Outgrower Schemes – Why Big Multinationals Link up with African Smallholders*

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- Outgrower schemes in the agricultural supply chain present opportunities for globally active firms and local smallholder farmers alike.
- Outgrower 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 screen of international investors but so far they are concentrating on extractive industries, especially minerals and oil. For sure, 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 provides 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. However, companies have actually found ways to effectively deal with this challenge through outgrower schemes.

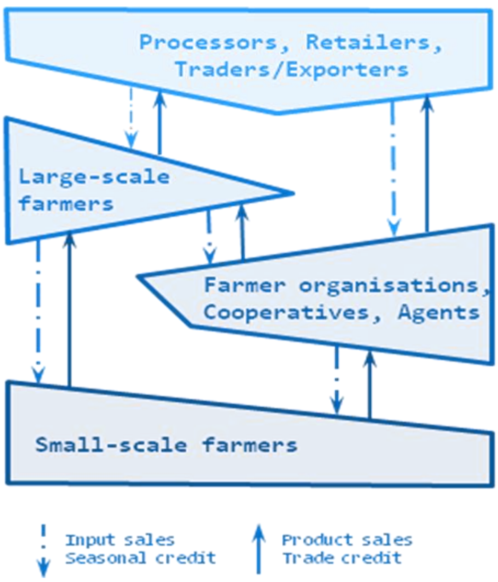
Outgrower schemes, also known as contract farming, are broadly defined as binding arrangements through which a firm ensures its supply of agricultural products by individual or groups of farmers. In other words, *ad hoc* trade agreements are being replaced by co-ordinated commercial relations between producers, processors, and traders leading to a vertical integration of the agricultural value chain. Under this umbrella, a variety of arrangements exist which differ in each partner's input and management. The following discussion will reveal why such partnerships are attractive for private firms and how they can succeed.

The Prime Motivation: Ensuring Supplies and…

Outgrower schemes offer improved control over supply. Thus, large private companies demonstrate an interest in these partnerships if the desired produce is not easily available or quality standards insufficient. Tobacco, for example, is dependent on specific local soil and climate conditions so that British American Tobacco has contract farming schemes to cover 70 per cent of its supply needs; the rest is provided by private suppliers, e.g. from Malawi or Zimbabwe.

The South African brewery SABMiller initiated contract farming schemes 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, so that standards

Outgrower Scheme



could be better implemented. As a result, the firm has enabled its producers to meet future supply requirements, thus ensuring the sustainability of these business relations.

…Exploring Local Markets

Outgrower schemes can also be attractive options for firms to explore local market opportunities. SABMiller has engaged in smallholder-based production in Zambia and Uganda to get an excise tax break from the government but also to respond to local demand. Adapting products and prices to local preferences allows tapping into underexplored niches.

Where the local market is targeted, "home-grown" approaches are on the rise. SABMiller aims to increase sourcing from Africa to between 60 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 the vulnerability to commodity price fluctuations and facilitates the implementation of quality standards.

A Long Term Perspective is Indispensable

Smallholder-based contract farming schemes are not easily implemented: they may take years to set up. Therefore, a long-term business interest is an indispensable pre-requisite. The US-based restaurant company Darden Restaurants got involved in African fish farming out of long-term self-interest in sustaining fish stocks. However, it took them five years to set up the supply chain. Or as Alexandre Cantacuzène, Senior Vice President for Asia, Oceania and Africa of the Swiss-based food and beverage company Nestlé, puts it: "We are in a country to stay." Nestlé seeks only long-term engagements in Africa and has been present on the continent since the 19th century, irrespective of political and economic problems.
Similarly, the Dutch cocoa processor ADM is going a long way to ensure its cocoa supplies in Côte d'Ivoire. In this country, only two estates are bigger than 50 hectares; the rest of the cocoa production is done by 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 end, ADM has developed a co-operative "graduation" scheme. When co-operatives have proved to be a reliable partner for two or three years of business, they gradually become eligible for technical training and extension services provided by ADM. As the quality of the cocoa produced influences the price paid by ADM, 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 at the same time, as described by the World Business Council for Sustainable Development (WBCSD). However, only business-minded commercial partnerships will 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, and therefore also to sustainable contract farming, lies in knowing your partner. However, it is exactly this knowledge which is neither available to the investor nor to the farmers when initiating an outgrower scheme. Therefore, trust can only be established over time and the fear of exploitation has to be dealt with. This is an area where donor support can be crucial.

Outgrower schemes naturally involve information asymmetries related to production and marketing. As a consequence, 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, also to the favour of the private firms involved. Focus areas of intervention need to be determined in partnership to capitalise on local natural, institutional and political resources. It is crucial for the success of the scheme that a multitude of issues are addressed right from the beginning such as the cost and benefits of production choices faced by farmers, what varieties to plant, when to harvest, how to store, 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 will search 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 is attractive for investors as well; FMO is willing to finance such models at lower interest rates of 8 to 10 per cent.

Ways Forward

Once initial constraints are 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. However, questions arise as to how far such schemes preserve the current smallholder structure of African agriculture, and if this is a desirable outcome.

Further reading:

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

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