



OUTGROWER SCHEMES - ENHANCING PROFITABILITY

Introduction

Global prices for agricultural commodities have risen dramatically in recent years, making agriculture an attractive investment once again. This, coupled with improvements in the overall business climate in Africa, has seen a resurgence of large-scale investment in agriculture on the continent.

Such investment has the potential to create jobs and raise rural incomes, particularly by promoting uptake of improved production techniques and greater use of inputs. Whether that potential is realized, however, depends largely on the extent to which commercial buyers and Africa's smallholder farmers, who dominate the landscape, can discover mutually beneficial ways to work together.

Many factors limit the ability of smallholder farmers to boost their productivity and make the transition from subsistence farming to market-oriented production. They commonly lack security of tenure over the land they farm, restricting the investments they are willing or able to make in improving the land. They also typically lack access to productivity-enhancing inputs such as improved seed, fertilizers, water and information or to the credit needed to finance investment in these inputs. As a result, smallholder farmers are unable to deliver the volume and quality of produce that commercial buyers – retailers, processors and other agribusiness firms – require, which in turn limits the development of markets for agricultural produce.

Outgrower schemes are one possible way to overcome these obstacles while securing mutual benefit for all stakeholders involved. Such schemes bring together four elements: a central facility surrounded by growers

who produce on their own land under contract; the provision of inputs and technical assistance to growers; guarantees to purchase the growers' crop subject to meeting predefined standards; and growers typically receiving a pre-agreed percentage of the final sales price of their product, thus leaving them still fully exposed to price risk.¹

This brief presents a synthesis of key findings from a review of global experiences in developing and managing outgrower programmes. The purpose of the review, commissioned by IFAD, was to identify:

- key factors (crop type, institutional arrangements, management structure, technology, geography, culture, regulatory environment etc.) that influence a programme's success or failure; and
- how to design replicable, scalable outgrower programmes with broad impact.

The findings suggest that no universal approach guarantees success; rather, success depends on a range of factors. Chief among these are:

- having direct access to a viable market (local, regional, global) for the end product;
- maintaining a clear, transparent pricing mechanism, a price that is attractive to farmers, or both;
- avoiding monocropping systems (especially low-value, high-volume annuals);
- avoiding overreliance on credit to purchase inputs;
- leveraging a competitive advantage in production, product attributes (e.g. brand, certifications) and/or proximity to the end market;

¹ Farmers and farmers' associations in developing countries and their use of modern financial instruments, UNCTAD/ITCD/COM/35, 2002, pp. 10-11



- building/sustaining credibility of the buyer and trust among farmers via regular direct interaction between the buyer and the farmers.

The evidence also suggests that ad hoc, opportunistic investments that do not pursue and sustain an integrated and comprehensive farm-to-market approach are likely to fail.

Understanding Motives

Key to understanding what contributes to the success of outgrower schemes is an understanding of what motivates buyers and farmers to engage in such relation-

ships in the first place. At the most basic level, both buyers and farmers share a common objective – to reduce overall market uncertainty and secure the highest possible return on their investment. For smallholders, this translates into obtaining access to assured markets, credit that is reasonably priced and adapted to their needs, and technical skills and innovations that will help them satisfy market requirements. For buyers, the priority is to secure reliable sources of raw materials that meet their specifications in terms of quality and volume at the least possible cost. Outgrower schemes offer a means by which both buyers and farmers can

TABLE 1 - Major benefits of outgrower schemes.

For the Buyer:	For the Outgrower:
<ul style="list-style-type: none"> • Reduced capital investment in centralized production (land, infrastructure, equipment etc.) • For processors, enhanced control over sourcing (variety, quality control, timing, food safety, traceability) • Potential for improved product quality • Enhanced flexibility to target new market segments with specific qualitative specifications (e.g. fair trade, organic) • Diversifying production risks (e.g. crop disease) via smaller, geographically-diverse production areas • Greater flexibility in responding to market signals • Reduced labour costs (and conformity to labour laws) through subcontracting • Favourable public relations with government and the wider public • Potential for enhanced transactional efficiencies and reduced procurement costs via direct-sourcing linkages 	<ul style="list-style-type: none"> • Improved access to credit for purchase of inputs, or direct provision of inputs by the buyer • Guaranteed access to new, higher-value markets (e.g. processing, export, niche) • Improved access to extension services and post-harvest technical assistance • Better access to new technical and management skills required to satisfy market requirements • Improved access to information and enhanced market transparency • Reduced fixed (e.g. equipment) and/or variable costs (e.g. inputs, transport) • Higher income due to increased yields and/or quality-related price premiums • Potential for higher farmgate prices via direct linkages to buyers

meet their objectives by sharing economic risks and rewards. At the operational level, each stakeholder stands to benefit in unique ways (Table 1).

