all agriculture support granted by parastatal organizations to subsistence agriculture in former homelands (e.g. management of irrigation schemes, mechanization, input supply) has been withdrawn (Shah et al., 2000). Market liberalisation in South Africa has created both new opportunities and major problems for farmers. It has ensured a leaner and stronger agricultural industry, with farmers and agribusiness able to position them as players in a globally competitive environment (Vink and Kirsten, 2000). However, it has increased the gap between the two kinds of agriculture (Magingxa, 2003). Small-scale farmers are most of the time ill-equipped to deal with changing market conditions (Killick et al, 2000). Small farming systems are very partially integrated into incomplete markets, such as products markets, land market, labour market, credit market and input market. Despite high expectation on the potential of the private sector to provide the services previously provided by state organs, its emergence has generally been less smooth and less rapid than expected (Magingxa, 2003).

However, agriculture provides substantial employment especially in rural areas. There is about 940 000 farm workers, including seasonal and contract workers, adding to at least 1,3 million smallholder households, for which farming constitute a full or part time employment. It is currently estimated that 6 million people depend on agriculture for their livelihood (NDA, 2005). However, off-farm activities being frequently more remunerative than agriculture and biased toward men (notably mines and industry), many adult males and young people prefer to immigrate to urban centers rather than practicing farming in rural areas. Many rural households are headed by pensioners or women. For small-scale farmers, the role of agriculture is complex and integrates several dimensions, such as social, economic, technical and legal dimensions (Anseeuw et al., 2001). In low-developed rural areas of South Africa, agriculture is an important contributor towards food security and reduction of dependency from outside (Perret et al., 2005). For the majority of small-scale farmers, especially for social transfer dependant people (pension or remittances), farming activities are first

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<sup>6</sup> In South Africa, by statistical definition, a small-scale farmer has a maximum of 20 ha of land. If he owns larger land, he is categorized as medium to large scale farmer (Lange (de) et al., 2003). The denomination “small scale agriculture”, “resource-poor farmers”, “historically disadvantaged communities”, “emerging farmers”, “subsistence farmers” “small growers” or “smallholder farmers” are commonly used to refer to these people. It is opposed to “commercial farmers” or “large scale farmers”.

aimed at ensuring consumption needs, and only occasionally at generating income (NDA, 2001)<sup>7</sup>. Agriculture also provides people involved in part time jobs and earning irregular incomes with a safety net.

Small-scale farming households usually combine several gainful activities, related or not to agriculture (Ellis, 1998; Lange (de) et al., 2003). Social grants and remittances are also significant at household level in the poor rural provinces of South Africa. Diversification of income sources appears to be a key strategy to reduce poverty in bringing more resilience and sustainability to households (Perret et al., 2005).

The unemployment rate is very high in South Africa, especially in poor rural provinces such as the Limpopo. Thus, despite a low contribution to income, a major source of rural growth and livelihood improvement remain smallholder agricultural production (Dorward et al., 1998). Agriculture is often pointed out as the first potential move for development in rural areas (Brooks, 2000) whereas rural people themselves do not see agriculture as an answer to their plight (May et al, 1997).

## **2. Depicting the local retailer procurement scheme**

As was shown in the first section, given the high level of procurement centralisation in the South African retail sector, a vast majority of stores mainly procure through central distribution systems which rely mostly on commercial large-scale farmers. Local procurement by retail stores from individual local small-scale farmers, as described in this section, represents an interesting deviation from common practices.

### **2.1 Main features of and drivers for local procurement schemes**

The studied retail stores operate as franchise like stores of the SPAR group and are both market leaders in the respective local retail markets, with current market shares of 70% in the case of Thohoyandou and 62% in the Giyani case. They have to procure at least 65% of their grocery goods from the SPAR central distribution system. However, as mentioned earlier, all SPAR stores are allowed to procure fresh produce through alternative channels. Their fresh produce procurement involves mainly local procurement from commercial farmers and small-scale farmers, with complements from wholesale markets such as the Johannesburg Fresh Produce Market (mainly for less sensitive produce like potatoes and onions) and the SPAR Central Distribution system. Procurement from small-scale farmers in Thohoyandou represent between 10 and 20% of the store fresh produce requirements and involves mainly spinach and cabbage on a consistent basis, while the Giyani store procurement from small-scale farmers represent between 20 and 30% of its requirements and involves mainly spinach, cabbage and tomatoes, but also butternuts, carrots, beetroot, green onions and green peppers. The daily vegetable procurement volumes of the stores are similar. Spinach and cabbages, which are mainly supplied by small-scale farmers, are very important within these retailers' fresh produce offering, since these vegetable types are a significant part of the daily food consumption basket of consumers in Giyani and Thohoyandou. These SPAR stores have a strong focus on local procurement.

