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Preface

In May 2008, the OECD Development Centre released the new edition of *Business for Development (B4D): Promoting Commercial Agriculture in Africa*. It highlights the status of African agriculture and agribusiness and discusses new business opportunities in both domestic and export markets. This volume complements that work.

Following the publication of B4D 2008, the members of the Development Centre research team and the Paris Office of the Japan International Cooperation Agency (formerly Japan Bank for International Cooperation) conducted an extensive series of interviews with bilateral donor agencies, leading research institutes and key private stakeholders to obtain supplementary information from a European perspective on what is happening "on the African ground". The interviews yielded a rich collection of material and a good sense of the views of people involved in promoting Africa-Europe business relations, particularly in the agriculture and agribusiness sectors. This information, presented here in a series of short, quasi-journalistic pieces, both adds to and rounds out the analysis of the more formal B4D 2008 study.

African agriculture is a sleeping giant. Agribusiness remains in its infancy in most sub-Saharan African countries. Many of them now pay higher prices for imported food products and struggle to keep inflationary pressures under control. Given the strong long-term prospect for world food prices, increasing the productivity of food crops becomes a top priority. It requires sizeable investments in irrigation, storage, transport infrastructure and logistics, as well as better access to markets for inputs (fertilizers, seeds, planting materials and credit).

While successful contract-farming schemes exist for export crops, they remain rare for food crops. Greater involvement of the private sector in designing and implementing such food-crop commercialisation programmes could develop viable local food industries. Existing international financing facilities such as the Enhanced Private Sector Assistance (EPSA) for Africa should get full use. Whether Africa can unleash the potential of commercial agriculture in the coming decades also depends in no small part on the continuous and effective support of the international development community.

The findings summarised in this volume can serve as building blocks for further international discussions on fostering agro-based private-sector development and lifting smallholders out of poverty.

Javier Santiso

OECD Chief Development Economist and
Director, OECD Development Centre
Paris
November 2008

EDITOR'S NOTE

Editor's Note

This report contains 12 Focus Articles (FAs) that fall into two broad categories. The seven FAs in Part I look at new ways of approaching African agriculture and agribusiness. They point to some successful efforts undertaken by African farmers and businesses, with the support of governments and donors, to improve supply conditions and spur long-term agricultural growth. Two of these FAs focus on private equity and development finance as new sources of financing for private business initiatives. The five FAs in Part II describe major challenges and emerging opportunities facing the agro-based private sector in five African countries (Ghana, Mali, Senegal, Tanzania and Zambia) — the same five countries covered in the case studies on which B4D 2008 was in part built.

The articles in this report may be read as free-standing pieces, but we offer them here in a single volume because, taken together, they convey a more powerful message: that Africa should turn the curse of higher food prices into a blessing by further promoting agricultural commercialisation, scaling up successful ventures and initiating new ones.

This report was partly based on the AFRICA 2008 Seminar which was jointly organised by the African Development Bank and the OECD Development Centre in Dar es Salaam on 3 July 2008 in co-operation with the Italian Embassy in Tanzania: for more information, see the OECD Development Centre website (www.oecd.org/dev/business). During this meeting, Professor Andrew Temu from the Sokoine University of Tanzania emphasised:

> "Commercialised agriculture is one where farmers plan their production and execute such plans for the market. The objective function of the production entities ought to be maximising profit. Very few Tanzanian smallholder farmers have this as their objective function."

African governments and the donor community should take this critical assessment seriously. Indeed, much needs to be done to mobilise private investment, both domestic and foreign, and foster local entrepreneurship. It is to be hoped that this report will help promote a better understanding of the major opportunities and challenges facing African agriculture today.

Acknowledgements

Mitsuaki Harada (JICA/Paris), Hiroyuki Kodera (JICA/Paris), Yoshiko Matsumoto-Izadifar (OECD/DEV) and Denise Wolter (OECD/DEV) jointly managed this JBIC-OECD project under the general guidance of Akihiko Koenuma (Deputy Director-General, Africa Department, JICA) and Kiichiro Fukasaku (Head of Regional Desks. OECD Development Centre). Other participants included Myriam Andrieux, Federico Bonaglia, Thomas Dickinson, Katharina Felgenhauer and Patrizia Labella from the OECD Development Centre, and Rie Higuchi-Coudin (JICA/Paris). Thomas Dickinson, Katharina Felgenhauer, Patrizia Labella, Yoshiko Matsumoto-Izadifar and Denise Wolter co-ordinated the interviews held in Amsterdam, Berne, Berlin, Bonn, Cologne, Geneva, Lausanne, London, Paris, Rome and The Hague, as well as Bamako, Dakar and Dar es Salaam.

Through the interviews and other contacts made during the past year, many people in the public and private sectors in both OECD and non-OECD countries provided valuable input and comments to this project. Although it is not practical to mention all their names, the authors acknowledge those who made direct contributions to their articles. The Annex to this report provides a full list of institutions and persons interviewed.

Financial support from a number of OECD member countries is gratefully acknowledged.

The report was co-ordinated and edited by Kiichiro Fukasaku with the assistance of Myriam Andrieux, Bob Cornell (consultant), Patrizia Labella and Jane Marshall (consultant). The views expressed are strictly personal and do not necessarily reflect those of the OECD, the Development Centre or the Japan Bank for International Co-operation.

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SUGGESTIONS

For Further Reading

This report complements the B4D 2008 publication and has no pretensions to serve as a full-blown study by itself. The editors therefore encourage readers to dig more deeply into the subject, and to this end they recommend the following associated works:

OECD DEVELOPMENT CENTRE (2008), *Business for Development: Promoting Commercial Agriculture in Africa*, OECD Development Centre, Paris.

Five detailed case studies (Ghana, Mali, Senegal, Tanzania and Zambia) are available at

www.oecd.org/dev/publications/businessfordevelopment :

Bonaglia, F. (2008), *Zambia – Sustaining Agricultural Diversification*, OECD Development Centre, Paris.

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PART ONE

New Ways To Approach African Agriculture

ARTICLE ONE

Big Players in African Fields

Katharina Felgenhauer and Patrizia Labella*

- Large foreign agro-food companies in Africa do not limit their activities to trading but manage entire integrated supply chains.
- Foreign private companies increasingly adopt business models favouring the integration of small-scale farmers into their supply chains.
- The agro-food industry serves as a key enabler of economic and social development by creating opportunities, including employment, along the value chain.

Africa has a good business story. Its agro-food industry is gaining importance in the supply chains of multinational corporations (MNCs).

African markets appear increasingly in the sights of large MNCs in the sector. These very large corporations have entered the most dynamic economies of the continent through a variety of activities — mostly non-equity linkages such as franchises and licensing, but also including wholly owned subsidiaries as well as sales and marketing offices.

Beverages form the sub-sector with the highest exposure to multinationals. For Coca-Cola — present in most African states — the continent offers a major market, averaging 5 per cent growth since 2002 and employing 16 per cent of its labour force. The US-Belgian brewer Anheuser-Busch InBev conducts licensed production in five African markets and works with distributors in several other countries, while the brewer SABMiller, which started in South Africa and grew globally, has brewing and beverage interests, e.g. bottling services for Coca-Cola, in 30 African countries.

Chemicals and seeds also show high activity. Seven companies in this sub-sector operate in Africa, the three most important being BASF, Dow Chemicals and Bayer. Yet agricultural input demand remains too low to furnish an attractive market. Africa plays only a marginal role in the rise of global fertilizer consumption, projected to increase by 3 per cent in 2007-2008 with most demand (about 70 per cent) coming from East and South Asia as well as North America.

SMALL FARMERS: IMPORTANT PLAYERS IN THE SUPPLY CHAIN

Most foreign agro-food corporate giants — from the input side along the value chain to retailers — have adopted a particular business model in Africa: linking small-scale farmers into their supply chains. Contract farming provides security of supply and product integrity, with better planning cycles and more limited exposure to fluctuations in the global market.

Yet not all smallholders can get on board, given the strict standards imposed. SABMiller benchmarks both brownfeld and greenfeld suppliers according to their business acumen, skill sets, pricing, service levels and technical accreditation (i.e. quality of machinery owned), explains Eric Leong, Supply Chain Manager for Africa and Asia.

Three markets stand out in SabMiller's portfolio: uganda, Zambia and South Africa. The company has put over 10 000 of their subsistence farmers into job-creation schemes. SABMiller's economic footprint in South Africa shows that beyond its 9 000 direct permanent employees, the company has created an additional 378 000 jobs through its operations along the supply chain.

British American Tobacco (BAT) has a presence in 40 African markets. Altogether, 77 per cent of the tobacco produced in these countries comes directly from smallholder farmers, all managed through contract-farming schemes (the remainder comes from third parties). In the six countries where BAT sources tobacco leaf, the company has signed contracts with 50 000 farmers.

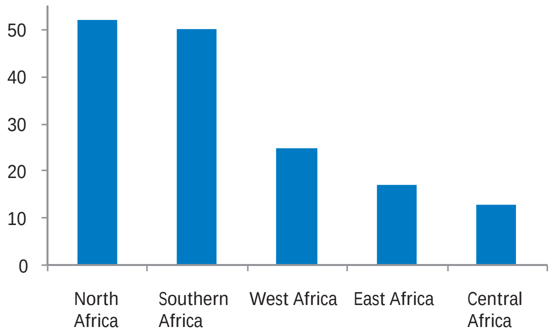
BAT assesses its suppliers by their historic performance. Crucial indicators include profitability, quality of supply and payback rates. For new farmers, land availability, the size of the family working unit and membership of tobacco unions count the most.

Most foreign companies do not invest financially in their business partners, but may provide them with services in kind (e.g. seeds and fertilizers), advice on cultivation techniques or preferential financial terms, especially for greenfield suppliers. Local sourcing therefore translates into benefits for both sides: it keeps costs down for a foreign corporation and scales up opportunities for farmers. Overall, “the economics of doing it locally are better”, summarises Richard Morgan, Corporate Relations and Communications Director at Unilever.

INTER-REGIONAL DIFFERENCES: MARKET SIZE MATTERS

Some areas of the continent attract intensive business activity, but others remain marginalised from economic dynamism. North Africa leads with the highest number of foreign agro-food companies (Figure 1). Relatively high levels of economic growth, reinforced by strong ties with the European single market, progress in economic liberalisation and improvements in the infrastructure system have positioned the region as the main competitor to South Africa’s long-established market.

Figure 1. Foreign Agro-Food MNCs in Africa



Note: The number of companies present in each region covers only those listed in Fortune Global 500 and may include multiple subsidiaries of the same firm.

Source: OECD Development Centre (2008).

Southern Africa as a whole also ranks high among foreign MNCs, second only to North Africa. By contrast, West, East and Central Africa have less attraction for foreign corporations, although individual countries in these regions offer good fields for foreign agribusiness multinationals.

The concentration of agro-food firms is higher in countries with above-average GDP (economic size) and GDP per capita (a proxy for the level of development). Thus Nigeria — with 47 per cent of the entire population of West Africa and a GDP more than 1.5 times the aggregate GDP of the rest of the region — is the most important hub in West Africa. It hosts about one-third of the leading international agro-food corporations.

In East Africa, Kenya is the number one destination for foreign MNCs, and it dominates in terms of market size. The geographical concentration of large agro-food enterprises in major regions and countries of Africa underscores the importance of the size of a target economy as a criterion for doing business.

ASIA VENTURING INTO AFRICAN FIELDS

Petroleum and metals from Africa, in high demand from Asia, boost Africa-Asia trade relations. Agro-related products have also taken an increasing share of trade flows between the two continents. The world’s two most populous countries, China and India, are among Africa’s most important export markets for agricultural products, accounting for about 7 per cent of world agricultural imports from Africa.

The relationship goes beyond just arm’s-length trade. Asian agribusiness companies invest directly in the African continent. The Currimjee Group, based in Mauritius, has adopted such a strategy. A commodity trading company founded by an Indian entrepreneur back in 1890, it later diversified into distribution and services across various African countries. Bottling, marketing and distribution of Pepsi Cola and mineral water are some of its activities.

Olam International, founded by the Indian diaspora in Singapore, spreads across 24 countries throughout Africa and "plans to expand its coverage to 10 more countries in the next 3 years and to the whole continent in the next 10 years", according to M.D. Ramesh, President and Regional Head – Southern and East Africa. Not only does the company span the globe, it also integrates entire supply chains into its management strategy. Olam taps into sourcing, processing and distribution of raw materials such as cocoa, sugar, beans and nuts. The company fully recognises the continent's potential and re f ects this in its portfolio. Africa generates 27 per cent of its total sourcing volume and 29 per cent of sales turnover.

Rice extension farming in Nigeria and outgrowers' programmes in cashew processing in Tanzania and Mozambique exemplify Olam's approach in linking farmers to its supply chain. It supports farmers with activities like extension services, training, produce purchases and acquiring farm equipment.

Olam boasts of the employment it generates: 5 200 outgrower farmers in Nigeria (compared with only 1 000 in 2005); 5 500 women in cashew processing in Tanzania; and 3 000 employees in Mozambique (thousands of incremental jobs have been created since 2005 in both Tanzania and Mozambique). Olam plans to "support 50 000 farmers through rice-farming initiatives by 2010", says Ramesh.