Whether buyers are willing to outsource to smallholders depends on a number of factors. Outsourcing to smallholders may be the only viable option if land is in short supply. In other cases, working with smallholders may be more cost-effective than investing in commercial production, or may simply be imposed as a prerequisite for foreign direct investment.

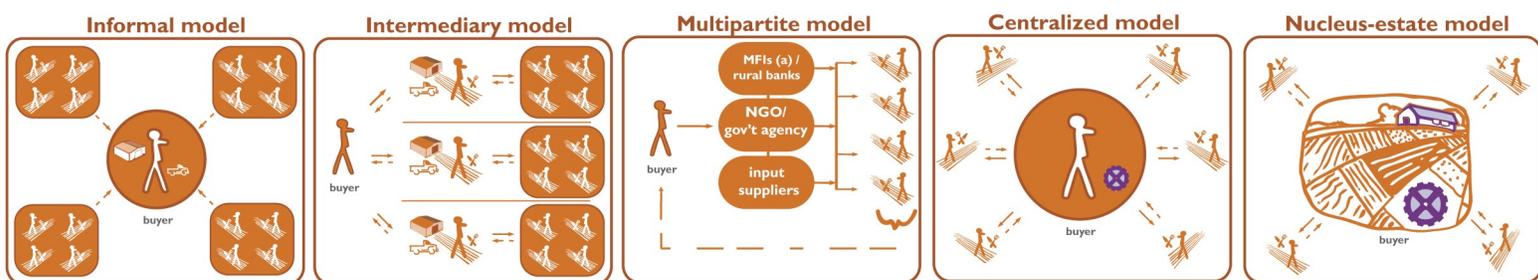
Basic models and key characteristics

Outgrower schemes are incredibly diverse, not only with regard to the products grown but also in the myriad ways in which they can be structured and managed. The one element that all models have in common, however, is that they are founded on linkage-dependent relationships through which companies provide inputs and technical support to farmers in return for access to their produce.

Figure 1 illustrates the basic organizational structure of the most commonly recognized outgrower models.



FIGURE 1: OUTGROWER MODELS AND DEFINING CHARACTERISTICS.



inputs →
 outputs →
 processing ⊗

← Increasing buyer investment
 ← Increasing risk of inconsistent supply →

	Informal	Intermediary	Multipartite	Centralized	Nucleus-estate
Input/credit	○	◐	◐	◑	◑
Extension services	○	◐	◑	◑	◑
Use of contracts	○	◐	◑	◑	◑
Farmer grouping	○	◐	◑	◑	◑
Grower management	○	◐	◑	◑	◑
Centralized production/processing	◐	◐	◐	◐	◐
Post-harvest logistics (packaging, transport)	◐	◐	◐	◐	◐
Summary:	speculative, seasonal sourcing on an adhoc or semi-formal basis and spot-market transactions; few if any inputs/services provided to farmers; minimal firm/farmer coordination; little to no product specification by buyers	semi-formal to formal subcontracting by buyers to partner intermediaries (e.g. lead farmers, farmer groups, buying agents) who manage outgrowers & provide services; limited direct firm/farmer interaction; enhanced but limited product specification	buyer sources from farmers & farmer groups, but TA (b)/input/credit provision & grower management via third parties; limited firm/farmer coordination; higher level of product specification necessitates close monitoring/supervision of production	buyer provides TA/inputs directly, purchases the crop, and handles many post-harvest activities (processing, packing etc.); farmers provide land & labour; high degree of firm/farmer coordination; strict product specifications monitored by in-house technical staff; often linked to processing	buyer operates centralized production and processing (estate), supplementing throughput via direct contracting with outgrowers; buyers often own/control land used by farmers, who supply labour. buyer provides TA/inputs/credit; close monitoring/supervision
Pros:	little to no buyer investment in technical/financial support; low operational costs; high level of sourcing flexibility	reduced risk, assuming effective management; minimal buyer investment in technical/financial support; marginally improved supply-chain management; low-cost of switching to new partners	limited investment & reduced costs due to partner cost-sharing; reduced risks (vs commercial production) due to geo-dispersal of outgrowers	enables high level of control over product quality & volumes; frequent interaction with farmer inhibits side-selling	high level of control over supply chain; simplified TA/extension/farmer oversight; reduced risk of supply ruptures
Cons:	limited control over production (i.e. products, varieties, quality etc.); high risk of supply ruptures; strong buyer competition	lower buyer visibility among farmers; marginal control over production (volumes, quality)	greater risk of sideselling; no core production, reliant on smallholder production; high transport costs	high level of investment needed in developing in-house TA and pre- and post-harvest logistics and related infrastructure	requires heavy investments (land, labour) in production; higher crop-related risks; limited flexibility/options in selecting outgrowers

Never ○
 Rarely ◐
 Sometimes ◑
 Often ◒
 Always ◓

(a) microfinance institution
 (b) technical assistance



Seven key aspects can be used to define these models and any of the myriad hybrid variations that exist:

1. Access to inputs;
2. Extension services;
3. Use of contracts
4. Farmer grouping
5. Grower management
6. Centralized production/processing
7. Post-harvest logistics (including packaging, chilling and transport)

Whether it is palm oil in Indonesia, rubber in Sri Lanka, poultry in Brazil, baby corn in India, pigs in Vietnam or sorghum in Ghana, the way in which management chooses to address each of these seven key aspects defines the overall nature of the scheme and its prospects for long-term viability.