To initiate procurement from small-scale farmers, the stores' managers communicated their plan in their area through radio advertisements and by talking to customers in their store in order to spread idea by means of word-of-mouth. A number of enthusiastic small-scale vegetable farmers willing to produce vegetables for the SPAR

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<sup>7</sup> According to a study by Statistics South Africa (1997) in a survey realized on 1, 654, 299 household engaged in farming activity, the reason for engaging in farming activities is firstly to ensure household consumption needs (92% of households). Only 5% of people said they are engaging in agriculture to earn a living by selling farm produce.



approached the stores. Currently about 12 small scale farmers are engaged with the Giyani store as suppliers, while 12 to 14 small-scale farmers are delivering to the Thohoyandou SPAR with different levels of regularities. In terms of the number of small-scale farmers supplying the stores, different evolution paths occurred in the two areas. In Giyani, there was a gradual process of integration of farmers, with the development of a stable core supplier base, while the Thohoyandou case has been characterized by a high number of small-scale farmers involved in the beginning and a subsequent decline and variability in the size of the small-scale core supplier base.

A number of factors have been identified as driving the local procurement strategies and initiatives of these retailers. Given the remote locations of the stores (500 – 600km from Johannesburg), fresh produce procurement from the Johannesburg National Fresh Produce Market<sup>8</sup> or from the SPAR group's central distribution centre is expensive due to the high cost of cold storage road transport. These SPAR retail outlets are operating in an area with good agricultural production potential and are surrounded by large numbers of commercial- and small-scale farmers. By procuring from local farmers, transportation costs are drastically reduced, and produce freshness increased. Another factor relates to the up-market and expensive nature of the fresh produce product range offered by the central distribution system, which is not well suited to the needs of the less-affluent emerging consumer markets of these retailers. Procurement from local commercial and small-scale farmers provides for a more affordable range of fresh produce with acceptable quality characteristics. In addition to cost and quality considerations, a community involvement component forms part of the corporate strategy of the SPAR group, with freedom of interpretation on how to implement it. The stores in Thohoyandou and Giyani engage in local fresh produce procurement as a way to stimulate local economic activity and upliftment of farmers within the local communities. The strategies were initiated before the AgriBEE policy was devised and it is very important to note that, according to the local retailers, AgriBEE was not a motivation behind their strategies to procure fresh produce from local small-scale farmers. Another driver for local procurement relates to consumers' perceptions towards locally procured fresh produce. In contrast to urban consumers' generally negative quality perceptions associated with the produce of small-scale farmers<sup>9</sup>, the consumers of these stores are aware of and value the fact that some vegetables sold in the stores are procured from local small-scale vegetable farmers as long as the produce is of a good quality. The Thohoyandou store even organizes for farmers to be present in the store on certain Fridays to promote their small-scale farmer procurement among the consumers in the store.

## **2.2 Insights into the farming systems**

From the establishment of the stores, the small-scale farmers participating to the procurement schemes have known different trajectories of engagement with the retailer (1) farmers that have been delivering to the retailer consistently for a long time period, (2) farmers who supply the retailer with vegetables, but on an irregular basis and (3) farmers who supplied the retailer with vegetables in the past, but who stopped delivering.

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<sup>8</sup> The largest National Fresh Produce Market in South Africa

<sup>9</sup> According to interviews with SA retailers, the majority of South African consumers living in urban areas generally associate quality fresh produce with supply from the commercial farming sector limiting current possibilities to use procurement from small-scale farmers as a promotion angle in their marketing strategies.

Interestingly, farmers that form part of the reliable suppliers to the retailers are located relatively far from the supermarket and do not have the highest education levels among the sampled farmers. Some of these farmers produce a larger variety of vegetable than non participating farmers, while others have specialized their farming system. Crop variety production is in contrast with most other farmers who mainly produce spinach, since it is relatively easy to produce all year round. All the interviewed small-scale farmers are relatively well-endowed with land, having access to at least four hectares of land, when considering that the normal allocation of tribal land in South Africa is traditionally between one and four hectares. The farming systems of the farmers are labour intensive and involve low levels of machinery utilization (e.g. tractor). The labour force mainly consists of family labour, but also some seasonal and permanent hired labour. In terms of inputs, commercial seed / seedlings are not used by all the farmers, but the application of pesticides and fertilizers are a common practice. Almost all the farmers have easy access to transportation either through ownership or through family networks.

In order to deliver vegetables to the retail stores, the small-scale vegetable farmers initially had to have access to land and at least some farming infrastructure to start producing for the supermarkets, but they did not necessarily had to have their own delivery vehicle from the beginning. Over time these small-scale farmers had to implement a number of changes to sustain their engagement with the retailers:

- Planting of good quality seed / seedlings planting.
- Improved production planning especially in Giyani.
- Application of higher quality, retailer approved fertilizer and pesticides.
- Technology for adequate irrigation capacity.
- Employment of more workers due to increased production levels.
- Due to progressive increased production and the use of more and more expensive inputs, the farmers had to learn how to manage their farms' cash flows properly, and many of them developed a need for production finance.
- The farmers had to develop better technical skills in order to produce higher quality produce.