* The authors would like to thank Phoebe Bennett (Accenture), Roy Beadle, Dr. Peter Gibbon (Danish Institute for International Studies), Ben Guest and Karin Müller (British American Tobacco), David Grant, Eric Leong and Christine Thompson (SABMiller), Richard Morgan (unilever) and M.D. Ramesh (Olam) for their valuable insights provided during interviews.

ARTICLE TWO

Global Agro-Food Supply Chain: Is There Space for Africa?

Katharina Felgenhauer and Patrizia Labella*

- Large African agro-food companies are moving beyond national borders and challenging globally leading multinational corporations (MNCs).
- Their internationalisation goes beyond continental borders, and they increasingly seek co-operation with foreign MNCs.
- Rising investor interest both within the continent and beyond offers indigenous companies easier access to finance.

Internationally active corporate giants such as British American Tobacco, Unilever and Coca-Cola are not the only companies leveraging the African agro-food market. A growing array of medium-to-large indigenous companies is moving beyond national borders to operate in neighbouring countries.

AFRICAN COMPANIES ON THE RISE

African companies show enormous potential: the turnover of the leading 100 African firms ranked by *Jeune Afrique* increased by 12.3 per cent in a single year, 2005/06. In the Global 2000 ranking published by the American *Forbes* magazine, 17 South African companies, five in North Africa and one from West Africa ranked among the top global firms. Today, the South African food services supplier Bidvest plays in the same league as France's Sodexo. Similarly, South African Sasol competes in the chemical and fuel industry with US-based Chevron and Dutch Royal Shell.

In the agro-food industry, the combined revenue of the 111 largest African companies places the sector second after the oil, gas and fuel industries. To escape saturated domestic markets, the rising challengers to foreign corporate giants explore new frontiers in neighbouring countries. Households in Burkina Faso, Côte d'Ivoire, Gabon and Gambia use the oils and soaps produced by the Moroccan Lesieur Cristal. Namibian Breweries supply beverages to ten other countries in Southern and Eastern Africa. Additions to this list are easy to find.

South Africans still have the lion's share of this business expansion. The globally successful brewer SABMiller originated in South Africa and now has brewing and beverage interests (e.g. bottling services for Coca-Cola) in 30 African countries. It now outperforms the local competitor Distell Group, ranked second in the beverage sector, four times in revenue. The South African Illovo Sugar, which cultivates and refines sugar, manages factories in Malawi, Tanzania and Zambia. It has recently opened a new establishment in Mali.

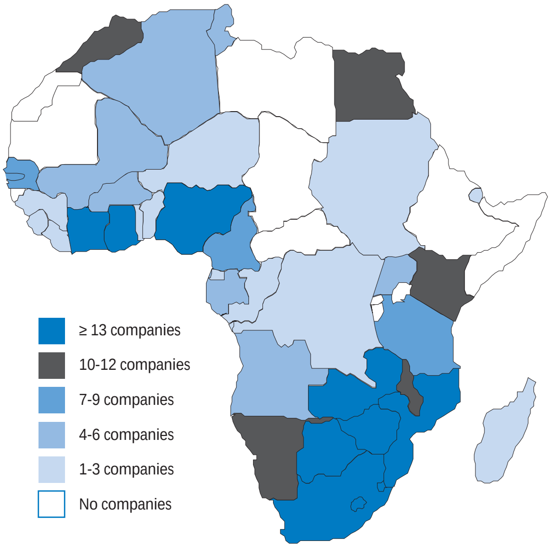
REGIONAL CONCENTRATION OF GROWTH

While South Africa boosts the entire region, West Africa also attracts many domestic firms in the agro-food sector (Figure 1). In terms of the number of leading African companies present, the region followed Southern Africa and overtook North Africa in 2007. Nigeria is the most important regional economic hub.

East Africa encounters difficulties in nurturing strong domestic enterprises but excels in attracting companies from other African countries. The region is a favoured FDI destination partly because of an ongoing regional integration initiative, the East African Community (EAC) of

Kenya, Uganda and Tanzania. Implementation of its customs union protocol in 2005 largely eradicated intra-regional trade barriers.

Figure 1. Geographic Distribution of African Agro-Food Enterprises and Their Target Markets



Note: Figures include headquarters and target markets.

Source: OECD Development Centre (2008), based on *Jeune Afrique* (2007).

Central Africa lags seriously behind in terms of successful domestic agro-food f rms. Only a few companies have headquarters in the region, although agriculture has a major share of GDP. Central Africa remains a small and fragmented market with regional integration efforts among the least developed.

LOCAL MARKETS, INTERNATIONAL GROWTH

Local and regional demand primarily nurture the growth of African agro-food companies. Retailers provide a good example. While independent, small owner-operated shops slowly disappear, large supermarket chains have extended their geographic reach. With market liberalisation and especially urbanisation, supermarket chains are spreading rapidly throughout Africa.

Local companies take advantage of the scarce foreign presence in retail and distribution and are rapidly expanding. Among the top foreign retailers, only Metro and Carrefour have a physical presence in the continent. The South African players Pick'n Pay, Massmart and Shoprite head the league of African f rms. They not only shield their domestic markets from foreign distributors but also speedily spread to neighbouring countries, where they either invest in new supermarkets or license their brands to franchise partners competing with local informal markets.

Other African companies also seek their share of the pie. Increasingly aggressive players include Morocco's Marjane, Ghana's Produce Buying Company and Prosuma of Côte d'Ivoire. The supermarket Nakumatt, headquartered in Kenya, pursues investment interests in Rwanda, Uganda and Tanzania. The emergence of these important actors underlines the strengthening of the food-production chain in the continent.

African consumer markets have many other niches for local companies to explore. Major beer brewers have ventured into local markets by substituting locally grown sorghum for imported barley malt. The f nal products, such as SABMiller's Eagle Lager, are cheaper than other beers and reach poorer households, although the impact of rising food prices on consumption and market opportunities is diff cult to predict.

REACHING BEYOND THE CONTINENT

Internationalisation needs not remain within continental borders. SABMiller has established its brand across the globe. Several food-processing companies, e.g. Cameroon's Société Nouvelle des Plantations du Haut-Penja and Cairo Poultry Ltd., readily export their products worldwide.

Successful African agro-food businesses increasingly seek co-operation with non-African companies. Morocco's ONA group partners with Lesieur France, while Tunisia's Régie Nationale des Tabacs et des Allumettes collaborates with British American Tobacco. Nigeria's Dangote Sugar Ref nery imports raw sugar from Brazil to process it at home for industrial and domestic consumption (see Box 1).

Box 1. Dangote – Nigerian Ventures in Foreign Markets

Dangote Sugar Refnery Plc from Nigeria illustrates internationalised African business. The company imports raw sugar from Brazil, refnes it into Vitamin A-fortifed white sugar and sells the fnished product to consumers across Nigeria and beyond. Dangote also supplies unfortifed sugar to large industrial users, including Nestlé, Cadbury, Seven Up Bottling Company and Nigerian Bottling Company.

Dangote's products rapidly found their way into neighbouring West African countries through informal cross-border trading. In December 2007, the company offcially entered the West Coast market with a successful frst consignment to Ghana. The frm expects its exports to grow between 15 per cent and 20 per cent over the next fve years. Offces will open soon in Congo, Ghana and Liberia.

The company follows an even more ambitious vision, with plans to open a sugar refnery in Algeria already underway. Sugar consumption in Algeria consistently exceeds home-market fgures, despite the country's smaller population than Nigeria's. Moreover, Dangote's presence in North Africa would grant access to European customers. The timing could not be better for the Nigerian company, because the EU is progressively removing subsidies on domestic sugar production under a 2005 WTO ruling.

AFRICA: A NEW FRONTIER FOR INVESTORS

Higher FDI outfows from African companies provide additional proof of indigenous frms' progress towards internationalisation. They surged in 2006 to $8 billion, quadrupling from the year before. According to UNCTAD estimates, South Africa accounted for four-ffths of the total outfows across sectors. Nigeria, Liberia and Morocco followed with outfows ranging from $0.2 to $0.4 billion.

Increasing quotations on local stock exchanges have made headlines among brokers and traders. Firms across the agro-food value chains are quoted not only in Johannesburg – the principal market in Africa – but also in "non-traditional" territories across the continent, from Egypt to Namibia and from Kenya to Côte d'Ivoire.

These positive developments facilitate access to fnancial resources for African private companies and spur the rise of indigenous investors. The African Venture Capital Association, a global network of private equity organisations, counts more and more members from Africa. The interest of all international investors in the continent is rising. "Where others see bottlenecks and gaps, we see investment opportunities", explains Allan Kamau, Managing Director of Africa Investor.

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* The authors would like to thank David Grant, Eric Leong and Christine Thompson (SABMiller), Allan Kamau (Africa Investor), and Willi Graf, Lukas Rüttimann and Peter Tschumi (SDC) for their valuable insights provided during interviews.

ARTICLE THREE

Private Equity: Helping to Fill Africa's Financing Gap?

Thomas Dickinson*

- Booming private-equity investment in Africa and the Middle East reached $5 billion in 2007.
- Risk premiums have fallen significantly for African private-equity investments.
- With the commitment of African governments to foreign investment, the African private-equity boom looks set to continue.

All but the largest of African companies still have great difficulty in raising capital at competitive rates through conventional channels, such as borrowing from banks or issuing public securities. When necessary capital for new investments is unavailable or unaffordable, firms find their competitiveness and growth constrained. Private equity can serve a useful role in filling the gap between self-financing and conventional capital-market activity for the continent's dynamic and growing private enterprises.

Drawing attention as an effective and innovative vehicle for private-sector development on the continent, private equity has benefited from improvements in African investment environments and enjoyed some spectacular successes, such as the private-equity-backed African telecommunications pioneer Celtel's $3.4 billion buy-out in 2006.

The recent global boom pushed demand for African assets to new heights. Low correlations with global markets, high liquidity and the commodities boom all fuelled investment, but they also tended to force opportunities outside the primary sector into the background.

In contrast, private equity has tended to work against the grain of international investment, focusing its attention less on raw materials and the extractive industries than on the consumer-related and communications sectors[1]. Such investments arguably have a stronger impact on Africans' daily lives than do large extractive projects, making private equity stand out as a dynamic and diversified complement to classic sources of foreign investment in Africa.

Private equity, through investment in local firms, can perhaps play a catalytic role more efficiently than other forms of foreign investment where spillovers are not guaranteed. By bringing outside funds and expertise to work with local firms, private equity raises efficiency and directly transfers skills to the countries in which it operates.

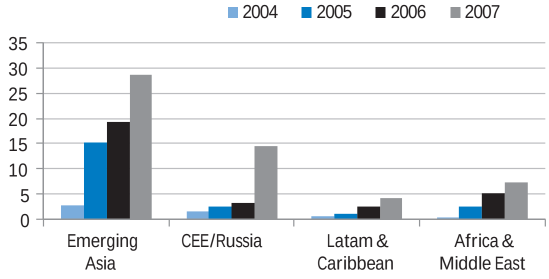
Strong private-equity investment in Africa rose by nearly 200 per cent to $2.3 billion in 2006[2]. This brought the sub-Saharan Africa (SSA) share of global private-equity funds to 7 per cent, well behind Asia (58 per cent), but comparable to other emerging regions (Latin America: 8 per cent; Middle East / North Africa: 8 per cent; Central & Eastern Europe (CEE) / Russia: 10 per cent). More generally, funds focusing on North Africa and the Middle East grew by 50 per cent over 2004-2007 (Figure 1).

African funds, while still small by international standards, have rapidly increased in both size and reach: Pamodzi, a South African private-equity firm, launched the continent's largest ($1.3 billion) pan-African fund in 2007. International financial institutions have also developed their own vehicles: Citigroup launched a $200 million fund early that same year.

1. African Venture Capital Association, South African Venture Capital Association, 2007.

2. *Ibid*.

Figure 1. Developing World Private Equity
(Funds raised, 2004-07 – $ billion)



SOUTH AFRICA

The South African private-equity industry, mirroring the country's fnancial predominance, is the largest on the continent, at 1.7 per cent of GDP – a fgure comparable to those of many developed markets (Europe: 1.5 per cent; the United Kingdom 3.7 per cent; North America: 2.8 per cent)[3], and 17th in the world in terms of investment activity (2005). South Africa saw a 409 per cent increase in managed funds in 2006, to ZAR 11.2 billion ($1.6 billion). South African funds manage over 80 per cent of total SSA private-equity capital, followed by Nigeria with 10 per cent.

CHANNELS FOR INVESTMENT

Developed economies, particularly the United States, remain the major source of capital, accounting for 50 per cent of total funds raised for African investment in 2006. Europe's share was 9 per cent. A quarter of the funds raised for the continent are South African, continuing a growing trend towards local sourcing. For the frst time, a third of the capital raised in South Africa also came through foreign pension and endowment funds, revealing institutional investors' growing appetite for and confdence in African assets.