Access to inputs

Asset-poor and geographically dispersed, smallholder farmers are handicapped by their limited access to affordable inputs. Outgrower schemes address this fundamental constraint to smallholder productivity. Motivated by their need to access a supply of produce that meets precise quality and volume requirements, buyers have a strong incentive to ensure that their outgrowers have access to inputs.

The extent of buyer investment in input provision depends on the complexity of end-market requirements and the quality of local input markets. For example, commodities destined for specialized export markets or for downstream processing, such as fine beans, mangoes and malting barley, typically require specific seed varieties, high-quality fertilizers and other agrochemicals to achieve buyer requirements. Often these inputs are not readily available on the open market. In such cases, buyers typically supply the outgrowers with the required inputs (directly via retail centres or indirectly via supplier networks) on credit at the start of the planting season, either at prevailing market prices or at a subsidized price. At harvest, the buyer recoups the investment by deducting the value of the inputs from the farmgate price. In captive markets, where there are limited outlets for the farmers' output, this arrangement can be mutually beneficial to both parties – as long as the farmers have market price transparency and expectation of

“We believe in and are focused on leveraging the core competencies of external partners that already exist in the market rather than developing in-house services. Banks have a core competency of financing. Our core competency is building our sourcing network and selling agri-inputs.”

**-- Nirmal Reddy
ITC Limited (India)
Agri-Business Division**

realising a positive margin. However, in open markets, where there is strong competition among buyers, outgrowers are more likely to sell their produce to third-party buyers for more than the contracted price; this “side-selling” can pose a significant challenge to a programme’s viability.

To avoid the risk posed by side-selling, buyers often seek out partnerships with financial institutions to facilitate formalized input credit for their outgrowers, thereby transferring risks of non-payment to the bank. Under this arrangement, the buyer typically negotiates a preferential rate of interest using their financial position as leverage. The buyer may also assist with processing the loan application, thereby helping the bank reduce its overheads and associated rates.

Nevertheless, leveraging formal credit is not always an option, particularly where rural credit markets are weak or non-existent. In these cases, buyers may be forced to provide credit directly.

In a recent survey of buyers, the vast majority of respondents highlighted the provision of credit and its associated risks as the biggest challenge they faced in working with smallholders. Well-placed investments that facilitate buyer-driven credit schemes can be effective in helping stakeholders acquire credit and the inputs they need to boost their productivity. In addition, investments that enhance interaction between buyers and producers can help build the credibility of the buyer with outgrowers and enhance trust in the buyer, thereby reducing risks of side-selling.

Extension Services

Smallholder farms typically suffer from low productivity and poor product quality, largely as a result of lack of access to advisory services. Buyer-driven outgrower programmes provide a vehicle through which effective



extension services can equip smallholder farmers with the knowledge and tools they need to boost their productivity.

An overwhelming majority of the buyers surveyed for this brief cited the provision of extension services as critical to the success of their outgrower schemes. A large majority expressed a willingness to invest up to 10 percent of the market value of sourced products to ensure effective extension services.

The scale of a buyer's investment and level of direct participation in providing extension services depends on their assessment of:

- the relative complexity of product requirements;
- the firm's in-house technical capacity;
- the quality and reach of state-run services;
- the potential for partnering with credible third-parties; and
- the availability of related resources/funding.

Food retailer ITC Limited was one of the first Indian companies to enter into large-scale, direct procurement arrangements with smallholder farmers. Today, the company has the established capacity to source produce from more than 4 million farmers across the country via an extensive network of rural community platforms. ITC is currently focusing on diversifying the range of products and services it offers to outgrowers as a strategy to broaden and deepen its farmer relationships and to remain competitive. For example, the firm is facilitating local access to weather forecasting and market information, as well as supplying high-quality seeds, fertilizers and other inputs through more than 6 000 rural outlets. It has also partnered with the State Bank of India to make affordable loans available to farmers to purchase inputs. Under the arrangement, ITC facilitates all documentation and verification procedures, thereby reducing associated costs to the bank and allowing the bank to offer more favourable loan terms to more farmers. For providing this service, the company receives a nominal commission at loan disbursement to help defray the administrative costs that it incurs. Since the programme was launched in 2008, ITC has helped to facilitate nearly US\$65 million in credit to more than 70 000 of its suppliers.