### **2.3 The key dimension of the interaction between the stores and the farmers**

The local small-scale farmers in Thohoyandou and Giyani face relatively low barriers to entry in the procurement systems of the local SPAR retailers. This is related to numerous aspects such as quality requirements and payment arrangements. When procuring from commercial- and small-scale farmers, neither the Thohoyandou nor the Giyani stores enter into formal contracts with them. Delivery is based on verbal orders, agreements and price negotiations with farmers to deliver specific quantities at specific periods in time<sup>10</sup>. Commercial suppliers and small-scale farmers are both paid once a week on Fridays with cash<sup>11</sup>, cheques or electronic transfers, in contrast to the payment schedules of central retail procurement systems that could be up to 42 days. The conditions of the commercial transactions between the SPAR retailers and small-scale farmers remained stable over time.

#### **2.3.1 Price determination**

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<sup>10</sup> Applicable to orders by the Thohoyandou SPAR from commercial farmers, as well as orders by the Giyani SPAR from commercial- and small-scale farmers.

<sup>11</sup> Small-scale farmers are usually paid with cash.

The prevailing price on the National Fresh Produce Markets is used as a benchmark for price setting. Other considerations include the balance between supply and demand, seasons, transportation costs to the store, produce quality, the produce prices of retail competitors, and in the case of the Giyani store, knowledge about the production costs of farmers. Prices are normally stable on a weekly basis, and it has been observed that variation of prices over longer period is not very significant. According to the surveys, price information does not appear to be a major issue. In some cases, farmers arrange inspection of their crop with the store manager at their farm to verify the quality of the produce before delivery and provide a basis for price negotiations. The stores usually run price promotions on Fridays. They purchase larger quantities of produce from the farmers, generally at discounted prices.

### ***2.3.2 Quality management***

The vegetable quality requirements of the stores are based on the official quality standards of the SPAR group and on the requirements of the customers. However, it is important to note that these quality requirements are not very sophisticated. They are not based on any formal food quality and safety systems (such as EurepGAP). Quality assessment is based on the visual inspection of produce, and requirements are communicated to producers through discussions and by showing the farmers what good quality produce looks. In addition, the Giyani store also engages in farm visits to monitor the quality of produce during the growing season preceding delivery to the store. Small-scale farmers, following the stores guidelines and advice, could progressively meet store requirements.

### ***2.3.3 Coordination issues***

Differences in terms of small-scale farmers' supply management are significant among the two stores. The Giyani store has engaged in production planning since the inception of the scheme and places orders before deliveries, which the manager in Thohoyandou is not doing or not doing consistently. The Giyani store could consequently avoid oversupply, which has represented an important shortcoming in the Thohoyandou procurement scheme and contributed to the withdrawal of some small-scale farmers. Furthermore, given this lack of coordination with small-scale farmers, it is thus much more difficult for the Thohoyandou store to plan its needs with regard to procurement from commercial farmers, especially in terms of those crops for which production from small-scale farmers can be significant but prone to fluctuations (e.g. cabbage). From the commercial farmers' point of view, procurement by the store does not represent a significant outlet. The lack of consistency and capacity to plan needs, which is reinforced by the perceived lack of commitment from the store to procure from them, discourages many commercial farmers to supply the Thohoyandou store.

Another difference between the stores is the ownership of a truck by the Giyani store, which provides it with flexibility and a higher range of option in procurement, be it from commercial farmers or from National Fresh Produce Markets. The store can thus more easily organise unexpected needs to collect produce.

### ***2.3.4 Access to production finance***

Access to credit for small-scale farmers in the studied areas is very limited and the use of production credit is not a common practice. The stores recognized the need to provide the farmers with production loans to enhance their capacity to meet their requirements and have engaged in provision of financial support. At the start of the

scheme, the Thohoyandou store provided interest-free production loans to a few selected small-scale farmers upon presentation and approval of a proper business plan. However, as the crops of these farmers failed, the store did not recover their loans and seized to extent loans to farmers.

The Giyani store is providing production finance based on the calculation of farmers' anticipated production expenses by the store management. Arrangements are based on trust with no formal contracts established between the stores and the benefiting farmers. Conditions for repayment are flexible for farmers and are based on repayments subtracted from farmers' delivery earnings upon payment on Fridays. The loans provided by the Giyani store to farmers are targeted loans, tailored to the specific needs of farmers (e.g. credit for production, the acquisition of essential assets and recovery from natural disasters). Some farmers that benefit from this kind of loans from the Giyani store fostered their ability to maintain their cash flow and withdrew from financial support from the store. Their access to these loans also improved their ability to cope with risk and recuperate after adverse climatic conditions, as the Giyani store cancelled some of the farmers' debts in such events.