Public funds, particularly from European development -fnance institutions, are also important sources of capital. Seeking to foster private-sector activity, these government-backed agencies have historically served as important guarantors of private-investment funds on the continent. Representative entities include France's Proparco, the Netherlands' FMO and Britain's CDC (formerly Commonwealth Development Corporation), with $845 million committed in Africa since 2004 through 12 African fund managers (see the next article for further details).

AN IMPROVING INVESTMENT ENVIRONMENT

Over recent years, African governments have made serious progress in adopting market-friendly policies, improving investment environments and taking energetic steps to stimulate foreign involvement. Forty African countries introduced new measures promoting foreign investment in 2006. Botswana, Burkina Faso, Burundi, Cape Verde, Ghana and Namibia all allowed foreign participation in the telecoms industry. Important banking-sector reforms took place in the Republic of Congo, Egypt and Nigeria. Morocco legalised foreign ownership of large tracts of land. Several countries eased registration and taxation constraints on new businesses and established special investment zones.

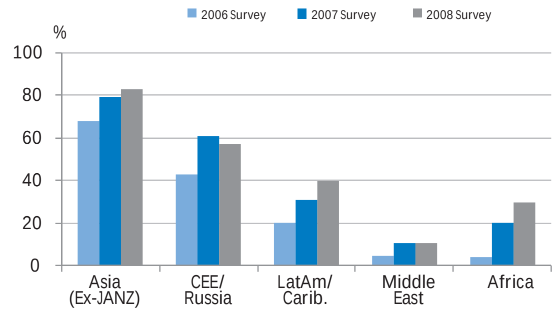
Private-equity companies themselves have become much more attuned to the realities of investing in developing countries. They often employ local managers and base their offces within their countries of operation.

In the Emerging Markets Private Equity Association (EMPEA) 2008 LP Survey, Africa ranked ffth out of ten regions and countries in attractiveness for investors. This strong and sustained increase in investor confdence indicates the change in perception that Africa has enjoyed over recent years, passing from backwater to the oft-touted "last investment frontier". Furthermore, private equity also helps to attract young and highly qualifed Africans back to work in the region, bringing with them both human capital and high aspirations for the continent.

According to the same survey, Africa has gained enormously in private-equity investors' investment strategies, moving from barely registering at 4 per cent in 2006 to 30 per cent in 2008 (Figure 2). In terms of planned investment strategies, investors' desire for increased diversifcation works to Africa's advantage, with over 50 per cent of private-equity investors including Africa in their medium-term (three to fve years) investment strategies.

3. Funds under management in December 2006 for South Africa, December 2005 for Europe/USA.

Figure 2. Current Investment Strategy

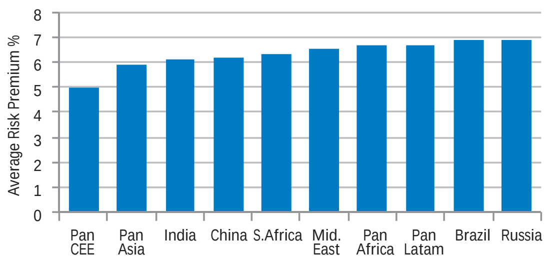


Note: Ex-JANZ: excludes Japan, Australia and New Zealand.

Source: EMPEA (2008*b*).

Africa also compares favourably with other developing regions in terms of expected returns on investment, reflecting the exuberant mood of the sector towards the region. The perceived risk premiums (Figure 3) assigned to the Africa region in the same EMPEA survey also registered a sharp decrease in 2006-2007, falling from 8.9 per cent to 6.7 per cent. Furthermore, return expectations of African funds rose slightly over the same period, in contrast to those for other regions such as Asia, the Middle East and the CEE, whose funds registered a slight decline.

Figure 3. Assigned Risk Premiums, 2008 EMPEA Survey



Source: EMPEA (2008*b*).

Although this is not the first private-equity surge in the developing world – the first half of the 1990s saw a short boom in Latin American private equity – the context for investment in Africa today is better grounded than ever before. Private equity in particular, with its consumer-oriented investments supplying fast-growing domestic African markets, contributes to the major shift in perceptions of Africa from investment backwater to frontier of opportunity.

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* The author would like to thank Kofi Klousseh (Helios Capital) and Jean-Marc Savi de Tové (CDC) for their valuable insights and suggestions.

ARTICLE FOUR

Development Finance Institutions: Profitability Promoting Development

Thomas Dickinson*

- Development finance still plays a critical role in financing private enterprise in Africa. It deserves further promotion as an important complement to overseas aid.
- Development finance institutions (DFIs) are cost-effective for donor countries and efficiency-enhancing for countries where funds are deployed.
- DFI partnerships with private investors in project finance provide a rich potential source of development externalities.

WHAT ARE DFIs?

Development finance institutions (DFIs) occupy an intermediary space between public aid and private investment, "facilitating international capital flows" in the words of the Chief Executive of CDC, Britain's DFI. Distinct from aid agencies through their focus on profitable investment and operations according to market rules, DFIs share a common focus on fostering economic growth and sustainable development. Their mission lies in servicing the investment shortfalls of developing countries and bridging the gap between commercial investment and state development aid.

DFIs provide a broad range of financial services in developing countries, such as loans or guarantees to investors and entrepreneurs, equity participation in firms or investment funds and financing for public infrastructure projects. DFIs will initiate or develop projects in industrial fields or in countries where commercial banks are reticent about investing without some form of official collateral. DFIs are also active in financing small and medium-size enterprises, supporting micro loans to companies often viewed as too risky by private sources of financing. A benefit of this approach is that DFIs often find themselves with first-mover advantage in markets with strong growth potential. A case in point is the famous African experience of the Celtel telecommunications company, where DFIs invested early as part of their developmental charter and later found themselves with enormous profits.

DFIs depend on profits from their investments to ensure resources for further engagements. Currently, this model is proving successful, with institutions such as CDC or the European Bank for Reconstruction and Development (EBRD) outperforming emerging-market indices (see Box 1).

Box 1. DFIs Outperform

Britain's CDC showed a return of 33 per cent in 2007 outperforming the global Emerging Markets Bond Index (EMBI) by 20 per cent.

The consolidated portfolio of European DFIs at year-end 2006 reached €12.3 billion, up from €10.6 billion in 2005.

Bilateral DFIs, majority-owned by national governments, have served historically to implement governments' foreign development and co-operation policies. Multilateral DFIs, also known as international finance institutions (IFIs), usually have greater financing capacity and provide a forum for close co-operation between governments.

Both types of institutions retain operational independence from their funding governments. Backed by government funds and guarantees ensuring their credit worthiness, DFIs can raise large amounts of funds on international capital markets to provide loans or equity investment on competitive, even subsidised terms.

RISK AND INVESTMENT PRACTICES

Through their developmental mission and public funding, DFIs have by definition a higher risk tolerance and a longer investment horizon. They can call upon the guarantees of the state and are free from the short-term constraints of private investors. Thus, they have the capacity to make long-term investments at attractive rates in markets to which the private sector finds it too risky to commit. Furthermore, DFIs pay no corporate tax or dividends[1].

Bilateral DFIs tend to make partnerships with the private sector in developing countries, while the regional development banks (see Table 1) generally focus primarily on loans to the public sector (e.g. via sovereign loans for commercially–run public enterprises). The Asian Development Bank (ADB) also has major exposure to equity investments in the private sector. The EBRD provides direct investment on commercial terms not only to public and private projects, such as infrastructure, but also to large commercial ventures in its region of specialisation (Eastern Europe to Central Asia).

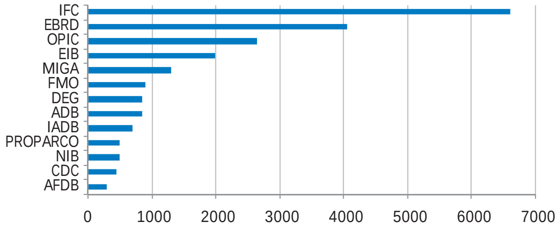
Table 1. Major DFIs

Bilateral		Regional	
CDC	United Kingdom	ADB	Asian Development Bank
PROPARCO	France	IADB	Inter-American Development Bank
FMO	Netherlands	AfDB	African Development Bank
DEG	Germany	EIB	European Investment Bank
OPIC	United States	EBRD	European Bank for Reconstruction
Multilateral			
IFC	International Finance Corporation		
MIGA	Multilateral Investment Guarantee Agency (World Bank)		

Source: Velde and Warner (2007).

The IFC and EBRD are by far the biggest DFIs in terms of annual commitments to the private sector (see Figure 1). Some concentrate primarily on loans (EIB, Proparco), others primarily on equity (CDC). The equity portion within the total portfolio of European DFIs reached 52 per cent in 2006, up from 41 per cent in 2005[2], a significant shift away from loan finance towards equity stakeholding. AfDB, ADB and IADB lend principally to sovereign states.

Figure 1. DFI Commitments to the Private Sector, 2005
(to developing countries, USD million)



Source: Based on Velde and Warner (2007).

The financial support that DFIs bring to relatively high-risk projects aims to serve as a catalyst to attract and mobilise the involvement of other sources of private capital. Development banks also often act in co-operation with governments and other organisations in providing funds for management consultancy and technical assistance, and serving as channels for policy implementation in areas such as governance, compliance with environmental regulations, good business practices and sustainability.

DFI involvement can mitigate risk with public guarantees in countries and sectors where private investors would be unwilling to operate alone. Their public status allows DFIs to make loans with longer maturities and at good interest rates, to provide advantageous guarantees and to undertake high-risk equity investment. DFIs may also help lower the cost of capital for firms through partial credit-risk guarantees.

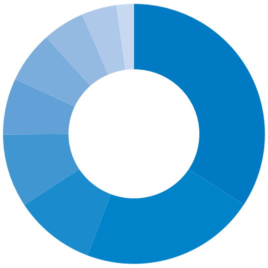
1. Only FMO and Proparco pay dividends because they are partly owned by private banks. The EBRD has discussed a dividend, but rejected it in favour of a grant fund. *Source:* ODI, interviews with EBRD officials.

2. *Source:* European Development Finance Institutions (2008).

DFIs FOR AFRICA

Although Africa remains marginal in the portfolios of some large DFIs such as the IFC, it is rapidly growing in importance. Britain's CDC in 2007 held half of its total portfolio in African investments, across a broad range of sectors and industries. This underlines the important difference from traditional FDI, which goes overwhelmingly towards extractive industries (see Figure 2).

Figure 2. CDC African Portfolio by Sector 2007



	%	USD million
Financial services	34	200
Materials	22	127.2
Consumer	10	58.8
Telecoms	9	53.3
Industrials	7	40.7
Infrastructure	6	37.5
Energy	5	30.5
Agribusiness	4	25.6
Health care	2	12.7

ISSUES FOR DFIs

DFIs must tread carefully to avoid the risk of crowding out private investors through their subsidised pricing structure. Many DFIs (e.g. IFC, EBRD) have explicit mandates not to compete or bid against private f rms and banks and to play a delicate balancing act, providing f nance just beyond the frontiers of private involvement. Others, such as Britain's CDC, choose to invest through intermediaries, thus mitigating the risks of direct involvement and economising on in-house capacity.

The double objectives pursued by DFIs express the contradiction of seeking both prof t and development. On the one hand, DFIs must invest shrewdly and generate returns; on the other, they must facilitate the economic development of the countries in which they invest. Balancing social and f nancial returns can be complex, time-consuming and sometimes contradictory, especially in light of diff culties in measuring the social impact of projects.

DFIs actively promote best practices in business and environmental terms. Although some people argue that strict social and environmental sustainability policies constrain their f exibility and capacity to close deals, anecdotal evidence indicates no adverse impact on returns to date.

Investor enthusiasm for emerging and frontier markets has helped DFIs in their mission to promote investment in developing countries. Return-hungry private investors have even edged out DFIs in a number of markets — EBRD out of Eastern Europe, most notably. This is a sign of success. Experience is building up throughout many developing and frontier markets, and impressive track records are emerging as many markets become mainstream and better information reduces private investors' fear of committing.

It remains to be seen what DFIs will do in the face of important market shifts like growing domestic capital sources in the developing world. DFIs will have to adapt to the gradual mainstreaming of many hitherto off-limits markets and to the very strong commitments of certain emerging countries in developing-world infrastructures — for example, China's involvement in African infrastructure. For-prof t f rms already undertake much microf nance activity, and local high-net-worth individuals often cover small-cap venture-capital markets, as in Nigeria[3].

The best way forward for DFIs may be to continue in their catalytic role through tighter collaboration with private investors and stakeholders, to share f nancial risk while maintaining their strong commitment to promoting best practices in their invested funds and projects.

DFIs should not lose sight of their responsibility to expand access to f nancing through consistently searching out under-invested countries and sectors, while working to maximise the social outcomes of their projects. This diff cult and sometimes contradictory mission has proved remarkably successful.

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* The author would like to thank Phillipe Belot (EBRD), Pauline de Saint-Gérard and Anne-Lucie Lafourcade (BlueOrchard Finance), Kofi Klousseh (Helios Capital) and Jean-Marc Savi de Tové (CDC) for their valuable insights and suggestions.

