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Supermarkets: Smallholder Participation in the Global Food Value Chain

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This Hot Topic paper was drafted Deborah Rubin, USAID, Washington, USA, for the POVNET Agriculture Task Team Consultation on 20-21(am) September 2004

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SUPERMARKETS: SMALLHOLDER PARTICIPATION IN THE GLOBAL FOOD VALUE CHAIN^{1 & 2}

1. What is the issue and why is it important?

Recent studies³ of the changing shape of the global value chain and the role of smallholders in agriculture markets in Latin America, Asia, and Africa have confirmed a) rapid growth in the number and distribution of supermarkets and their increasing share of the retail food market, as well as b) changes in the operation of bulk commodity chains. New procurement strategies are reshaping the production, harvest, and post-harvest practices of developing country producers, particularly of horticultural crops. These changes are occurring not only among export-oriented producers but also increasingly among producers selling to local wholesale markets. Centralized product procurement, particularly in the fresh fruits and vegetables (FFV) sector, is creating new market chains that include stringent quality and safety standards. But while there are some clear benefits of these buyer-driven global food chains to the supermarkets and their consumers, there are also emerging doubts about the abilities of the world's smallholders to take advantage of these new trends.

On the positive side, these new procurement arrangements for FFV ensure a steady supply of higher quality products from a known set of producers who have internalized quality and safety standards, and in some countries, have reduced the need for middle actors. These supermarkets are able to cut transportation costs, reduce losses, increase product quality, and minimize their transaction costs. Producers can also benefit from having a reliable buyer whose needs are expanding and whose prices often exceed local wholesale market prices. Preferential relationships between suppliers and the specialized wholesaler or distribution center offer business development services and technical support to the producers. Consumers benefit from higher quality for lower prices and regular supply.

On the negative side, there are significant costs to meeting the supermarkets' higher quality and safety standards that may set the barriers to entry into these changing market relationships too high for smaller farmers with few options for obtaining credit for needed inputs. As national and multinational corporations increasingly set the terms of agricultural trade, processing, manufacturing, and retailing, in a vertically integrated process, there is a danger that smaller farmers will be unable to negotiate favorable terms and will increasingly receive a smaller share

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1. This Hot Topic paper was drafted Deborah Rubin, USAID, Washington, USA, for the POVNET Agriculture Task Team Consultation on 20-21(am) September 2004
 2. Further information on this topic is available on the POVNET website under <http://webdomino1.oecd.org/COMNET/DCD/PovNet.nsf>.
 3. See selected references at the end of the text.

of the value of their agricultural production. There is also concern about the impact of these new marketing practices on local food availability and food security. Overall, there is little understanding of the costs to the environment and human health of the increased levels of pesticides, herbicides, and irrigation used to achieve better looking products.

For producers of undifferentiated staples, although the issues are somewhat different, there is also concern that recent changes in these procurement systems are potentially disadvantageous for smaller farmers. In the past, bulk commodity chains were more open to the smaller farmers as there were few barriers to production, and their produce could be consolidated with others in one standard grade. Purchasing was often mediated by national marketing boards and state subsidies. As developing country economies liberalized, however, corporate concentration in bulk commodity markets has increased, reducing further the number of buyers and increasing their ability to influence prices. Vorley and Fox (2004) note that as states have withdrawn from involvement in the bulk commodity markets, not only have production and price risks devolved directly onto the farmers, these producers have also lost an avenue of political negotiation with the state. A parallel trend shows the buyers of bulk commodities concentrating on promoting product distribution, brand management, and marketing of their products to increase their profit margins and reduce their risks (Vorley and Fox 2004).

The on-going reconfiguration of the global food chain therefore holds opportunities, particularly for those already positioned as larger, well-capitalized, globally competitive rural producers and processors, recently characterized as “Rural World 1” (cf Vorley and Fox 2004; Orden et al 2004) but holds both peril as well as promise for those of “Rural World 2” – the farming families and/or small farm managers who are oriented towards but not yet fully engaged with these larger market networks. The marginalized rural actors of “Rural World 3” participate in this new scenario as laborers and consumers. This paper briefly describes some of the changing practices now in place and identifies emerging policy issues that will need to be addressed by donors, governments, and other actors, to achieve the poverty reduction potential of increased investments to agriculture.