SOURCE: Interview with ITC Limited, January 2011

Some buyers choose to build their own networks of extension staff and related infrastructure (e.g. demonstration plots, training centres) in close proximity to the outgrowers to simplify smallholder oversight and ensure compliance with food-safety regulations (e.g. Global GAP, ISO:22000). This approach raises both the firm's visibility among outgrowers as well as its credibility as a committed partner among farming communities. Olam International, for example, typically invests in model farms in the farming communities they work with; these are used to demonstrate improved production techniques, produce and distribute seeds and conduct training programmes. "We feel strongly that the best approach is Olam working directly with these communities," explained Senior Vice President Chris Brett.

Other buyers prefer to contract other companies, local non-governmental organizations (NGOs) or state-run extension agencies to provide customized extension services. Such arrangements are the most defining characteristic of the multipartite model described in Figure 1. Outsourcing extension may be a particularly attractive option for buyers that do not have the technical capacity to deliver such services or that are looking to reduce their operating overheads. However, if a buyer outsources this essential function, it is important that they take other measures to maintain their visibility among the farming community so as to not jeopardize farmer loyalty to their brand.

Use of Contracts

Many outgrower schemes employ contracts between the buyer and the outgrower, ranging from written legal documents to memoranda of understanding (MOUs) and simple verbal agreements. Whether formal or informal, if structured and communicated effectively, contracts can facilitate transactional transparency and help build the trust between buyers and their outgrowers that is so critical to long-term success.

Contractual terms and conditions depend largely on the scale of the buyer's investment. They may be open-ended or structured to fit within a specific calendar period or volume of produce. Contracts may also include input supply and repayment terms. However, all such contracts should clearly and unequivocally set out the terms of pay-



ment and prices to be paid; anecdotal evidence suggests that these are the most common source of dispute over outgrower contracts.

Pricing arrangements are typically based on either an agreed fixed price or on a flexible agreement – one in which the price is tied to the market or other variables. Most buyers prefer to avoid tying themselves down to a predetermined fixed price, particularly when there is a high level of market volatility. A recent survey of buyers showed that the majority prefers using flexible agreements, such as MOUs, that merely specify a minimum volume expectation.²

ITC Limited of India, for example, has adopted a dynamic market reference pricing strategy, announcing its purchase price one day in advance. This approach offers farmers a high level of price transparency and flexibility in their decision-making about when and to whom to sell their produce. It also helps to avoid situations where farmers feel trapped in the relationship, which encourages side-selling and defections.

Buyers commonly make any price agreed conditional on the farmer meeting quality requirements or standards that are specified in advance. In such cases, buyers should ensure that such terms are clearly stated and that farmers understand their obligations from the outset; misunderstandings may harm trust in the buyer and lead to farmers refusing to enter into contracts with them.

In practice, there are few incentives for buyers to formalize their relationships via binding agreements as potential gains are perceived as limited. In developing countries contract enforcement and dispute settlement mechanisms are rarely underpinned with the force of law. Farmer groups are commonly not recognized as legal entities, making it difficult for buyers to engage with them directly in contractual agreements. Moreover, existing laws are often highly protective of farmers' interests; in the case of farmer default, buyers often have little hope of recovering their investments.

Farmer Grouping

Engaging with groups of outgrowers, rather than many individuals, can help buyers achieve important economies of scale. By working through farmers' groups, companies

In 2003 FieldFresh Foods Pvt. Ltd. established a US\$10 million, 120-ha crop development facility, the Agri Center of Excellence (ACE), in Ladhawal, India, with support from the State Government of Punjab. The company wanted a centre where appropriate farming techniques could be demonstrated and supported by post-harvest infrastructure. The location was chosen for its close proximity to Punjab Agricultural University (PAU), a world class agricultural university. As part of its long-term collaboration with PAU, FieldFresh provides scholarships to a few students pursuing postgraduate degrees in horticulture. Upon graduation, many of these students join the company, which helps to ensure a steady supply of high-calibre talent for the scaling up of its business. The company also uses ACE as a training centre to expose its suppliers to the latest agricultural techniques and to improve their understanding of quality and certification requirements.

SOURCE: Interview with FieldFresh, January 2011

can reduce the cost of delivering services such as extension, inputs, farmer management and transport. If managed effectively, such groups can take on a range of roles, including product bulking, quality control, facilitating members' access to inputs, credit and market information, and training in new production technology. Farmer grouping also tends to promote cohesion among members through shared values and 'peer policing', making it easier for buyers to secure and sustain farmer commitment to the partnership and to mitigate the risk of side-selling.

Common farmer grouping strategies employed by buyers investing in outgrower programmes include the following:

- Buyers set up sourcing arrangements with existing farmer organizations.
- Buyers organize individual farmers into commercially-oriented farming groups, often in cooperation with local NGOs, state agencies or other third parties.
- Buyers identify and work through 'lead farmers', who act as intermediary agents. The lead farmers develop their own sourcing arrangements with individual outgrowers.