3. According to Helios capital, a London-based private equity firm, only mid-size venture capital investment is profitable in Nigeria, as the market for small venture investments (over $5 million) is already covered by high-net-worth Nigerians.

ARTICLE FIVE

Outgrower Schemes: Why Big Multinationals Link up with African Smallholders

Katharina Felgenhauer and Denise Wolter*

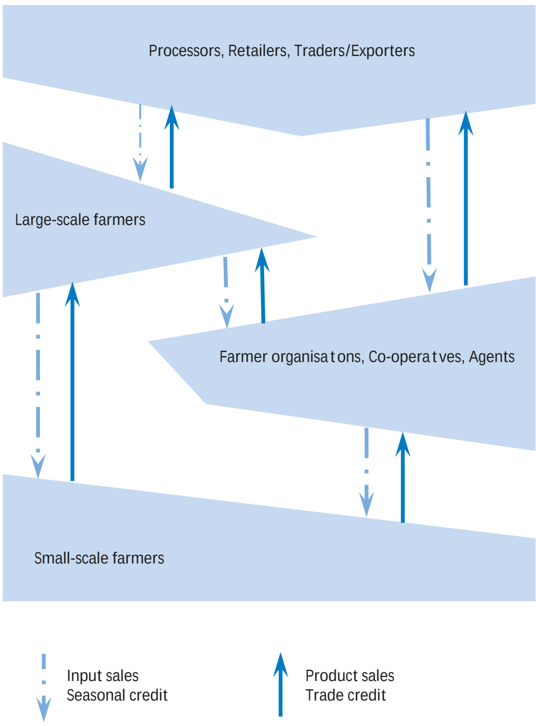
- Outgrower schemes in the agricultural supply chain present opportunities for globally active firms and local smallholder farmers alike.
- These schemes are attractive models for agro-food companies: they ensure control over sourced supply while at the same time granting access to local markets.
- Key ingredients for success are a long-term business interest and the development of mutual trust.

Africa is reappearing on the radar screens of international investors, but so far they have concentrated on extractive industries, especially minerals and oil. Despite its immense potential, Africa's agricultural sector does not lend itself easily to investment. Next to classic constraints such as insufficient infrastructure or insecure property rights, the production structure itself acts as one of the most severe impediments to commercial development.

African agriculture remains dominated by smallholder farmers working on fields of less than three hectares, and it is not obvious for a foreign multinational to engage with small-scale farmers. Yet companies actually have found ways to effectively deal with this challenge – through outgrower schemes.

Such schemes, also known as contract farming, are defined broadly as binding arrangements through which a firm ensures its supply of agricultural products from individual farmers or groups of them. Co-ordinated commercial relations between producers, processors, and traders replace ad hoc trade agreements, leading to vertical integration of the agricultural value chain. The schemes embrace a variety of arrangements, which differ according to the partners' input and management obligations (Figure 1). The following discussion will reveal why private firms find such partnerships attractive and how they can succeed.

Figure 1. Outgrower Schemes



THE PRIME MOTIVATIONS: ENSURING SUPPLIES …

Outgrower schemes offer improved control over supply. Large private companies show interest in them if the desired produce is not easily available or quality standards are insufficient. Tobacco, for example, depends on specific local soil and climate conditions. British American Tobacco has contract farming schemes to cover 70 per cent of its supply needs; the rest comes from private suppliers, e.g. in Malawi or Zimbabwe.

The South African brewery SABMiller initiated contract farming in India and South Africa when yields turned out to be unsatisfactory. Through its direct involvement, the company injected management know-how and improved technology to raise and maintain standards. As a result, the firm has enabled its producers to meet future supply requirements, thus ensuring the sustainability of these business relations.

… AND EXPLORING LOCAL MARKETS

Outgrower schemes also attract firms seeking to explore local market opportunities. SABMiller engaged in smallholder-based production in Zambia and uganda to respond to local demand as well as to get excise tax breaks. Adapting products and prices to local preferences allows tapping into underexplored niches.

To target local markets, "home-grown" approaches are on the rise. SABMiller aims to increase sourcing from Africa to between 60 per cent and 70 per cent. The benefits are evident. Local sourcing minimises production and transaction costs while stimulating local demand. Direct control over crop production also diminishes vulnerability to commodity price fluctuations and facilitates the implementation of quality standards.

A LONG-TERM PERSPECTIVE IS INDISPENSABLE

Companies do not find smallholder-based contract-farming schemes easy to implement. They may take years to set up. This makes a long-term business interest an indispensable prerequisite. The US-based restaurant company Darden Restaurants got involved in African fish farming out of long-term self-interest in sustaining fish stocks. Yet it took five years to set up the supply chain. As put by Alexandre Cantacuzène, Senior Vice President for Asia, Oceania and Africa of the Swiss-based food and beverage company Nestlé: "We are in a country to stay." Nestlé seeks only long-term engagements in Africa and has operated on the continent since the 19th century, irrespective of political and economic problems.

Similarly, the Dutch cocoa processor ADM goes a long way to ensure its cocoa supplies in Côte d'Ivoire, where only two estates are bigger than 50 hectares; the rest of the cocoa production comes from about 800 000 smallholder farmers. Commerce is controlled by 500 licensed private traders (80 per cent) and 500 co-operatives (15 per cent), which supply 50 licensed exporters. ADM must therefore source mainly from co-operatives and has an interest in ensuring their sustainability.

To achieve this, ADM has developed a co-operative "graduation" scheme. When co-operatives prove to be reliable partners for two or three years, they gradually become eligible for technical training and extension services provided by ADM. Because the quality of the cocoa produced influences the price ADM pays, co-operatives have a high incentive to participate in the scheme. The company also offers agricultural finance, investing several million euros in co-operatives each year with a default rate of less than 1 per cent. Currently, ADM services reach about 12 000 farmers.

The imperative lies in making business "inclusive", tackling yields, quality, skills development and supply-chain linkages simultaneously, as described by the World Business Council for Sustainable Development (WBCSD). Yet only commercially oriented partnerships can be sustainable in the long run. By strictly linking its outgrower schemes to core business, SABMiller has achieved the greatest impact in terms of scalability and sustainability, summarises Christine Thompson, Policy Issues Manager.

THE BIGGEST CHALLENGE FOR BOTH SIDES: ESTABLISHING TRUST

The key to any successful business, including sustainable contract farming, lies in knowing your partner — but neither the investors nor the farmers have this knowledge when initiating outgrower schemes. Trust can emerge only over time, and the fear of exploitation needs resolution.

Here, donor support can be crucial. Outgrower schemes naturally involve information asymmetries related to production and marketing. The Swiss Agency for Development and Cooperation (SDC) has realised that any support aimed at leveraging the smallholders' potential requires consistent dialogue with stakeholders and beneficiaries, including the private firms involved. Focus areas of intervention need determination in partnership to capitalise on local natural, institutional and political resources. It is crucial to address from the start a multitude of issues, such as the costs and benefits of production choices faced by farmers, what varieties to plant, when to harvest, how to store, and where and how to market.

At the same time, the cost of developing trust works towards ensuring long-term business relations. The Dutch supermarket chain Ahold searches for new suppliers only when needed, i.e. in cases of change in demand or general supply shortage. The company also minimises its communication costs and risks by working only with exporters who organise the sourcing among smallholders themselves.

Working with partners who assume the responsibility of co-ordinating farmers seems an attractive option. The Dutch development bank FMO suggests an "estate model", where a central management unit serves as a hub for suppliers and handles the transfer of knowledge and technology. Consequently, the mitigation of costs and risks in centralised outgrower schemes attracts investors as well; FMO is willing to finance such models at lower interest rates of 8 per cent to 10 per cent.

WAYS FORWARD

With initial constraints overcome, outgrower schemes provide firms with the opportunity to control supply while helping farmers improve production standards. Both sides stand to gain, and under the current smallholder production system, contract farming appears to be the main road towards making African agriculture more market-oriented. Linking smallholders to firms, therefore, also figures prominently on the agenda of governments and donors. Questions nevertheless arise about how such schemes preserve the current smallholder structure of African agriculture and whether this is a desirable outcome.

* The authors would like to thank Marc Buiting (FMO), Alexandre Cantacuzene (Nestlé), Roy Beadle, Ben Guest and Karin Müller (British American Tobacco), Alain Frédéricq (ADM Cocoa International), Willi Graf, Peter Tschumi and Lukas Rüttimann (SDC), David Grant, Eric Leong and Christine Thompson (SABMiller), Eva Haden, Roland Hunziker and Filippo Veglio (WBCSD), Deborah Vorhies (ICTSD), Bill Vorley (IIED) and Roland Waardenburg (Ahold) for their valuable insights provided during interviews.

ARTICLE SIX

Africa Can Develop Domestic Agribusiness Better

Yoshiko Matsumoto-Izadifar*

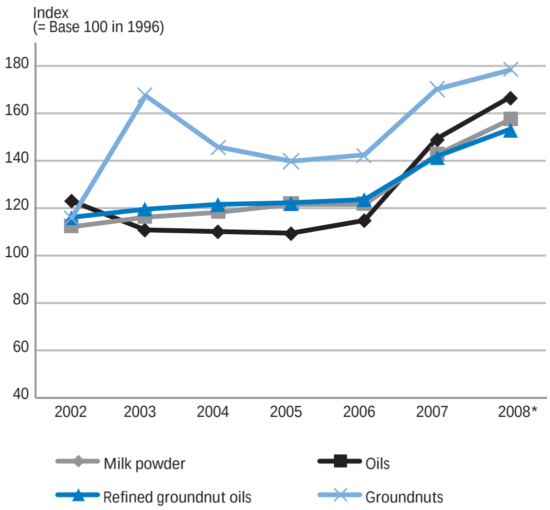
- Higher primary-commodity and food prices in the global marketplace could transform the African food market, including that of processed foods.
- Senegal exemplifies how private enterprises and entrepreneurs are rapidly exploiting new business opportunities in domestic food markets.
- Sustaining private business initiatives needs more public support.

Surging world food prices have highlighted Africa's heavy dependence on food imports: 52 per cent of sugar and sugar products, 30 per cent of vegetable oils and 10 per cent of milk products consumed in the countries of sub-Saharan Africa between 1996 and 2003 came from abroad. Moreover, higher basic-food prices directly affect African consumers. For example, Senegal experienced a 29 per cent increase in the price of milk powder and a 17 per cent increase in the price of oils between 2006 and 2007 (Figure 1).

Higher primary-commodity and food prices in the global marketplace could transform African food markets, including that of processed foods. Following a number of demonstrations and sometimes riots against high food prices, African governments have turned their attention to the potential of domestic agriculture to meet food requirements at home. Private enterprises and entrepreneurs are rapidly adapting their business strategies to the new market conditions.

This geo-economic situation has resulted in renewed political attention to the overall potential of African agribusiness. The discussions, however, focus mainly on upstream activities (the production segment of the value chain) rather than downstream ones (processing and marketing); the latter have not fully received the attention they deserve, especially in view of developing small, local, food-processing industries.

Figure 1. Evolution of the Food-Price Index in Senegal
(Annual averages, 2002-08)



* Index as of February.

Source: Ministry of Economy and Finance of Senegal (2008).

POOR INCENTIVES TO DEVELOP LOCAL PROCESSING

Rapid urbanisation in sub-Sahara African presents great business opportunities. Since the 1970s, the urban population in Africa has grown and will continue to grow much faster than in any other part of the globe (3.4 per cent annually in 2010-15 — 40 per cent more rapidly than in Asia). According to United Nations estimates, more than half the population of sub-Saharan African countries will be living in towns in 2030. These urban consumers will demand better and more diversified food products.

Yet African economic and political circumstances have not favoured the development of the domestic food-processing sector, for three reasons.

- *First,* incumbents enjoy monopolistic rents and tend to discourage new entrants.
- *Second,* rapidly growing urban food markets have resulted in massive food imports. Benefting from economies of scale (and partly from subsidies in developed countries), food imports tend to be cheaper than domestically produced foods. Moreover, because imported foods are marketed better, African consumers prefer them, associating them with high product quality.
- *Third,* African domestic politics have historically been biased in favour of export crops. Consequently, domestic and regional market opportunities for food crops have been neglected in policy formulation (see the next article). At the same time, massive numbers of local micro- and small-scale agro-food processers remain small and unstructured, missing opportunities to develop.

THE PRIVATE SECTOR LEADS THE GLOBAL MARKET CHANGE

How can sub-Saharan African countries reverse these traditional tendencies? Answers have started coming from the private sector. Although the markets are not large, private companies relying on domestic or foreign capital and micro- and small-scale food processors have found domestic food processing proftable.

Case 1 - Expanding Businesses in Domestic Markets

Advens, of French origin, is the leading export-oriented company in the food-processing industry in Senegal. After initially exporting food from Europe to Africa, Advens has gradually engaged in local processing of groundnuts and cotton.