### ***2.3.5 Access to technical assistance***

Initiatives from the stores to involve the local public extension services have not proved very successful. While initially engaged in farm visits and assisted farmers in training regarding required quality standards, the Thohoyandou store does no longer provide technical assistance.

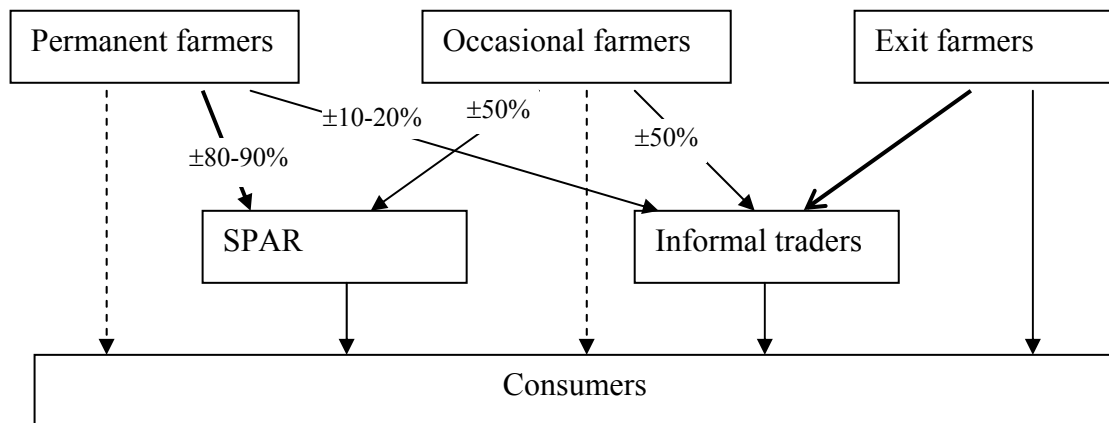
On the other hand, the small-scale vegetable farmers in Giyani dealing with the store receive technical assistance from three sources: the personnel of the store, input suppliers and to a very limited degree, the local Department of Agriculture. The owner of the store was a commercial farmer for many years before opening the store and the fresh produce manager was a trusted employee on his farm. Thus, they have a good understanding of farming, a good technical knowledge base and they know how to access professional help from input suppliers or commercial vegetable farmers.

The Giyani store also engages in regular farm visits. With the consolidation of the farming production systems, frequencies of visit went from up to once a week to once a month. In case of unexpected problem with the crop, the store intends to provide the farmers with technical advice or to arrange for technical support by professional people working for the input suppliers. The store has also organised collective training for the small-scale farmers with successful commercial farmers. Furthermore, in order to broaden the store potential to support the small-scale farmers on a technical level, the retailer recently identified a person in the community (the son of one of the head of community) and supported its formal agricultural training in an agricultural college. This person is in particular involved with a group of women farmers from its community. This group got recently engaged in the scheme on the initiative of the head of the community that contacted the store.

Over the years, the store developed a good understanding of the tribal system in the Greater Giyani area and has established good relationships with some heads of community in the area. Most of the small-scale vegetable farmers engaging with the SPAR live within the communities of these heads of community. The owner's relationships with the heads of community provide a kind of accountability on behalf of the small-scale farmers.

## **2.5 Other marketing channels**

As illustrated by the Figure 1, the marketing alternatives of the small-scale farmers are limited. Produce sales to informal traders are the only other real marketing alternative to to the retail stores. The quality of produce sold to the informal traders varies. In certain cases, the farmers will sell their lower quality produce to the informal traders at discounted prices. However, hawkers also buy the highest quality vegetables from the farmers at similar prices as the retailer. Many farmers sell vegetables directly to consumers in local communities and similar quality produce will usually be sold at the same price. However, it is not a major marketing channel in terms of volumes. Household-level consumption of produce is very limited (accounting for less than 1% of the total production). A common practice of the farmers is to give low quality produce to their farm workers for consumption or to sell it to community members at drastically discounted prices.



**Figure 1: Overview of the market alternatives of selected small-scale farmers in Thohoyandou and Giyani**

### **3. Assessment of the innovative schemes and critical success factors**

In this section, we evaluate the cases presented in the previous section and examine the key drivers of the inclusion and / or exclusion of small-scale vegetable farmers in the specific supermarket supply chain considered.