Whichever approach is adopted, buyers will commonly need to invest in capacity-building in the farmer groups to help strengthen their effectiveness in allocating and

² TechnoServe web-based survey conducted December 2010–February 2011



managing their resources. Companies often look to third parties such as local NGOs or donor projects to provide capacity-building support services, as these are normally not in line with their core competencies.

Finally, selecting the right growing areas and farmers is crucial to the development of effective outgrower schemes and should be handled with the utmost care. Depending on the commodity and buyer requirements, selection criteria might include some or all of the following:

- Farmers should ideally be located close to the buyer and other participating farmers. Close proximity facilitates supervision; long distances increase the likelihood of side-selling and raise the cost of transport and other logistics.
- Farmers should demonstrate an existing capacity to reliably supply the required product, or similar products, to the market.
- Farmers should demonstrate an ability to manage resources effectively. This may include a positive credit record.

Grower management

Good grower management is an essential element of operating successful outgrower schemes. With the right approach, buyers are able to gain the confidence of their outgrowers, which encourages their sustained commitment to the relationship over the long-term. With this objective in mind, buyers often look for ways to differen-

tiate themselves from their competitors by providing better bundles of services (e.g. extension, inputs and market information) directly or through third parties or by staging meetings with farmer groups and other local events at regular intervals. Loyalty programmes that reward farmers for improved performance or consistent supply can be particularly effective. Nespresso's AAA Sustainable Quality™ Program is one such example. Launched in 2003 in Costa Rica in partnership with the Rainforest Alliance, the initiative rewards farmers with price premiums and other benefits for consistently delivering high-quality coffee beans over the long term. The company credits this programme with allowing it to rapidly scale up its procurement of speciality-grade coffee in a number of countries. The popular programme has expanded across Central and South America and, more recently, to Kenya.

Centralized production and processing

Centralized production refers to a commercial farming operation that is owned and operated by the buyer. Under this scenario, the company develops an outgrower programme to supplement its existing commercial production. Rather than acquire more land, the buyer makes use of outgrowers to meet volume requirements that it can no longer meet through its commercial farming activities alone. If linked with processing, buyers can depend on outgrowers to ensure sufficient and consistent throughput and to minimize interruptions in supply. Centralized production and processing is most often associated with plantations (the nucleus-estate model in Figure 1) for perennial tree crops such as oil palm and rubber. Nevertheless, it is also relevant to high-value fresh fruit and vegetable crops for export wherein an agribusiness employs out-

A recent survey of buyers with experience of operating outgrower schemes found the following:

- Crops intended for speciality markets are best suited to outgrower production
- A large majority (60 percent) of respondents highlighted the need for governments to upgrade production and marketing infrastructure, which they see as critical to the success of their outgrower programmes.
- Maintaining a constant field presence and paying premium prices are the most effective ways to maintain farmer loyalty.
- Four out of five respondents indicated that technical extension services were critical in enabling them to source the quality and volume of produce they required. The majority indicated a willingness to pay up to 10 percent of the value of the goods sourced from smallholders for effective extension.
- Lack of extension agents and physical distance were rated as the most important factors influencing the size of outgrower schemes.

SOURCE: TechnoServe web-based survey conducted December, 2010—February 2011



growers to supplement its own commercial production and to smooth out seasonal variations in supply.

The findings of the review indicate that centralized production and/or processing activities have a direct, positive impact on the long-term viability of linked outgrower programmes. This is likely due to the large economies of scale and value added by the centralized activities. Buyers benefiting from improved profit margins are better equipped to reinvest in upstream services that strengthen outgrower capacity and their commitment to the relationship. In addition, the high sunk costs associated with centralized production/processing infrastructure limit a firm's options because of the high costs associated with switching suppliers or relocating.

Post-harvest logistics

The extent of a buyer's involvement in providing post-harvest logistical support (grading, packaging and labelling, cold chain infrastructure, transport etc.) largely depends on the type and relative value of the final product marketed. Chief among considerations are the level of product perishability, quality requirements, existing infrastructure and services and the relative sophistication of participating outgrowers. Some buyers choose to provide such services directly, particularly when sourcing fresh produce or

crops subject to strict quality or food-safety standards or that demand rapid processing soon after harvest. Others rely on intermediaries such as lead farmers or NGOs who are in closer proximity to the farmers to facilitate simple product bulking, quality control and delivery.

Role of government

African governments need to do more to facilitate investments in the rural sector. According to buyers interviewed, governments and their development partners have a key role to play in helping firms to develop sustainable outsourcing arrangements with smallholders. For example, new spending to upgrade rural infrastructure (water supplies, roads, power and communications) and policy reform to improve the business climate are needed to catalyze future investments.