The current global context has favoured the company. Not only does it beneft from surging demand from China for groundnut oils, it also sees a growing domestic business opportunity and plans to introduce new products like groundnut milk and four into the Senegalese market in the coming years.

Case 2 – Re-boosting Local Processing Capacity

With decades of operational history, the Senegalese company Socas produces tomato paste by processing local fresh tomatoes. It represents a rare example of vertical integration by linking production to processing at the local level.

Socas has also experienced reduced marketing constraints. Soaring global agriculture prices have stopped mass smuggling of imported products, which used to erode the company's proft margin. Benefting from the results of its years of investment in local fresh tomato production through outgrower schemes, the company plans to increase local processing capacity. It has invested in producing local packaging to reduce production costs and foresees exporting tomato paste to neighbouring countries.

Case 3 – Turning Attention back to Domestic Sourcing

Many micro and small food processors coexist and process local products in sub-Saharan Africa. Broutin and Bricas (2006) revealed that they have succeeded in developing niche markets despite a large fow of imported foods and even without government support.

High food prices have turned urban consumers' attention to locally processed cereals (i.e. millet, maize and sorghum) as well as fruits and vegetables, fsh and daily consumables sourced domestically. Moreover, foreign investors such as Advens have recently recognised the high nutritional quality of domestic produce. Most local processors have reasons for staying small and in many cases informal, but scaling up their processing capacity is foreseeable. Maria Distribution, a typical small-scale Senegalese company, offers an example of successfully expanding a business in local fresh-fruit processing.

Food processing has had a strong impact on employment creation. In Senegal, it accounted for 57 per cent of total turnover in the industrial sector in 2004; in 2003 it employed half of the country's industrial workers and one-third of its seasonal workers (Table 1). Given the importance of the food-processing sector, the government's Accelerated Growth Strategy (Stratégie de croissance accélérée - SCA - 2007) has made developing domestic food processing one of its top priorities. Implementation of the SCA started in 2008.

PUBLIC SUPPORT IS KEY TO SUSTAINING PRIVATE INITIATIVES

From large food industries with foreign capital to small-scale local food processors, the private sector needs to collaborate with government to make business easier to conduct and more proftable. To increase the capacity of local agricultural production, Advens works with the Senegal Ministry of Agriculture to provide groundnut producers with technical assistance. Micro and small-scale domestic food processors worked closely with the public food-research institute (ITA) to improve the quality of their product under the Canadian International Development Agency (CIDA)-fnanced Agro-Food Operators Support Program (PAOA, 2002-07).

Table 1. **Inventories of Senegalese Processed Foods**

	Food Industry				Micro- and Small-Scale Food Processors	
Final products (use of domestic inputs)	Groundnut oil	(Yes)	Tomato concentrates	(Yes)	Juice and jams	(Yes)
	Canned fish	(Yes)	Refined sugar	(Yes)	Dried fish	(Yes)
	Cotton oil	(Yes)	Dairy products	(No)	Processed cereals	(Yes)
			Flour	(No)	Palm or other edible oils	(Yes)
			Beer and other beverages	(No)	Dairy products	(No)
Targeted markets	Exports		Domestic (import substitution)		Domestic (niche markets)	
Sector of activity	Formal				Formal / Informal	
Economic impacts	57 per cent of the total turnover in the industrial sector (2004)				Not available	
Employment effects	Employed 1/2 of all industrial workers and 1/3 of seasonal workers (2003)				Not available	

Source: Compiled by the author based on field interviews, and Broutin, C. and N. Bricas (2006).

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* The author would like to thank Donald Baron (Socas) and Frédérique Bernasconi and Jean-Jacques Château (Advens) for their valuable insights provided during interviews.

ARTICLE SEVEN

Linking Smallholders to Markets: What Role for Donors?

Denise Wolter*

- Donors increasingly adopt a value-chain approach, with encouraging results for export crops, especially in the horticultural sector.
- While the adoption of a more commercial approach to agriculture is welcome, donors need to ensure that they do not create market distortions.
- The major challenges are to scale up existing interventions and to move towards the commercialisation of food-crop production.

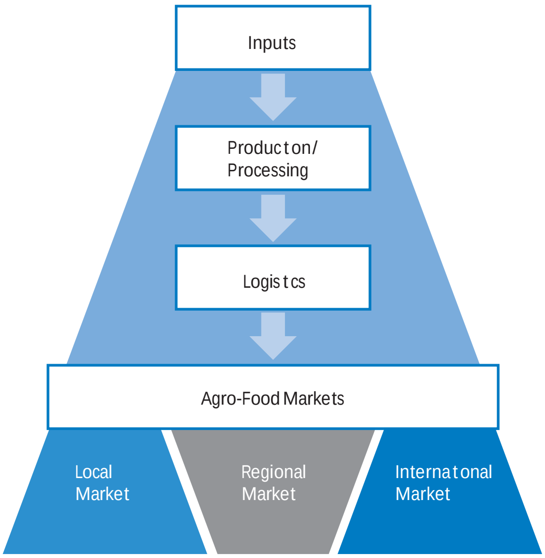
After long neglect, agriculture has returned to the international development agenda, attracting new donor funding. Donors increasingly adopt a value-chain approach (Figure 1). In Ghana, for example, the major new agricultural programmes target entire product chains. In Mali, the United States will merge three stand-alone agricultural projects into one large programme covering whole value chains for certain products. Donors' stronger market orientation is a welcome step forward, but it is not without risks. What are the challenges and opportunities linked to the value-chain approach?

REDISCOVERING THE MARKET

The major change in agricultural development due to the value-chain approach is the focus on markets. Donors used to concentrate their interventions mostly on production and achieving food self-sufficiency. Now the analysis starts at the end of the value chain with the crucial question — is there a market for the product and, if so, what needs to happen to make farmers produce for it?

Using the value-chain approach means analysing all factors influencing agricultural performance, including access to and requirements of end markets; the legal, regulatory and policy environment; co-ordination among firms in the industry; and the level and quality of support services.

Figure 1. The Agricultural Value Chain



ONE LABEL, MANY APPROACHES

As donors apply the value-chain approach, actual practice varies. In Ghana's horticultural sector, the American aid agency USAID operates through consultancy firms, and its work includes linking smallholder farmers via larger, so-called nucleus farmers, to big international companies such as Coca-Cola or Chiquita.

The African Development Bank (AfDB), also active in Ghana's horticultural sector, works through government structures and tries to avoid areas dominated by large international companies.

For the Netherlands, embassies play a crucial role in identifying likely win-win situations where linking Dutch firms with farmers could meet market demand at home. The embassy in Mali works with the Dutch retailer Royal Ahold to promote mango exports to the Netherlands. After exploring the commercial opportunities at a time of year that presented a "window" in the Dutch supermarket system, the embassy invested in a packaging house in Mali to ensure a cold mango supply chain.

MAKING FARMERS FIT FOR THE MARKET

Donors can play a key role in making farmers fit for the markets. Ides de Willebois, Director for Eastern and Southern Africa at the International Fund for Agricultural Development (IFAD), stresses the importance of making farmers aware that they are part of the value chain and that taking a more active role will benefit both them and agribusiness companies. Donor support for organising farmers into larger entities is also crucial because firms find it difficult to engage directly with a large number of smallholders. Furthermore, donors can help ensure that deals between farmers and firms are fair, through training to improve farmers' business and bargaining skills.

Dr. Michael Brüntrup, agricultural economist at the German Development Institute DIE, points out that farmers engage with big companies to obtain access to inputs such as fertilizer, seeds or credit. To reduce this kind of dependence — which may in the worst case imply that the farmer cannot produce without a contractual arrangement with a large agro-firm — alternative service providers need to be developed. The problem of agricultural credit particularly needs attention.

Most farmers are not willing to pay for support services, especially if they used to be free. Farmers' organisations therefore remain dependent on donor funding, which in turn reduces their accountability to their members. An information system clearly explaining the benefits of support services is necessary, and farmers should increase their contributions over time to ensure the sustainability of their organisations.

One example of such a strategy is Kilicafe, the Association of Kilimanjaro Speciality Coffee Growers, which groups about ten associations representing more than 10 000 smallholders. Kilicafe still receives donor funding, but should become sustainable in the next few years. While coffee farmers were at first reluctant to pay for Kilicafe's services, they have started to pay as the organisation has demonstrated its value added. Supported by TechnoServe, Kilicafe has successfully lobbied for coffee-sector reform and increased producer prices.

HELPING AGRIBUSINESSES TO ENGAGE WITH SMALLHOLDERS

With the value-chain approach, donor interventions become more strongly oriented to the commercialisation of agriculture. Actors to be involved are no longer only smallholder producers or poor farmers, but also traders, wholesalers and exporters, who may not be poor but who are important intermediaries.

This presents a challenge for donors whose primary objective remains poverty reduction. Potential conflicts with overall development objectives need consideration before interventions begin. At the same time, greater private-sector involvement promises to make interventions more sustainable, because the ultimate goal is to create commercially viable agribusiness ventures.

Donors can act as facilitators for companies willing to engage in African agriculture. Facilitation can start by improving the agricultural business environment. Many agribusiness companies see the lack of transport infrastructure as a major impediment to expansion. Another is insecurity of land rights, which makes it difficult to acquire property for larger agro-investments. When agribusiness companies engage with smaller farmers, the enforcement of contracts poses yet another big difficulty. Devising more efficient mechanisms for conflict resolution in cases of farmer side-selling could make the wider application of contract farming easier. According to Dr. Brüntrup, currently contract farming can only be introduced in areas where a marketing bottleneck exists, i.e. when farmers do not have other buyers or need access to inputs.

The challenge is to devise interventions that result in win-win situations, which means combining development objectives with the private sector's profit-making interest. Given the objective of poverty reduction, donors may focus too much on farmers. Strengthening farmers' negotiating positions is good; destroying the incentive for agro-firms to engage with farmers by setting producer prices too high is not. If donors link farmers to agribusiness, they must clearly define their role as facilitators to minimise the risk of market distortions.

THE CHALLENGE: MOVING BEYOND EXPORT CROPS

Donor interventions using a value-chain approach still occur mostly in the agricultural export sector. In horticulture, donors have successfully linked smallholders to the market, mainly through outgrower schemes. In future, donors, governments and the private sector should capitalise on the supply chains developed so far and move towards the establishment of agribusiness clusters. Dr. Lucian Peppelenbos, Senior Advisor at the Royal Tropical Institute, says that this is one strategic area for good returns on investment; it provides an opportunity because the interests of development agencies and the private sector are aligned.

At the same time, the recent food-price crisis shifted the focus back to national and regional food markets. Urbanisation and rising demand for processed foods provide many opportunities for developing local agro-industries. Yet examples of commercialisation programmes for staple food crops are rare. For food crops, product characteristics and market structures contribute to reducing the incentives for agribusiness firms to engage in such arrangements. It is also difficult to find strong local companies that can engage with smallholder farmers. For some crops, such as maize, the current structure of smallholder production is a major impediment because commercial production becomes viable only when the scale is larger. While public-private partnerships are more demanding in the food segment of the agricultural sector, their potential impact and outreach for poverty reduction are much greater. More efforts are necessary to develop and sustain local food industries in Africa. Recent initiatives, such as IFAD’s Northern Rural Growth Programme in Ghana to promote the commercial production of food crops, are a welcome development.

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PART TWO

Challenges and Opportunities for African Agriculture: Five Country Cases

ARTICLE ONE

Ghana – Seizing New Agribusiness Opportunities

Denise Wolter*

- Ghana has two-speed farming: export-oriented agriculture grows strongly, while food-crop production lags.
- Ghana needs to sustain and scale up both traditional and non-traditional agricultural export sectors.
- The country needs to devise credible strategies to boost productivity in food production to meet rising local demand and develop a viable local agro-industry.

Ghana offers one of Africa's success stories. In the past 20 years the economy has grown at an average of 5 per cent a year. A major recent growth driver has been the high demand for gold from emerging economies. In 2006, gold overtook cocoa for the first time as Ghana's most important export. Yet agriculture continues to dominate the economy, employing over 55 per cent of the workforce and accounting for 40 per cent of GDP. It has performed quite well, with annual growth averaging 5.5 per cent over the past five years. Closer examination, however, shows it growing at two speeds. Export crops like cocoa and horticulture flourish while subsistence farming still prevails for food crops.

PAYING THE PRICE FOR NEGLECTING FOOD PRODUCTION

Ghana's agricultural production meets only half of domestic cereal and meat needs and 60 per cent of domestic fish consumption, according to the Ministry of Food and Agriculture (MoFA). Without transport and storage infrastructure, small subsistence farmers have hardly any access to local markets. Yet they have significant untapped potential, as yields for cereals and starchy staples lie far below the maximum attainable (see Table 1). Food production is concentrated in the poverty-stricken North, so commercialising it could also help reduce the North-South divide in the Ghanaian economy.

Ghana pays the price for neglecting food-crop productivity when high food prices fuel inflation. In 2007, inflation averaged 12.7 per cent, up from 10.5 per cent in 2006, with a new high of 13 per cent expected in 2008. The Ghanaian government has announced short-term relief measures such as removing import duties on rice, wheat, yellow maize and vegetable oil, and banning their re-exportation. In the medium to long term, however, modernising food-crop production will require substantial productivity-enhancing investment, including rural infrastructure, irrigation, marketing, extension, and agricultural research and development (R&D).