#### **3.1 Qualitative costs and benefits assessment**

We first briefly assess qualitatively the main costs and benefits for small-scale farmers and retailers in the scheme. For small-scale farmers, the main benefits stem from the secure and stable market provided by the store. This directly improved the farmers' household income by providing bigger market opportunity compared with the restricted alternative market outlets available. It also provides farmers with incentives to invest in farming assets (vehicles, access to electricity, pumps, water pipes and buildings, drip irrigation instead of flood irrigation) and to consolidate their farming system in response to the supermarket requirements. Some farmers could purchase assets with their own capital, while others benefited from interest-free loans from the stores. Improved vegetable quality and higher yields linked to these investments also resulted in higher income for these farmers. Access to tailored technical assistance through the store also contributed to improve farmers' technical knowledge and capacity to efficiently utilise resources towards the production of better quality fresh produce. On the other hand, in addition to higher costs associated with investment and maintenance, farmers delivering to the supermarkets also modified their practices in terms of increased purchases of good quality seed / seedlings, fertilizer and pesticides, which further increased their production costs. They also incur higher fuel costs due to increased production and deliveries. Less successful farmers could also experience these benefits associated with involvement in the scheme but to a lesser extent.

Farmers are also facing risks in investing in farming production because of the lack of significant alternative market opportunities in their area. Informal traders can provide a market but most of them are unlikely to offer a significant alternative market. Benefits from investment are thus, to a certain degree, dependent on the sustainability of their relationships with the store, which can contribute to the vulnerability of these farmers and undermine their capacity to consolidate their farming systems. On the other hand, lack of investment contributed to some small-scale farmers' withdrawal from the schemes, which also affected the stores. Another important point for farmers to consider when investing in agriculture and in their relation with the stores seems to be the possible risk of isolation from community-based resources due to their business success, as observed in the studied case. This can be relevant in many rural areas in South Africa where local traditional authorities have the power to allocate land on behalf of the State.

For the stores, the main benefits result from the short supply chain and consequent freshness of produce sold in the supermarket associated with higher frequency of procurement of small quantities of vegetables, as well as minimal transportation costs. This positively impact on their competitiveness with regard to the other local stores which are relying on suppliers from remote distribution centers. Furthermore, local procurement is part of in their community involvement strategy and is advertised and acknowledged by the customers, which significantly contributes to the promotion of the stores with the local communities.

On the other hand, main risk and cost implications are associated with higher risk of shortages. This first results from seasonally bounded production and higher risk of failure of small-scale farmers and from the difficulties, in some cases, to balance with

commercial farmers' supply. Furthermore, due to the local nature of their procurement systems, the stores can be severely affected by adverse local production conditions. This is in contrast to a procurement system based on a national supplier base with lower risk exposure due to procurement from various geographical regions in the country. Engaging with many small-scale farmers and coordinating supply between commercial and small-scale farmer also entail higher administrative load and transaction costs. However, especially in the case of Giyani, the scheme is still beneficial to the store given the remoteness of the stores and high transportation costs that would result from alternative procurement options.

An important limitation in procuring from small-scale farmers is related to the lack of variety of crops that they generally produce, especially in the Thohoyandou case, which contribute to explain why small-scale farmers' supply only between 10 and 30% of the stores' total fresh produce procurement. Capacity of the store to expand the scheme depends largely on the possibility for product diversification.

Another dimension to assess success or failure of the schemes relates to the number of farmers that could not sustain their participation to the scheme, representing the majority of the farmers in the Thohoyandou case. Small-scale farmers' capacity to sustain the relationship with the store cannot be explained by a single factor or set of factors. Consistent suppliers are not significantly different from the other farmers but they generally produce vegetables on a larger scale, are fulltime farmers who depend on farming to make a living<sup>12</sup>. Given the high diversity in small-scale farming in South Africa and the various roles that agriculture is fulfilling as highlighted in the first part, withdrawal from the scheme of farmers may not necessarily be assessed as a failure from the farmer's point of view. It may reflect the opportunistic behaviour of farmers for whom agriculture represent a 'refuge' or default subsistence activity. Many farmers that stopped delivering to the stores terminated their farming activities to seek alternative employment. However, this is also to be related to the lack of alternative marketing opportunities.

## **3.2. Key drivers for sustainable inclusion**

### **3.2.1 External factors**

For this type of scheme to emerge and develop, several factors have been identified from the case study as key drivers. A major incentive for local stores to engage in local procurement is the remoteness from distribution centers and fresh produce wholesale markets. As pointed out by Dries et al. (2004) among others, for perishable products, such as fruits and vegetables, for which proximity may be a source of better quality (e.g. in terms of freshness...), local small farmers stand a better chance to become supermarket suppliers. Furthermore, another supporting factor is the fact that the studied stores are operating in so called 'emerging markets' targeting low income rural consumers. Properly managed local supply from small-scale farmers can thus meet consumer requirements that are less sophisticated than more urban and wealthy consumers, especially in terms of traceability and safety requirements.