2. The current evidence

Although the supermarkets’ share of the food retail sector is quickly growing worldwide, there is variation by region and by product group. Producers formerly supplied either local or export markets. Now there is increasing overlap between these two destinations as supermarkets gain an increasing presence in developing countries. In Central America, for example, FFV sales to domestic supermarkets are approaching the levels of the export sales and are growing fast. Four types of market destinations have been identified: overseas export, regional, distribution centers serving national and regional markets, and local wholesale or retail markets. Typically producers with more capital are able to supply both the export market and the supermarket systems, while producers with less ability to maintain a steady product supply with consistent quality have difficulty becoming preferred suppliers. However, size is not an absolute determinant of ability to supply higher quality products. In a review of African conditions, Weatherspoon and Reardon (2003) find that supermarkets are willing to “upgrade” small producers when medium or larger-scale producers are not available by providing technical assistance to meet quality, safety, and cost standards.

Procurement

Until a few years ago, fresh fruits and vegetables were sold either in the export market, where quality and safety standards were clear and independently enforced, or in local wholesale markets that lacked standards. This distinction is fast fading, as shifts in the procurement process for domestic and regionally-based supermarkets are now shaping export-level quality and safety standards in local sales. While some independent supermarkets continue to purchase their FFV from wholesale markets, supermarkets increasingly rely on specialized wholesalers who draw on their own production or “semi-contractual relations with lead suppliers” to ensure a consistency in quality and volume that is unavailable from the general wholesale markets. Supermarkets are also using distribution centers to centralize the FFV procurement process. In Guatemala, two companies have centralized procurement to levels where between 90 and 100 percent of their FFV are purchased from these centers. In South Africa, one major company has also reached 90 percent. Elsewhere in Southern and Eastern Africa, where supermarkets have a smaller share of the retail food market, purchases from wholesale markets remain important.

Third party certification

As supermarkets gain a larger share of the FFV market, independent agencies certify the health and safety standards. These certification agencies are usually private, but occasionally are public-private entities formed through collaboration with government. In Guatemala, for example, the Ministry of Agriculture joined with private associations of exporters and agrochemical firms to form a certification agency.

Smallholder involvement

The research on national supermarkets has thus far focused on the supermarkets’ perspectives. Little data is available that specifically deconstructs the process from the side of the small- or medium-sized producer. In those countries with good infrastructure and established markets, smaller producers have access and can respond to these new opportunities. However, even in South Africa, with its well-developed transport and banking systems, Black producers who are the beneficiaries of new land trusts and empowerment programs and who trying to enter these emerging markets are beset by difficulties in obtaining financing for inputs, equipment, and transport, and often lack technical agricultural skills and business or management systems. Without targeted support, these producers will be forced out of business by the growing competition.⁴

Kenya, often used as an agricultural success story, was an early exporter of horticultural products to European markets, and its production was initially dominated by smallholders. By the late 1990s, however, the smallholder share of production was only 18%, with the majority (42%) originating from commercial farms and 40% from farms leased by exporters. Increasingly stringent quality and safety standards and the high costs associated with collection of produce from multiple sources contributed to the consolidation of production on larger farms (McCulloch and Ota 2002:4). In a study on the income effects of participation in the horticultural industry, McCulloch and Ota found that households involved in horticulture, either as producers or as

4. USAID PAL project, field interviews.

laborers in packhouses and factories, had higher incomes than did households not involved in horticulture, although they were unable to determine causality. Cross-country comparative research would be helpful in identifying more clearly the possible poverty reducing impacts of market-oriented agri-industries.

3. Policy concerns

Defining quality and safety standards

Quality standards, once limited to size and appearance, now also monitor the presence of pesticides and other chemicals, as well as genetic content. Some codes of conduct also demand that production systems limit or avoid the use of child labor and/or unsanitary or unhealthy working environments. These standards, originally used for export, are now used in national and regional contexts, requiring countries to harmonize policies that set safety standards for products and acceptable labor practices, regulate cross-border trade, and define quality categories (e.g., grades and market niches such as “organic”). Development assistance can provide training to help suppliers learn about and meet these emerging market requirements.

Environmental Concerns

Meeting quality and safety standards can require large quantities of inputs to control insect pests and diseases and to provide nutrients, which can be up to ten times the amounts for other types of crops.⁵ These inputs not only raise the costs of plant production that can be unmanageable for small producers, but may also have serious negative effects on both the environment and on the health of workers. Rising FFV production will also increase demand for irrigation systems, put pressure on groundwater supplies, and raise questions about systems of water rights. Policies on pollution control such as effluent discharge into waterways and groundwater contamination will also become more important.