COSTLY IMPORTS, BUT LOCAL PROCESSING STRUGGLES

The growing segment of middle-income households (about 5 per cent of the population) could provide a significant consumer base for locally processed foods. Yet because local food processing remains too meagre to meet local demand, high-value food imports have increased. Ghana currently produces less than 30 per cent of the raw materials that its agro-based industries need. The government has introduced incentives (e.g. tax holidays) to promote food processing, but had little response because major bottlenecks like lack of infrastructure, finance, etc. remain.

The market entry of South African retailer Shoprite through its first large investment in West Africa could change the scene. Dr. Lucian Peppelenbos, senior advisor at the Dutch Royal Tropical Institute, expects large spin-off effects for agriculture and agribusiness as Shoprite sets up its supply chains.

Table 1. **Current and Potential Yields of Ghana's Major Food and Export Crops**

Crop	a) Average Yield (tonnes per hectare)	b) Potential Yield (tonnes per hectare)	Yield Gap (b-a)	Yield Gap (per cent of potential)
I. Major Food Crops				
Cereals				
Maize	1.5	2.5	1	40
Millet	0.8	1.5	0.7	47
Rice – rainfed	2.1	3.5	1.4	40
Rice – irrigated	2.8	5	2.2	44
Starchy Staples				
Cassava	11.9	28	16.1	58
Cocoyam	6.7	8	1.3	16
Plantain	8.1	10	1.9	19
Yam	12.4	20	7.6	38
II. Major Export Commodities				
Cocoa	0.4	1	0.6	60
Pineapple	60	100	40	40

Source: Based on Breisinger, C. *et al.* (2008).

COCOA – A SUCCESS STORY

In 2006, Ghana regained its position as the world's second-largest producer of cocoa beans, with an output of 740 000 tonnes. Côte d'Ivoire remains the largest, producing almost twice as many cocoa beans as Ghana. These numbers need cautious treatment, however. About 100 000 tonnes of Ivorian cocoa get smuggled into Ghana each year because of political instability in Côte d'Ivoire and the higher producer prices paid in Ghana (EIU, 2007).

Like other export crops, cocoa production is concentrated in the South, carried out by around 1.6 million farmers on plots smaller than 3 hectares. Provision of technological packages and improved access to credit, together with partial liberalisation of cocoa marketing, have improved producer skills and incentives to raise productivity. Potential for further productivity improvements still exists; current yields remain 60 per cent lower than attainable yields (Table 1). Nevertheless, the objective of the Ghana Cocoa Board (Cocobod) to raise annual production to 1 million tonnes by 2010 appears too ambitious; in the past five years annual cocoa production has averaged only 600 000 tonnes (Business Monitor International, 2007).

International market risks will likely rise as competitors such as Côte d'Ivoire, Indonesia, Cameroon, Nigeria and Brazil expand their production. Although cocoa demand steadily increases by 3 per cent a year with new markets emerging in Asia, the current capacity of producer countries already exceeds demand. Without an annual loss of 30 per cent of the cocoa yield to disease, the market would be oversupplied.

In an effort to reduce its exposure to international price volatility, Ghana is trying to increase the amount of cocoa beans processed to 50 per cent, yet in 2005/06 it processed only 13 per cent of the cocoa beans it produced. Ghana has a small chocolate label, Golden Tree, sold only in small quantities in the United Kingdom.

According to Alain Frédéricq, Director for Global Business Development & Sustainability Programs at the Dutch cocoa processor ADM, the key to developing a successful chocolate industry is the existence of a local market. Chocolate is not yet part of the local diet, however, and high-income consumers prefer imported brands. Nevertheless, government subsidies and tax incentives make it attractive for foreign companies such as ADM, Barry Callebaut and Cargill to invest in or set up processing plants.

HORTICULTURE – AN EMERGING GROWTH SECTOR

The Ghanaian government and donors such as the World Bank and the United States promote horticulture to reduce Ghana's dependence on cocoa exports. The value of horticultural exports, only $9.3 million in 1994, increased to $50 million in 2006, thanks mainly to pineapple exports; in 2006 they reached over $19 million, 38 per cent of total horticultural exports.

Pineapples represent one of the products besides cocoa where private enterprises, such as the British Blue Skies and the Dutch Togu Fruits, have become increasingly involved in processing. Ghana has yet to learn how to adapt more rapidly to market developments. Changing consumer preferences to the sweeter MD2 pineapple variety posed a considerable challenge to producers. Because of the production shift to MD2, Ghana's share in European pineapple imports fell by 18 per cent between 2003 and 2007 (FAGE, 2007).

Internationally, Ghana faces the problems of a small player with limited visibility. Currently the fourth largest supplier of pineapples to the EU, its production of 38 000 tonnes (5 per cent of European pineapple imports) falls well behind leader Costa Rica's 574 000 tonnes (69 per cent) (FAGE, 2007). Ghana's international market share is even smaller (often below 1 per cent) for other fruit exports, such as bananas, mangoes and papaya. Even if it increases volume significantly, Ghana will still have to base its competitive advantage in horticulture on quality rather than quantity.

WAYS FORWARD

The recent discovery of oil in Ghana risks diverting attention again from the commercial potential of agriculture, which would be imprudent. Significant gaps between achievable and actual yields for all major food and export crops show that agricultural growth potential exists in Ghana. Furthermore, income growth in many Asian countries will likely create fresh demand for Ghana's traditional agricultural exports, and high world food prices, combined with rising domestic demand, offer new market opportunities for staple crop producers. To take advantage of these opportunities, Ghana must increase agricultural productivity and support the local agro-industry to regain domestic market shares and expand international business.

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ARTICLE TWO

Mali – Beyond Cotton, Searching for “Green Gold”

Yoshiko Matsumoto-Izadifar*

- Mali strives for agricultural diversification to lessen its high dependence on cotton and gold.
- The Office du Niger zone has great potential for agricultural diversification, in particular for increasing rice and horticultural production.
- Tripartite efforts by private agribusiness, the Malian government and the international aid community provide the keys to success.

Mali faces the challenge of agricultural diversification. It needs to lessen its excessive dependence on cotton and gold. Livestock, cotton and gold currently provide the country’s main sources of export earnings (5 per cent, 25 per cent and 63 per cent respectively in 2005). A decline in cotton and gold production in 2007 slowed economic growth.

Recent estimates suggest that Mali will exhaust its gold resources in ten years (CCE, 2007), and “white gold”, as cotton is known, has difficulties owing to stagnant productivity and low international market prices, although the international price of cotton increased slightly in 2007 (AfDB/OECD, 2008). Mali therefore seeks to develop “green gold” — commercial agriculture beyond cotton.

A trend among cotton producers to move away from cotton has already appeared. Currently low purchase prices and diminishing subsidies paid to producers have made cotton plantations less profitable than before. Producers are shifting to cereals (maize, millet and sorghum) or horticultural products, from which they now derive half their total income. In 2007, reduction in the areas planted with cotton resulted in a dramatic fall in production of more than 40 per cent, from 537 000 to 330 000 tonnes.

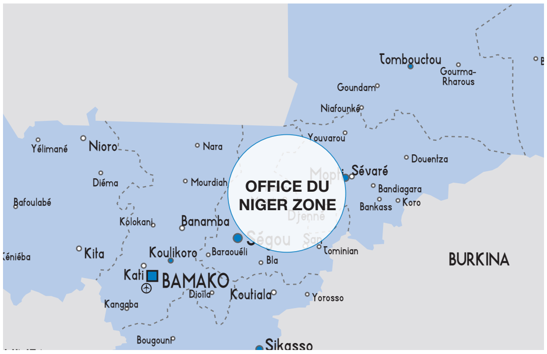
OFFICE DU NIGER ZONE: GROWING POTENTIAL FOR AGRICULTURAL DIVERSIFICATION

In contrast, cereals showed good progress in 2007. A substantial increase in rice output (up more than 40 per cent between 2002 and 2007) shows that Mali has the potential to overcome its dependence on cotton (FAO, 2008). The government hopes to make its Office du Niger zone a rice granary for West Africa.

The zone (see Figure 1), one of the oldest and largest irrigation schemes in sub-Saharan Africa, covers 80 per cent of Mali’s irrigated agricultural production, particularly rice. Rice is cultivated on over 90 000 hectares, more than 60 per cent of which lie in the zone. The average paddy yield per hectare in the zone tripled between 1974 and 2003, making it the biggest rice-producing area in the country.

Closely associated with rice production, out-of-season cash crops have also recently expanded in the zone. After millet, horticulture (e.g. mangoes, onions and potatoes) has provided a second source of out-of-season annual cash crops. The so-called “rice-based” production method combining irrigated rice, horticulture and millet cultivation with rearing sedentary or semi-migrant livestock allows producers to diversify their production.

Figure 1. Office du Niger Zone in Mali



Source: ht p://atlas.mapquest.com

The Off ce du Niger has started exploiting international market opportunities for its horticultural produce. For example, mango, the country's leading horticultural product, has made inroads in Europe. With technical support from foreign companies and donors, Malian mango producers and exporters increasingly qualify for GlobalGap Certif cation, an internationally recognised quality standard. Exports of Malian mangoes to Europe increased more than 40 per cent in volume in just one year from 2005 to 2006.

COLLECTIVE EFFORTS: THE KEY TO REINFORCING AGRIBUSINESS

Behind these success stories lie tripartite efforts involving private agribusiness, the Malian government and the international aid community. They continue to expand to new areas of Malian agribusiness.

Bakary Yaffa, Director of the Malian fruit exporting company Ets Yaffa et Frères and representative of the Malian Association of Fruit and Vegetable Exporters (AMELEF), recognises the importance of support that Malian mango exporters have received from the government and donors: "The government gives licences with reduced tariffs and exonerates taxes. We have also received technical assistance from the European Union and the American Aid Agency (USAID) to keep the traceability of our products. These helped our members of the association to export 800 tonnes of mangoes to Europe in 2007." Mr. Yaffa and the association currently hope to increase their exports and transform mangoes into juice or dried chips; they seek f nancial support.

Christian Viale, Financial and Administrative Director of the Grands Moulins du Mali (GMM), the biggest f our mill in the country, also insists upon the importance of close collaboration with the government and donors: "The GMM has started investing in domestic wheat production in the Of f ce du Niger zone to replace expensive wheat imported from Europe. As this was a very new initiative in Mali, we have called on the government and donors for support to f nance our pilot project." The company aims to attain self-suf f ciency in ten years by replacing wheat imports from Europe and Latin America.

CHALLENGES AHEAD

Mali still faces some major challenges to agricultural diversif cation beyond cotton. The f rst is to rehabilitate and develop irrigation schemes. Mali has 1 million hectares of potentially irrigable land in the Niger River Delta, but it currently uses only 15 per cent of this potential. In 2007, the government announced a large irrigation extension programme of 60 000 hectares in the Of f ce du Niger zone.

The second challenge is to reduce the allocation of the agricultural budget to the cotton sector. The government allocated around 12 per cent of the national budget to agriculture in 2005 and 2006, which exceeds the 10 per cent target set by NEPAD's[1] Comprehensive Africa Agriculture Development Programme (CAADP). However, some $64 million (FCFA 28 billion) went to subsidise the Malian Company for Textile Development (CMDT) in 2006 (AfDB/OECD, 2006). In 2008, the company was on the verge of privatisation to lessen the government's f nancial burden.

The third challenge is to improve access to credit for local producers and entrepreneurs. To meet this objective, the government has successfully restructured the National Agricultural Development Bank (BNDA). Through decentralised f nancial institutions, the BNDA today plays an essential role in providing short-term agricultural credits to private operators.

Mali's search for "green gold" progresses. The tripartite efforts of private agribusiness, the Malian government and the international aid community provide the key to success.

1. New Partnership for Africa's Development.

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ARTICLE THREE

Senegal – Challenges of Diversification and Food Security

Yoshiko Matsumoto-Izadifar*

- Rice production in the Senegal River Valley has high development potential and could contribute to domestic food security.
- Horticultural production has led Senegal's efforts to diversify its agricultural exports, although its domestic market potential has not yet been fully exploited.
- In both the rice and horticultural sectors, the challenge is to recognise the needs of smallholder farmers and help them to explore domestic market opportunities.

The high agricultural potential of Senegal continues to impress visitors, including Jean-Michel Severino, Head of the French Development Agency (AFD). "The surging demand for agricultural primary materials in the world market will provide new income-generating opportunities in Senegal," he said on his visit to the Senegal River Valley in February 2008. The valley is known as the Senegalese rice granary.

He was referring to the call by Senegalese Prime Minister, Cheikh Hadjibou Soumaré, to tackle the country's structural problem of high dependence on food imports, especially rice. Turning attention to domestic market potential marks an important change in Senegal's agricultural policies, which have centred on promoting traditional exports (e.g. groundnuts) since the 1960s.