As pointed out by Rondot et al. (2004), "*Buying locally from small holders may be also part of a supermarket socially responsible strategy and become an advertising slogan in the highly competitive environment in which they operate.*". This is evident within these cases, since in these rural markets, customers value local procurement from small-scale farmers in the community. However, these can only trigger local

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<sup>12</sup> As was pointed out in the first section, many small-scale farmers do not depend on farming as their main income generating activity.

procurement if the stores have a flexible fresh produce procurement option, which is generally the case of franchise stores but not of corporate stores, in South Africa. Significant development of franchise stores, especially in 'emerging markets', are thus to be pointed out as a supporting factor for replicating this type of scheme.

Obviously the presence of small-scale farmers close to the supermarket with access to land and capacity to expand their farm as well as initial farming infrastructure (especially in terms of irrigation) are enhancing factors. Favorable climatic and soil conditions, as well as water availability and farming knowledge and farming culture are also supporting factors. In the studied case, even if the small-scale farmers have been suffering in the last years from climatic disasters and vegetable production can take place all year long even under low technology-level flood irrigation systems. It is important to note that the requirements in terms of assets and practices to enter into the schemes are low. The schemes are based on learning processes, whereby farming systems are improved over time.

### ***3.2.2 Store engagement, commitment and intervention***

In the studied case, success in sustaining procurement from small-scale farmers is strongly related to the supermarket chain store pivotal role. Sustained procurement from a core of small-scale farmers in the study presented above has been relying on a number of functions performed by the store and on its commitment to establish long term relationship. These are mainly communication and coordination functions, and provision of technical and financial support.

As has already been pointed out, a critical factor in successfully managing procurement is the capacity to coordinate and balance procurement from small-scale farmers and with commercial farmers. Proper planning, orders and deliveries management are critical to prevent and/or anticipate shortage and uncontrolled oversupply of fresh produce to the store as well as to avoid tension with large scale farmers. The retailers' capacity to ensure good communication is strongly supported by the fact that all the small-scale farmers engaged in the schemes possess a cell phone. In addition to phone communication, success in procurement planning also relies on frequent farm visits and direct involvement in production planning decisions from farmers. This clearly contributes to establishing a trust based relationship between the store and the farmers, which then play a positive role in communication and coordination. It is worth noting that, with the development of the scheme and the production specialization among farmers in certain crops, production planning needs are reduced.

Flexibility in procurement management is also enhanced by the possible use of retail store owned transportation means as well as by innovative arrangements in terms of logistical planning. An interesting illustration of this is the linkage that the store has established with a fruit and vegetable wholesaler from a nearby town (Tzaneen) whereby it both procures fruits and vegetables that cannot be procured locally, and ensures absorption of small farmers' excess produce that it cannot take. Transportation is organised in such a way that the wholesaler collects small farmers' produce when delivering orders to the store.

As stressed by Weatherspoon and Reardon (2003) among others, supermarkets will purchase from farmers (large or small) as long as they meet the mandatory specifications and quality requirements. Quasi-formal and formal contracts are elaborated only in some specific cases to provide "*incentives to the suppliers to stay with the buyer and over time make investments in assets (such as learning and equipment) specific to the retailer specifications regarding the products.*" (Reardon et



al., 2003). In the studied cases, no formal contracts have been established between the stores and the farmers. However, the schemes have been sustained on the basis of long term commitment both from the store and the farmers to sustain their relationships, and can, to a certain extent, be compared to preferred supplier scheme. Preference is given to the farmers with long involvement in the scheme.

In addition to being in the store's interest to procure locally as already described, it is worth noting that, in the studied case, some sense of commitment, and even empathy, towards the local community and the small-scale farmer supplier base as well as a strong motivation to make a success of the local vegetable procurement system in the long-term have also been driving the development of the scheme. This long term commitment has been a key factor both in enabling for a learning process to take place and in incentivizing farmers to invest.

Long term provision of targeted support has also been instrumental in developing small-scale farmers' skills and ensuring on-farm investment to consistently plan and supply according to supermarkets requirements. This first consists of personalized agricultural technical assistance. This is directly provided by the store to farmers and/or by external role players (input suppliers and commercial farmers) but through the mediation of the store, and it is tailored to the individual needs of farmers linked to fulfilling the needs of the supermarkets. It also consists of small flexible interest-free production loans whereby these farmers decide upon the time frame for repayment. These loans are granted to some small-scale farmers, especially in critical times, even in cases when they failed to repay such type of loans in the past. These loans can transform in direct subsidies as the supermarket often writes loans off if failure to repay are linked to external adverse conditions such as climatic ones. This loan provision thus plays an important role as a risk coping mechanism. It made a major contribution to the long-term inclusion of farmers in terms of overcoming initial or periodic cash flow problems and funding recovery after natural disasters. It also fostered the capacity to invest in boreholes and more efficient irrigation systems to cope with climatic variation and reduce reliance on seasonally bounded production.