Underdeveloped legal frameworks need to be modernized to facilitate contract farming. Rules and regulations governing the distribution of seeds, fertilizers and other inputs and the provision of extension services need to be liberalized to stimulate competition and remove heavy administrative burdens and costs. Several stakeholders interviewed also highlighted the need for more and better credit and insurance mechanisms for smallholders; governments can create incentives and a transparent regulatory environment for companies to offer credit and insurance mechanisms, which can lead to the emergence of competitive markets for such services.

Governments can provide other incentives to encourage the private sector to make investments that might not otherwise be commercially viable, particularly during the initial start-up phase when outlays are high. For example, Mozambique recently succeeded in enticing brewer SAB Miller to relocate a cassava processing venture involving outgrowers that it had established in Angola by offering the company lower excise taxes, an incentive that the company says was critical to its decision-making.

Challenges to scaling up

While there are numerous examples of successful small to medium-sized programmes encompassing hundreds, sometimes thousands, of farmers, there are relatively few examples of large-scale programmes other than for perennial tree crops.

In 2008, the Seed Producers Association of Ghana (SEEDPAG) began working with the Alliance for a Green Revolution in Africa (AGRA) Program for Africa's Seeds Systems (PASS), a US\$150 million seed value chain intervention in West Africa. PASS aims to help improve value chains for staple food crops such as beans, cassava and maize. Most of the implementation is done through SEEDPAG members such as Savannah Seeds Limited, who provide on-farm demonstrations of improved seeds and technologies and train agricultural dealers in relaying information to farmers. These are new, value-adding measures the producer groups are providing in addition to simply selling seeds. PASS also supports two universities in Ghana to train new plant breeders to MSc and PhD levels; more than 150 West African crop scientists have been trained to date. AGRA reported in late 2009 that it had "funded some 60 crop breeding programs; steered 125 new crop varieties into the field; provided start-up capital for 35 African seed enterprises which have collectively produced approximately 15,000 MT of certified seed; and enlisted 9,200 agro-dealers who have provided smallholder farmers with \$45 million worth of seed and farm inputs."

SOURCE: Interview with AGRA, April 2011; AGRA corporate website, April 2011



“One key advantage of working with outgrowers (vs. commercial production) is lower overheads. We save a lot on our labor costs.”

**-- Ruwan Rajapakse
Hayleys Group
(Sri Lanka)**

There are a number of large-scale outgrower programmes for perennial tree crops across Asia, particularly in Malaysia and Indonesia, where massive government resettlement schemes drove smallholder production of palm oil and rubber in the 1980s. For example, global agribusiness group Wilmar International currently helps manage more than 34 000 hectares of outgrower production in Indonesia alone under the government’s smallholder development initiative. Such large-scale schemes are characteristically structured on the nucleus-estate model (Figure 1). An exception to this is the Sulawesi Alliance of Farmers, Olam and Blommer Chocolate (SAFOB) scheme in Indonesia. Today this programme encompasses more than 27 000 cocoa outgrowers across Indonesia, up from 2 100 farmers when the project was launched in 2005. According to Olam, funding from the United States Agency for International Development made scaling up possible as it enabled the company to increase the number of trainers in the field and reach out to new cocoa farming communities. Non-tree crop larger scale schemes have been developed in sectors such as cotton and horticulture.

The biggest constraints to expansion according to survey respondents is securing sufficient capital and identifying suitably skilled farmers located relatively close to existing projects. Increasingly, private investors will look to external sources, such as the local government or international public donors, to bear some of the associated costs and risks.

Crop suitability

A simple assessment of the relative suitability of various types of crop to outgrower schemes (Figure 2) indicates that certain crops may be more suitable than others and supported the following conclusions:

- Products for which there are limited market outlets have a lower risk of side-selling and might be considered well suited to outgrower schemes.
- Due to long gestation periods and extended lead time

- between investment and initial payback, products derived from tree crops (including some fruits, oil palm, cocoa and cinchona) need the initial capital investment, including costs of caring for saplings, to be assumed by the buyer.
- Due to the higher level of quality that can typically be achieved under the intensive management of small areas of production, crops that attract a high premium for improved quality (including most fruits and fresh vegetables, coffee, cocoa, tea, tobacco, cotton and paprika) are generally well suited to smallholder outsourcing.
- High-volume, low-value products (including many staples and some root crops) are particularly sensitive to transport costs and side-selling risks and are generally unsuitable for outgrower schemes, unless linked to processing to add value.
- Low-volume, high-value products such as fresh produce and processed non-traditional crops generate higher profit margins than high-volume, low-value products and thus are generally well suited to outgrower production.

Generally speaking, crops most suited to successful outgrower production are those for which the product value chain generates sufficient revenues for the buyer to cover not only their input costs and provide a profit but also to cover the costs of developing and maintaining an effective and healthy relationship with their growers. These costs will often include the payment of premiums for quality and consistency of supply, but may also include the costs of extension and/or grower management, of facilitating investment in both inputs and farm infrastructure and of transport. If the dynamics of the product value chain allow it, and the buyer is willing to forego some profit in order to maintain its relationship with growers, it is likely that such schemes will be successful.