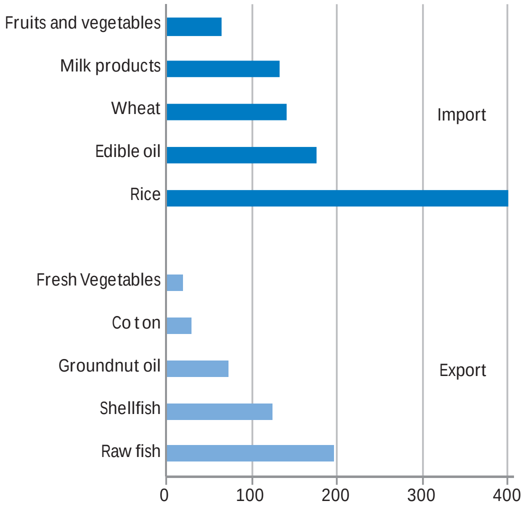
BEYOND TRADITIONAL EXPORT CROPS

Exports have been a major driver of Senegalese agriculture, but a decade of sluggish sales of groundnut products and a deepening crisis in the fisheries sector have reduced the contributions to GDP of the traditional agricultural exports. In contrast, the fruit and vegetables sub-sector has done well since the 1994 devaluation of the CFA franc. Production of rice, maize and manioc has also increased in recent years to meet rising domestic demand in urban areas.

Horticulture has offered the greatest hope for the future of Senegalese agriculture since the early 1990s, as a recent surge in FDI in export-oriented horticulture proves. Compagnie Fruitière, a French horticultural import company, for example, has set up a new production base, investing $9 million between 2003 and 2005. Its subsidiary, Grands Domaines du Sénégal (GDS), has rapidly increased its production and export capacity to send cherry tomatoes and green beans to Europe.

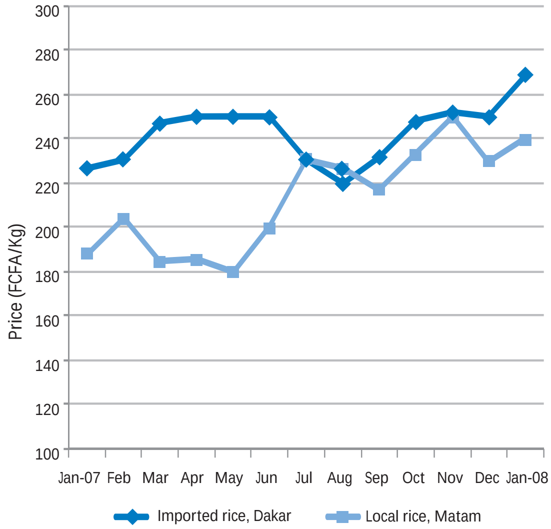
This helped Senegal obtain 10 per cent of the market for cherry tomatoes in Europe, after Israel and Morocco. In 2007 Senegal exported 18 000 tonnes of fresh vegetables, worth $20 million in export revenue. The government's 2007 trade statistics show, however, that export revenues from five major agricultural products (fish, shellfish, groundnut oil, cotton and fresh vegetables — $448 million in total) barely covered the cost of rice imports ($400 million) (see Figure 1).

Figure 1. Senegalese Agricultural Exports and Imports
(Values in USD million, 2007)



Source: Ministry of Economy and Finance of Senegal (2008).

Figure 2. Evolution in Price of Imported and Local Rice in Domestic Markets



Source: Ministry of Economy and Finance of Senegal (2008).

More than 80 per cent of domestic rice consumption in Senegal between 2001 and 2005 depended on imports, which made Senegal the world's tenth largest rice-importing country (third in Africa) in 2006 (Africa Rice Centre, 2007). In 2005, the government launched a new objective: self-suffciency by 2012. Production will need to increase six-fold from 150 000 to 1 million tonnes.

EMPHASIS ON DOMESTIC MARKETS, BUT SMALLHOLDERS NEGLECTED

The domestic market can support renewed attention to domestic rice production. Figure 2 shows that imported rice was much more expensive than the domestic product during the frst half of 2007, but this price gap has since almost disappeared because the domestic price adjusted to the imported price. This is good news for local rice producers, the majority of whom are small-scale farmers.

To increase domestic rice production more attention needs to be paid to the constraints faced by small-scale rice farmers. The experience of the Senegalese export-oriented horticultural sector shows that market opportunities favoured big players in the end. "A decade ago, 80 per cent of Senegalese horticultural produce originated from small- and medium-scale producers," says Julienne Kuiseu, who works on a Food and Fairness project in Dakar. Today their role has declined. With signifcantly fewer production and marketing assets (e.g. land, technology, fnance, business know-how and human networks), smallholders see that their chance to seize opportunities in horticulture is limited.

Contract farming used to be one way that small growers could take part in the export value chain. Then major operators, such as Safna and SEPAM, stopped working with small-scale outgrowers for reasons of traceability, food safety and hygiene. Eventually, large operators preferred investing in fully independent farming systems. Currently seven major large-scale private operators account for 75 per cent of Senegalese horticultural exports.

Without help, many small horticultural growers cannot meet the costs of complying with the legal and market requirements of the OECD markets and simply withdraw from the horticultural export sector altogether. How can Senegal avoid repeating this failure and promote small-scale rice farming?

TACKLING THE WHOLE DOMESTIC AGRICULTURAL SYSTEM

Senegal needs a coherent domestic agricultural production system, with high complementarity over multiple crop production. Throughout the seasons, farmers in the Senegal River Valley should harvest rice and horticultural products destined for both export and domestic markets. As business planners, they should set strategies to maximise input provisions, marketing know-how and finance. Neither the government nor donors have sufficiently covered this aspect until very recently.

Senegal's Agricultural Markets and Agribusiness Development Project (PDMAS, 2006-2015), supported by the World Bank, marks the first effort to tackle the complexity of domestic agricultural production as specifically practised by smallholder farmers. PDMAS has learned lessons from its previous Agricultural Exports Promotion Programme (PPEA, 1998-2004), which targeted only medium and large-scale export-oriented horticultural producers. The experience of the PPEA demonstrated that the value-chain concept applied originally in the Niayes region (the coastal zone between Dakar and Saint-Louis) could also be useful to small-scale farmers targeting domestic markets. PDMAS has taken this as a lesson.

The value-chain concept, which covers the whole agricultural value chain from inputs to production, processing and marketing, matches the needs of smallholder farmers. For example, rice producers in the Senegal River Valley produce onions in the off season (competing against imported European ones) and tomatoes (to export to Europe) in order to purchase seeds and fertilizers for rice production. Technical and financial support to their horticultural production activities would indirectly encourage their domestic rice production as well. Promoting horticultural production would not contradict the government's policy of increasing domestic rice production, if the government took fully into account smallholder farmers' needs to work on multiple crops and explore domestic markets.

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* The author would like to thank Anthony Bouthelier (CIAN) and Bernard Esnouf (AFD) for their valuable insights provided during interviews.

ARTICLE FOUR

Tanzania – Why a Potential Food Exporter Still Imports Food

Denise Wolter*

- Tanzania could be a major food-exporting country, but it currently struggles to meet its own food requirements due to low productivity and the predominance of subsistence farming.
- To achieve the transformation of agriculture, the business environment in general and that for agriculture in particular need improvement.
- Making food-crop production profitable, the biggest challenge, requires a significant scale enhancement.

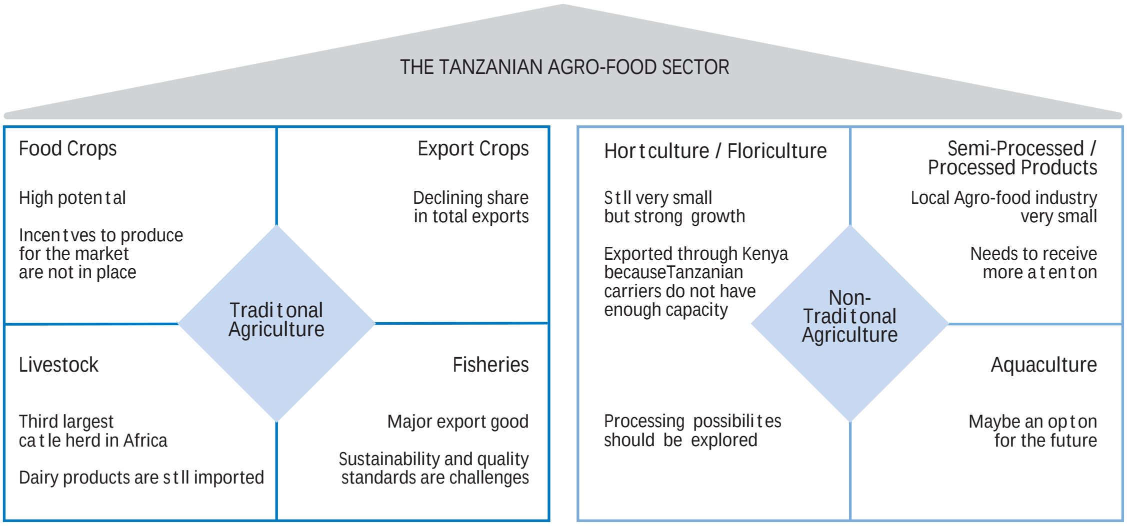
TANZANIA'S AGRICULTURAL SECTOR – A SLEEPING GIANT…

Agribusiness remains in its infancy in Tanzania, where commercial ventures focus mostly on traditional export crops such as coffee, tea, cotton, cashews, tobacco and, on a much smaller scale, cloves and sisal. Due to declining world market prices for agricultural commodities and rising mineral exports, traditional agricultural exports accounted for only 20 per cent of total merchandise exports in 2006, down from over 55 per cent in 1995/96. Tanzania's still very small horticultural sector (vegetables, fruits and cut flowers) contributes little more than a percentage point to total merchandise exports. Recently Tanzania's most important non-traditional agricultural export has become fish and fish products, which earned half as much ($138.6 million) as all traditional agricultural exports in 2006.

Higher food prices driven by higher energy costs and rising consumption in developing countries provide Tanzania with many opportunities to develop its agro-industry and tap into regional markets (see Figure 1). Food exports present a promising option because Tanzania shares borders with eight African countries (Burundi, Democratic Republic of Congo, Kenya, Malawi, Mozambique, Rwanda, Uganda and Zambia), and it has abundant natural resources. Of an estimated 44 million hectares of arable land, only about 10 million (23 per cent) are currently under cultivation. The planted area has held stable for several years, so land expansion could provide a major source of agricultural growth. Tanzania also has the third largest cattle herd in Africa, after Ethiopia and Sudan.

Yet smallholders with low productivity still dominate food production. Average food-crop productivity in Tanzania stands at 1.7 tonnes per hectare, whereas good management and optimal fertilizer use should result in yields of 3.5-4.0 tonnes per hectare. Only 15 per cent of all farmers use fertilizers. The use of hand tools and the reliance on traditional rain-fed cropping methods and animal husbandry further hamper productivity.

So at present Tanzania does not appear fit to take advantage of its agribusiness opportunities and is far from being a major food exporter. Agricultural imports have increased, with food imports, including wheat, rice and dairy products taking the largest share (80 per cent) of total merchandise imports. Since the 1999/2000 season, the Food Self Sufficiency Ratio (SSR), which compares the volume of domestic food production and the food requirements of the population, has fluctuated between a low of 88 per cent (2003/04) and a high of 112 per cent (2006/07). Furthermore, significant variations in food security have occurred between different regions and districts.



So what needs to be done to unleash Tanzania's agricultural potential? On the one hand, Tanzania needs to improve its business environment in general, especially for agriculture. A more severe challenge involves how to move beyond subsistence farming in food production.

TANZANIA NEEDS TO TACKLE THREE CLASSIC CONSTRAINTS: INFRASTRUCTURE, FINANCE AND PROPERTY RIGHTS

Since the late 1980s Tanzania has pursued structural reforms more or less consistently, leading to increased private-sector participation and macroeconomic stability. In the World Bank's Doing Business Ranking 2008, however, Tanzania ranks only 130th among 178 countries surveyed, still behind its East African Community neighbours, Uganda (118) and Kenya (72). Three constraints particularly hinder commercial endeavours in the agricultural sector: insufficient infrastructure, lack of access to finance and insecure property rights.

Insufficient infrastructure

Farmers lose a large proportion of the agricultural harvest because they cannot get their produce to the market and/or cannot store their products after harvest. According to the Board of External Trade, 40 per cent of the fish catch from Lake Victoria gets lost before processing because of insufficient storage. Cold-storage facilities are practically non-existent or subject to unstable electricity supply. Of Tanzania's road network of 85 000 kilometres, only 4 000 kilometres are paved and some parts, primarily in the south, become impassable during the rainy season.

Tanzania also faces considerable deficiencies in its trade-related infrastructure. The port of Dar es Salaam accounts for approximately 70 per cent of Tanzania's foreign trade, but many businesses have moved their shipping operations to Mombasa, Kenya to avoid severe congestion and tedious bureaucratic procedures. Two main agricultural exports, fish from Lake Victoria and cut flowers from the north of the country, currently travel by lorry to Nairobi for shipment to Europe, because Tanzania's carriers do not have sufficient capacity (USAID, 2008).