Finally it is worth stressing the highly innovative behaviour of the Giyani store in terms of taking advantage of networks to access resources and creating opportunities, which has already been demonstrated through a number of examples. Another illustration of this is the linkage that the store established between a commercial farmer and a small-scale farmer. This resulted in a formal collaboration between them whereby the large-scale farmer is sharing some of its assets and assisting the small-scale farmer in accessing markets and credits as well as low cost inputs in exchange for a share of the small-scale farmer's profit.

#### **4. Lessons learnt and case for up-scaling**

As already mentioned in the first part of the article, the main option considered by South African retailers to provide for the inclusion of small-scale farmers in their procurement systems is through different types of partnerships between small-scale farmers and large-scale farmers, and in most cases without being directly involved. Development of these partnerships are considered as a way of complying to both the AgriBEE framework and the land reform program as some schemes, such as the equity share schemes, have proved to offer opportunities for efficiently implementing these schemes (Knight et al., 2003). According to Ortmann, (2005), even if AgriBEE and land reform programs create uncertainty and confusion among commercial farmers, many of them support the idea of playing the role of mentors for small-scale farmers, and are looking for innovative ways of facing the land reform challenge.

However, this kind of partnerships is unlikely to develop in former homelands where commercial farmers are almost absent.

Because of the significance of the large scale farmers supplying supermarket chains in South Africa and the efficient preferred supply schemes these chains developed with them, they are not prepared to deal with a large number of small-scale farmers as part of their central procurement system. A shift of focus from a national perspective, where possibilities to include small-scale farmers are seldom, to a local perspective, where rural stores have been developing tremendously in the past few years, can bring interesting opportunities for small-scale farmers to be included in supermarket driven supply chains as proposed by the case study that have been examined in this article.

As shown in the studied case, local procurement by supermarkets in South Africa has a good potential in providing and sustaining small-scale farmers' participation in formal markets. However, as has been highlighted, its success will strongly rely on the ability to design and implement sound, long-term financial and technical support schemes, and also to ensure proper coordination in the schemes. As has been demonstrated in the previous section, capacity of the store to ensure these functions is dependent on agricultural technical skills and knowledge, and on the understanding of local community dynamics. Even when rural-based retailers face strong incentives to engage in local procurement, lack of these skills generally prevent them from it. This poses questions regarding the replicability of this type of scheme.

#### **4.1 The potential role of external support**

External support could improve the replicability of the scheme. In South Africa, some public instruments exist firstly to provide targeted technical assistance to small-scale farmers, and secondly to provide credit access. Examples are the extension services of the local branches of the Department of Agriculture or the current initiative of the National Agricultural Marketing Council through which training is provided to small-scale farmers with potential by external parties on a consultancy basis. In terms of access to production finance, policy measures, such as the initiatives of the Micro-Agricultural Financial Institution of South Africa (MAFISA), could be utilized, either through the store or directly. Public bodies could also act as collateral in production loan schemes provided by the stores. Thus, provision of public support and engagement within public private partnership agreements between local stores, farmers and government could address these issues and contribute towards the successful replication of the type of local procurement schemes presented in this article. In this regard an important issue to address will be the sharing of risk between the government, the credit suppliers (in the case of non government and non supermarket credit suppliers), the supermarket and the farmers.

However, it is worthwhile recalling that, even within the context of a strong commitment from the stores towards procuring from small farmers, high vulnerability towards production and market risks, have hampered some small-scale farmers' ability to invest in agriculture, and thus to sustain their inclusion in formal markets and consistently deliver to retail stores. On the other hand, the case depicted in this article tends to show that as soon as farmers can manage their farming system independently, they intend to withdraw from external support. The public private partnerships and associated procurement schemes should be tailored to specific situations in terms of involvement and capacity of the different stakeholders with consideration of the importance of facilitating a learning process.

Another suggestion is to consider government intervention in a broader sense. Government intervention could take different forms depending on the initial

commitment of the supermarkets, and thus the capacity to both initiate supermarket procurement schemes inclusive for small-scale farmers and ensure time for a learning process. In addition to public private partnerships with retailers, government bodies could assess the different available marketing opportunities locally and support a learning process whereby farmers could progressively build capacity to understand markets requirements and respond to them consistently. There is a strong need to rebuild skills among small-scale farmers to supply markets and this should be thought of as a gradual process that can be initiated by consistently supplying to informal traders and other market outlets with low entry barriers. Recognition of this and support to this process from the state could enhance the development of a commercially oriented small-scale farming sector with which supermarkets in rural areas could more easily develop procurement schemes.