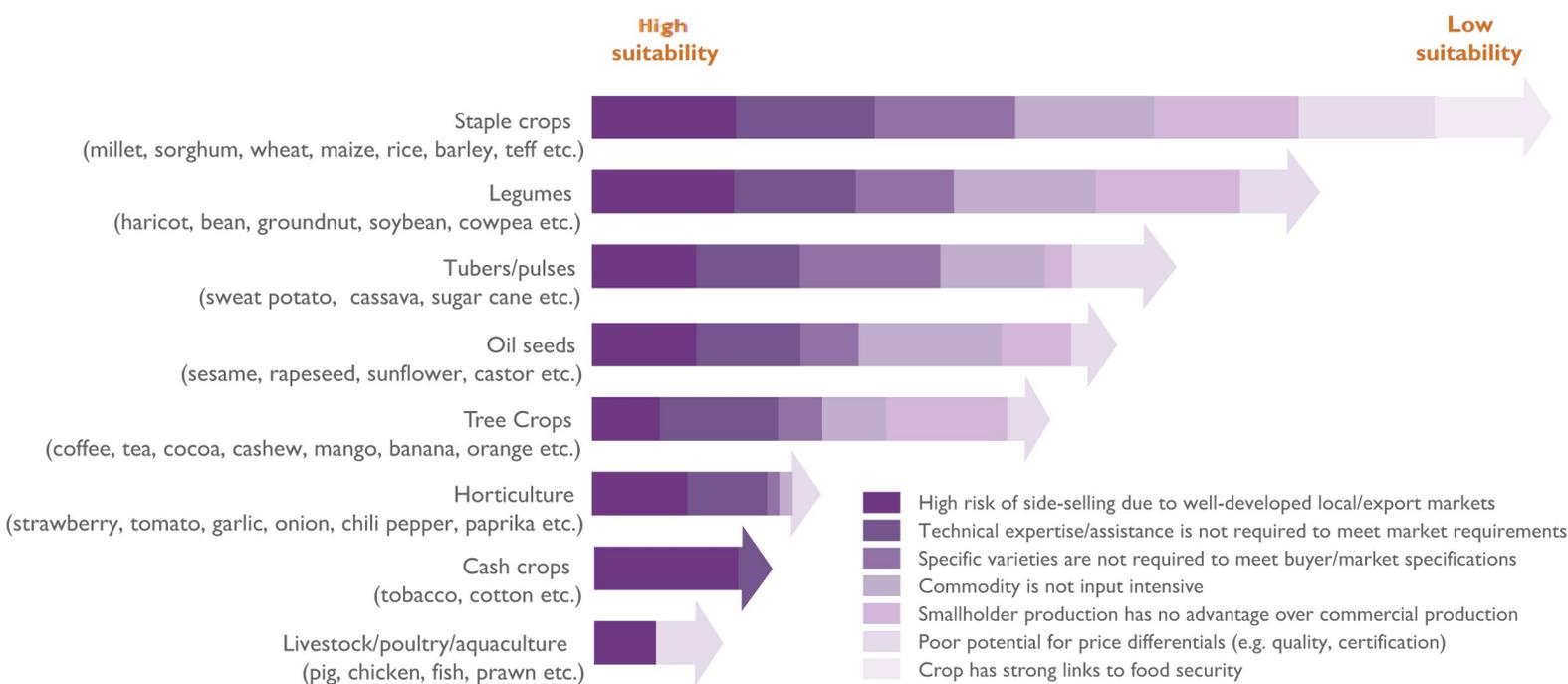
Investor Tips

Based on the above analysis, the following list highlights key issues that investors evaluating outgrower programmes may wish to consider:

1. **Know your end market** — Good market fundamentals are essential. Outgrower output must feed into a viable market. Buyers need to consider whether current local, regional and global trends support prospects for long-term market viability. They should also consider end-market requirements related to food safety and packaging and assess the capacity of local farmers to adopt new



FIGURE 2: CROP SUITABILITY FOR OUTGROWER PRODUCTION.



* The mini-diagnostic was designed to assess the relative suitability of various sub-sectors to outgrower schemes. More than 80 products were evaluated using 7 variables that were thought to have a significant impact on product/crop suitability. Each product/crop received 1 point if it was determined that a given variable was applicable. Then, an average was taken to determine how relevant that variable was in relation to the sub-sector broadly. The width of the bar indicates how relevant that variable was for a given sub-sector.

technologies needed to meet those standards. Will sales generate sufficient revenue to cover the cost of the close monitoring of outgrower production needed to ensure compliance? Will they generate sufficient profits to maintain relationships during periods of market volatility? If targeting niche markets, will there be sufficient demand to underpin higher procurement costs (e.g. certifications)?