Science and technology

National and private extension or technical assistance systems need to fill gaps in scientific and technical knowledge relevant to the production and post-harvest needs of both suppliers and buyers. Information Technology (IT) also has a key role for agriculture in improving agricultural market information systems, so that producers have access to accurate and current prices and demand data. In many countries, young people are not interested in entering agricultural careers, and greater support to education in agricultural sciences and business development skills is badly needed to increase the supply of knowledgeable producers.

Gender issues

Research on supermarkets' impact on small producers has not yet addressed the impact of gender inequalities (e.g., lack of access to credit and land, lower levels of literacy, education, and training, both in general and in agricultural disciplines), on women's and men's relative ability to enter into supermarket supply. A brief review of women's involvement in horticultural production suggests that as market and production pressure intersect with existing patterns of gender

5. USDA study (Project Number 6204-22000-017-01)

relations, women's roles in these emerging food systems will be relegated to low paid employment on large horticultural farms, greenhouses, and packing houses. Such work provides incomes, but women receive lower wages than men, working conditions are poor, and their positions are insecure. For minimum wage, they weed, transplant, water, harvest, and package horticultural products, while men, at higher wages, run the farm machinery, apply pesticides and fertilizers, and drive the vehicles.

Technical assistance and reform of land titling and banking systems that discriminate against women will be critical to expand the small pool of successful women who own and manage their own agribusinesses. As owners of small and medium-sized farms, women respond to incentives and increase production when there is trust in the markets and prices are good, but when markets are weak and household or institutional constraints inhibits women's control of their income, there is little incentive to expand production.

Programming implications

- Improved extension and research services to upgrade production and post-harvest handling practices to meet rising quality and safety standards
- Innovative credit programs to satisfy farmer demands for larger assets such as drip irrigation, greenhouses, trucks, and cold chambers.
- Business development skills.
- Capacity building for producer organizations, including women's groups.

4. Knowledge Gaps

Although data on export to overseas supermarkets is substantial, there has been little investigation of the rise of national or regional supermarkets. To identify where donor support can help the farmers of Rural World 2 to engage more easily and more profitably in the supermarket supply chain, there needs to be a better understanding of the process of their integration – what works and what doesn't. Currently, there are gaps in the knowledge about which producers benefit, and the opportunities for and constraints to participation in these markets by small producers. Little detail is available on the trade-offs between the expense of meeting quality and safety standards and the profit for preferred suppliers. There are also questions about the impact of larger-scale production and post-harvest practices on labor patterns, particularly the gender dimension of horticultural production systems. The most research has been done in Central and Latin America, with Africa and Asia less well covered.

Although this paper has focused on the emerging importance of supermarkets for the fresh fruit and vegetable market, there are also parallel changes occurring in dairy, livestock, seafood, fish, and flower markets. Additional research is needed on the labor practices and procurement systems that are channeling these products into the overseas, national, and regional supermarkets. Donors need to review both policy and program directions to determine if current efforts address the poor producers' needs to meet the demands of these new market forces. Factors influencing the growth of regional market systems are marketing, infrastructure capacity, the adequacy of transportation, and the need for new or rehabilitated irrigation systems.

5. Policy Recommendations

For governments and donors

- Provide support to institutional arrangements (such as producer groups) that will engage smallholder participation and maximize their gains from these new market arrangements
- Provide support to producer organizations and entrepreneurial groups that builds their capacity to meet national and international standards of quality and safety
- Enhance rural producers and processors access to market information
- Work towards harmonization of regional and international trade policies that will benefit smaller producers
- Support reform of banking systems to remove gender, ethnic, and racial discriminatory practices, and the enhancement of credit facilities for small to medium-sized entrepreneurs
- Support research on the scale of impact of supermarkets on rural society relative to other factors affecting poverty
- Study the need to regulate commodity markets
- Invest in rural infrastructure (e.g., roads, water supply, and social services)

For the private commercial sector

- Encourage gender-equitable employment practices on suppliers' and processors' farms and factories, allowing job rotation, equal wages, and the provision of safe working conditions.
- Recognize the developmental impacts of supermarket procurement practices on rural actors
- Explore with producer associations opportunities to jointly define standard setting processes

For civil society organizations

- Use women's advocacy groups and other NGOs to reform discriminatory land laws and banking systems that limit access to resources, including land, water, and finance
- Raise awareness of the local "costs" of supermarket procurement practices; support sustainable alternatives to supermarkets in the form of local farmers' markets

6. Selected References:

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