#### **4.2 Forms of organizations behind the coordination of the schemes**

The other important dimension in sustaining supermarket procurement from small-scale farmers and replicating this type of scheme is related to coordination and organization of the procurement. As pointed out by Biénabe et al. (2007), it is generally acknowledged that a form of organization is a prerequisite for small scale farmers' involvement with supermarkets: *“Organization is therefore a key component in the involvement of small-scale producers in supermarket supply chains and this role is generally taken on by producer associations, which standardize and aggregate production, ensure compliance with the requisite quality standards and deliver products on time and at a competitive price that enable producers to still make a profit.”* As shown in the studied case, the need for proper coordination is reinforced by the possible tension between small-scale and large-scale suppliers. Part of the innovative features of the schemes arise from the stores' direct involvement with individual farmers in production and delivery planning to a lesser or greater degree. This organizational arrangement appeared to be much more effective/ efficient than the intent to establish a farmer organisation as illustrated in the Thohoyandou case. The store decided at some stage to address the oversupply situation it was facing with small scale farmers' delivery, by assisting the farmers part of its supplier base to establish a farmer organisation in order to improve communication and coordination in terms of production planning and deliveries. However the attempt failed. Lack of trust among farmers was given by them as the main reason for the failure of the organisation. This organisation was never properly recognised by farmers that did not participate to set the rules and did not take ownership of it. The farmers that were supposed to cooperate within this organisation were lacking prior experiences of cooperation especially among themselves. This organisation was grouping farmers from different communities that had no close social proximity. Their involvement in the store procurement scheme came initially from their individual initiative in response to the store call for small-scale farmers to become its suppliers. Especially in the context of over supply, they were seeing each other much more as competitors than as potential allies.

The reduction of transportation cost through collective delivery and cost sharing was not a sufficient incentive for farmers to get organised. As pointed out in the case study, transportation does not appear to be a strong limitation for farmers to deliver to the stores. Furthermore, given the low quality requirements of the store and its commitment to procure from small-scale farmers, the farmers involved are not facing high barriers to entry. Thus, as stressed by Berdegue (2001), benefits arising from a farmer association in this regard would probably be low. In the presented case study,

several factors support the ideas that there is no strong need for bargaining power from farmers' side: prices are very stable, the payment delay period is short and promotional sales are taking place every Friday with the decision to deliver on this day mainly relying on farmers. On the other hand, individual and personal relations between farmers and the store have been contributing to farmers' learning of the store quality requirements.

In many rural parts of South Africa, experiences of cooperation among small-scale farmers are not very prominent, except in the context of irrigation schemes. On the other hand, the potential for developing local procurement schemes, at least partly, relies on the low barriers to entry faced by small-scale farmers given both low quality requirements and the store interest in procuring locally. The cost of establishing a producer organisation in these schemes with regard to the benefits that it could bring is probably too high in many cases.

Given the small number of farmers involved in these schemes, transaction costs incurred by supermarket for dealing with farmers individually may also not be very significant. However, as highlighted by the case study, capacity to ensure coordination with farmers outside producer organisations is to be related to the store agricultural knowledge and to its capacity to access resources from different networks.

## **5. Conclusion**

This article presented an interesting case of local retailer procurement from small-scale farmers where local procurement provides mutual benefit, and it discussed its potential for replication. The critical factors affecting the up-scaling and / or replication of this type of procurement relates to operation in a remote, emerging market, franchise stores with flexible fresh produce procurement options, small-scale farmers with potential and land in close proximity to the supermarket, good communication and coordination, long term commitment, technical support, interest-free farm loans and diversity in product supply among farmers.

Key indicators of mutually beneficial engagement are consolidated farming systems and improved income for the core of the small-scale suppliers. On the other hand, SPAR stores benefit through low cost procurement of fresh vegetables (short supply chain), as well as fostering of their broader community involvement strategy, which clearly contribute to their dominant market shares. Sustained well targeted support to small-scale farmers is economically worthwhile from a store perspective when compared with procuring from distant distribution centres or wholesale markets.

As evident from the case study, the store fulfilled a significant range of functions and allowed for a learning process on the basis of specific knowledge and skills which have been identified as critical success factors. However, up-scaling and / or replicating the scheme would probably require the involvement of external actors and the definition and establishment of public private partnerships. As put forward, these should be tailored to the specific local conditions and capacities of the different stakeholders. Insights from this case study confirm the statement by Berdegué and Escobar (1997): *"As rural market become more liberalized and integrated into global economy, local community will have to develop new skills and new institutions to interact with new set of actors whose decision will impact on rural family livelihood."* Specific emphasis should be put on support towards the development of critical skills at local community level to empower small-scale farmers to sustain beneficial participation in the market.

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