2. **Know your local environment** — Familiarity with local markets, communities and the overall enabling environment is crucial. Evaluate the competitive landscape. Considerable upstream investments in input supply, extension and other services may be required in open markets where buyer competition for the crop is high. Assess the business climate. What are some of the legal and regulatory barriers that might impinge on the project (e.g. land-use rights, contract law)? Can associated risks be effectively managed? How does the government view its role in the marketplace and how aggressive has it been in pursuing necessary sector reforms? Securing strong advanced support for the

project from local governments and communities can pay large dividends over the long run. Does the firm have the necessary credibility among target farmers to ensure their support?

3. **Know your product** — Not all products are suitable for outgrower schemes. Analyse the economic data to fully assess the value of the product or crop and its suitability to outgrower production. Low-volume/high-value products such as poultry, livestock and some fresh produce, for example, can generally sustain higher production and transport costs than high-volume/low-value products. Products targeting niche markets can better support payment of quality premiums at the farmgate that help sustain farmer commitment. If looking at staple crops such as sorghum or rice, what are some of the competitive advantages (e.g. landlocked country, brand value, local processing) that could help justify local sourcing vs importing? Is there strong potential for productivity upgrades? Will value-chain profits be sufficient over the long-term to support upstream investments required to meet market require-



ments and to weather inevitable periods of market instability?

4. **Know your farmers** — Choosing the right farmers is one of the most important steps during start-up. Map out project sites in advance and develop a rational approach to farmer selection. Based on the crop and volumes required, determine the number of farmers needed and the proximity of available farmers to project sites. If farms are geographically dispersed, assess the affordability of input/service delivery and associated costs. Evaluate the existing skill base of farmers and their capacity to adopt productivity-enhancing innovations. Identify and assess ancillary income-generating opportunities (e.g. intercropping, by-products) with potential to increase farmer livelihoods. Where possible, engage local partners (e.g. input suppliers, NGOs) who are intimately familiar with local farming communities to assist with the farmer-selection process.
5. **Know your partners** — Partnerships with third parties can be an effective means to mitigate risks and costs in developing and scaling up outgrower programmes. They can also be key in leveraging existing competencies in the marketplace, assuming that there is long-term alignment of interests among partners. Credible partners who are well placed to provide valuable services, will need to ensure that the buyer maintains a high level of visibility. Many buyers have found that subcontracting commercial farmers and other companies to act as intermediaries (e.g. SABMiller subcontracting to Cargill in India) can be an effective and sustainable strategy for organizing and training outgrowers. Many buyers have leveraged formal credit mechanisms by partnering with banks (e.g. ITC and the State Bank of India). Other buyers have identified productivity-enhancing innovations by partnering with local research institutes and universities (e.g. Ticofrut and the Earth Institute in Costa Rica; FieldFresh Foods and Punjab Agricultural University in India).
6. **Know your capacity** — Sourcing from smallholders is not an appropriate strategy for every buyer. To be able to source products successfully from smallholder farmers, buyers need to be able to adapt their business model and outgrower operations in response to changing market dynamics. Developing successful outgrower programmes also requires sustained institutional commitment and a considerable amount of resources to address challenges during the initial start-up and scaling-up phases. Buyers should consider all possible sourcing options and fully evaluate their short-term and long-term goals before investing in outgrower arrangements.
7. **Know your return-on-investment horizon** — Success does not happen overnight. It is important to set realistic expectations. Buyers should not underestimate the time and financial investment necessary to develop successful outgrower programmes. Long timeframes are needed for achieving profitability; allow for a pilot phase (2–3 years minimum) to test and validate innovations before scaling up the programme. Buyers should also evaluate at the outset their long-term commitment to the project, their available resources and the potential for securing buy-in from donors and other sources of supplemental funding support, if necessary. Profitability may not always be a realistic expectation during the start-up phase. However, the expectation of profitable returns must be a key driver behind any outgrower investment strategy if it is to be ultimately viable.

Conclusion

Certain trends at both the regional and global level suggest that prospects for growth in African agriculture are good. These trends include improved market conditions that are encouraging investors to take a more aggressive approach on the continent. However, the impact these new investments ultimately have on future growth will depend on the extent to which buyers are able to develop market-driven, competitive value chains that leverage and empower the continent's small-scale farmers. African governments and their development partners have a critical role to play in ensuring that an enabling environment and appropriate incentives are in place.

In theory, outgrower schemes offer a promising means for buyers to tap into and benefit from the productive capacity of smallholder farmers. In practice, however, experience has been mixed. Initial findings from this review suggest that buyers face numerous challenges when engaging smallholder farmers in sourcing arrangements. They also reveal that establishing and running outgrower schemes is not a science and that good relationships matter most. Although there is no single model approach that will guarantee success, all successful programmes are founded on good economic principles, transparency and a mutual, sustained commitment by all stakeholders to share equitably the market's risks and rewards.



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