Under the US-funded Millennium Challenge Compact (MCC), the government of Tanzania puts a strong emphasis on infrastructure development. Of the \$698 million total, \$206 million will go to energy projects, \$66 million to water projects and the largest part, \$373 million, to investment in transport infrastructure. It remains to be seen whether agricultural infrastructure receives the special attention it deserves.

Lack of access to finance

Tanzanian agribusinesses cannot obtain financing to buy productivity-enhancing inputs, such as seeds, fertilizers, chemicals and pesticides or intensification technologies. Tanzania's financial institutions view agricultural lending negatively, so rural areas have few banks. Only 3 per cent of agricultural households have access to credit. Even medium- and large-scale commercial farmers and agricultural investors face major financing constraints, and they therefore refrain from larger-scale investments.

Insecure land rights

The Tanzanian Investment Centre (TIC) has identifed diffculty in acquiring land as one of the 11 greatest impediments to attracting foreign investment. Land titling is permissible for surveyed land, but to date most rural land has not been surveyed, and so titling is rare. The inability of farmers to use a formal land title as collateral severely limits their access to credit. Tanzania has recently begun experimenting with several types of movable property as collateral, including the use of future crops, livestock and warehouse receipts. But at present, these provisions remain insuffcient and unreliable.

THE CHALLENGE OF MOVING FROM SUBSISTENCE TO PROFIT

Smallholder farmers in Tanzania principally maximise food self-suffciency instead of their profts, according to Andrew Temu, Professor of Agricultural Economics at Sokoine University. Two major constraints keep them in subsistence farming: the lack of incentives to produce for the market and the absence of economies of scale.

Incentives to produce food crops for the market are not in place

In Tanzania incentives to produce food crops for the market simply do not exist. According to the Agricultural Sector Review 2006 by the Tanzanian Ministry of Agriculture, Food Security and Co-operatives, existing taxation (e.g. high corporate tax, import duties on agro-processing equipment) discourages the production of food crops in general and those for the market in particular. The Tanzanian government should consider promotion schemes for agriculture similar to those existing in tourism and mining (e.g. tax reductions or special loan facilities).

The scale problem

In Tanzania, the average plot size currently ranges from 0.9 hectares to 3 hectares. Agricultural commercialisation thus has meant diversifcation into high-value products, such as horticulture and spices, where economies of scale are attainable by small farm units. Low-value, bulky agricultural commodities, i.e. most traditional crops, become proftable only when produced at high volume. Therefore, the intensifcation of agriculture by increasing use of fertilizer, seeds and water will not necessarily suffce to commercialise food-crop production; it also requires scale enhancement, currently pursued mainly by organising smallholder farmers into larger groups like associations or co-operatives. Such association building, however, has proved much easier for high-value crops (e.g. coffee, cashew) than for food crops (e.g. maize), as they provide a better income base. So facilitating the establishment of larger-scale agribusinesses might be a more effcient way of increasing food-crop production.

Finally, the current unstable and insuffcient supply of agricultural produce is also the major impediment to developing a viable agro-processing industry. Achieving the necessary economies of scale either through larger units of production or the grouping of smaller units around larger entities thus also represents a necessary frst step towards agro-industrialisation.

CONCLUSION

"Agriculture is not rocket science!" said M. Lyimo, Permanent Secretary of the Ministry of Agriculture, Food Security and Co-operatives during a seminar organised by the OECD Development Centre in co-operation with the African Development Bank in Dar es Salaam in July 2008. Nevertheless, the complexity of the agricultural sector should not be underestimated. More efforts must focus on the commercialisation of food crops, even though this may be much more demanding than the promotion of high-value export crops.

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ARTICLE FIVE

Zambia – Leveraging Agricultural Potential

Katharina Felgenhauer*

- Zambia's agricultural potential remains largely untapped, but policy attention is shifting favourably towards crop diversification and export promotion.
- Linking Zambian farmers to markets, for example through outgrower schemes, improves the quality and quantity of supply and spurs long-term agricultural growth.
- Improving market information enables smallholder farmers to conduct agriculture as a business and to contribute fully to economic development and poverty reduction.

Historically dependent on copper, Zambia struggled to diversify into other commercial activities when faced with volatile copper prices. With its urban bias and single-minded emphasis on maize for food self-sufficiency, the government long neglected the agricultural sector. Infrastructure, extension services and agricultural research and development are underdeveloped, especially in remote rural areas.

"If you had an evolutionary change across the country, it would take maybe five years for Zambia to start exporting crops to neighbouring countries instead of importing them," explains Dick Siame, Country Programme Officer of the International Fund for Agricultural Development (IFAD). So far, however, only 15 per cent of total arable land is cultivated, and only about 30 per cent of irrigable land actually has irrigation. Floods at the beginning of 2008 dramatically increased reliance on external food, input and machinery support.

Zambia's agricultural sector displays a dual structure, where a few (about 740) large commercial farms, concentrated along the railway line, co-exist with scattered smallholders (600 000 -800 000 families) and some small commercial farmers (25 000 families). Some 40 per cent of rural households engage solely in subsistence agriculture.

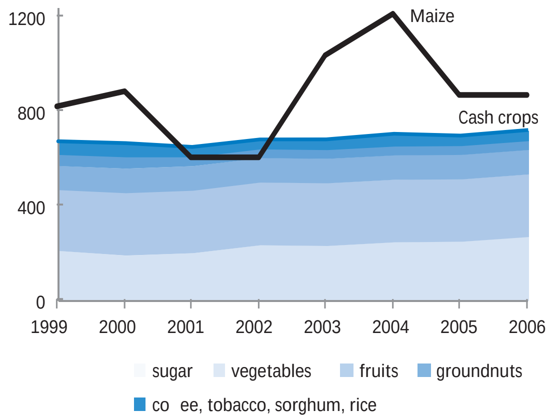
Under these circumstances, leveraging Zambia's agricultural potential requires multifaceted support strategies. Targeting diversification in agricultural production will not suffice without improving market information and promoting linkages between farmers and other participants in value chains.

DIVERSIFYING AGRICULTURAL PRODUCTION

Despite significant increases in variety and production, crop diversification still has a long way to go in Zambia. After promoting maize cultivation in the 1970s, the government broadened its focus to support crops like cassava, sorghum and cowpeas, but profit margins remain mediocre. Diversification into cash crops faces problems of market access, infrastructure and human capital.

With privatisation and trade reforms in the early 2000s, the production of export crops has risen steadily but still runs far behind maize production (Figure 1).

Figure 1. Agricultural Production
(Values in USD million)



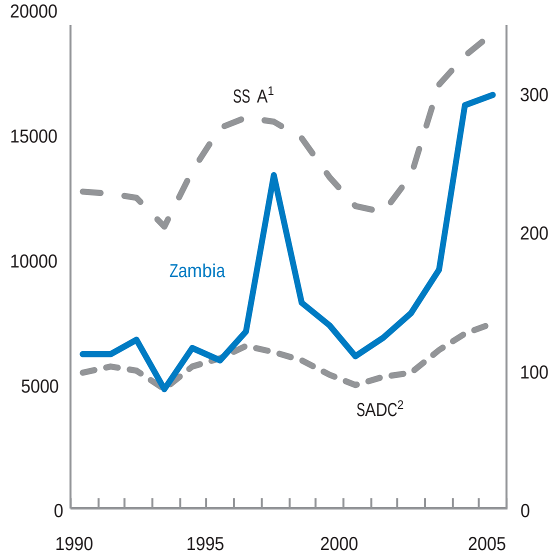
Source: Based on FAO (2008).

Agricultural exports (e.g. cotton, tobacco, spices, horticultural products and honey) have registered the strongest growth among non-mineral exports in the most recent years (Figure 2). Export processing zones, tax reductions for export goods and duty drawbacks for inputs have further boosted international trade.

The livestock sub-sector, which currently contributes 35 per cent of total agricultural production, is also set for growth. The industry could raise productivity, food security and income if quality and disease control were improved. Currently, Zambeef dominates the marketing of livestock; it also maintains franchise agreements with Shoprite's supermarkets in Ghana and Nigeria. This success, however, cannot conceal the sector's struggle to tackle livestock diseases effectively, as veterinary services are insuff cient.

The dairy industry, concentrated around Italian Parmalat and Finta Danish Dairies, could potentially supply the entire region but fails even to meet domestic demand. The processing industry markets only 20 to 30 per cent of the milk consumed in the country, with the rest sold directly in open-air markets. Strengthening smallholder producers' contribution to milk production is vital. US-based Land O'Lakes, which provides smallholder training in dairy farming, helps raise productivity, implement quality standards and improve supply-chain management.

Figure 2. Agricultural Export Trends
(Values in USD million)



1. Sub-Saharan Africa; 2. Southern African Development Community.

Source: Based on FAO (2008).

LINKING FARMERS TO VALUE CHAINS

Contract farming involving small-scale growers has been the most important route to achieving sustained expansion of production. In the cotton sector, private companies have actively set up outgrower schemes — such as Dunavant's "distributor model" — which now involve some 220 000 small farmers. Since privatisation in 1999, cotton production has steadily grown by about 15 per cent a year.

Other sectors follow this example: Shoprite's subsidiary Freshmark sources 97 per cent of its fruits and vegetables from local farmers; subsidiary processor Freshpikt consistently buys from 200 small-scale producers for regional markets. To improve smallholders' competitiveness in the international markets, the non-prof t Zambia Export Growers' Association (ZEGA) offers business advice, f nancial counselling and training. It also aims to improve quality standards and to train managers for outgrower schemes.

However, outgrower schemes face increasing challenges to sustaining their competitiveness. Low productivity, high rates of loan non-repayment and widespread side-selling by farmers discourage agribusiness enterprises.

Companies have therefore preferred to increase volumes of production by expanding the area and number of contracted smallholders, rather than investing in extension services to increase growers' productivity.

IMPROVING MARKET INFORMATION

Poor infrastructure leads companies to concentrate in easily accessible areas, cutting off smallholders in the countryside from transaction fows. Defciencies in the physical infrastructure hamper the timely exchange of goods and information about marketing opportunities, thus curbing sustainable agribusiness development for smallholders.

The development of markets and access to them is crucial. "It is very diffcult to push change on the technological or input side if there is not a proper market. Linkages to agro-processing and other value-adding activities might create demand for farmers," says Doyle Baker, FAO Chief of Agricultural Management, Marketing and Financial Service.

IFAD supports the Zambia National Farmers Union in establishing an SMS market information system and a complementary website that provide current market prices and traders' contact details. It allows smallholder farmers and traders easily to assess business opportunities, evaluate bargaining positions and optimise transport and production. More than 30 000 clients use the service regularly.

Evaluation of the system has been consistently positive. Users are mostly smallholders, who on average share the information with fve more people. Clients confrm that they can compare and negotiate prices better; over 90 per cent of the calls lead to actual transactions. The system will soon cover more commodities and has expanded to neighbouring DR Congo, where cross-border trade is already intense.

If the underused potential in diversifcation, value-chain linkages and market information were fully exploited, Zambia's farmers could rapidly increase production, produce a surplus, and conquer regional and global markets. "However," stresses Dick Siame, "the anti-agriculture bias in people's minds needs to be changed so that the sector is actually considered an income-generating opportunity."

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Annex. List of Interviews Conducted

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GTZ (Germany)	Dr. Annemarie Matthess
SDC (Switzerland)	Willi Graf, Lukas Rüttimann, Peter Tschumi
TechnoServe (United States)	Nicholas H. Railston-Brown (Ghana), Jacob Chuwa (Tanzania)
USAID (United States)	David Nyange (Tanzania)
Multilateral Donors	
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EC Delegation to Tanzania	Razi Latif
IFAD	Karim Hussein, Dick Siame (Zambia), Ides de Willebois
FAO	Doyle Baker, Andrew Shepherd, Carlos da Silva
Development Finance Institutions	
CDC (United Kingdom)	Jean-Marc Savi de Tové
DEG (Germany)	Roger Peltzer
EBRD (EU)	Phillipe Belot
FMO (Netherlands)	Marc Buiting
SIFEM (Switzerland)	Andrea Heinzer
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ADM Cocoa International (Netherlands)	Alain Frédéricq
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BlueOrchard Finance	Pauline de Saint-Gérard, Anne-Lucie Lafourcade
British American Tobacco (United Kingdom)	Roy Beadle, Ben Guest, Karin Mueller
CDC Entreprises (France)	Isabelle Bébéar
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OLAM International (South Africa)	M.D. Ramesh
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Rabobank (Netherlands)	Gerard van Empel
Royal Ahold (Netherlands)	Roland Waardenburg
SABMiller (South Africa)	David Grant, Eric Leong, Christine Thompson
Socas (Senegal)	Donald Baron
Syngenta Crop Protection AG (Switzerland)	Dr. Rudolf Guyer
Syngenta Foundation for Sustainable Agriculture (Switzerland)	Félix Nicolier
Unilever (United Kingdom)	Richard Morgan
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