Rural Productive Alliances: A Model for Overcoming Market Barriers

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SYNOPSIS

Rural productive alliances are formal agreements that bring commercial buyers together with producer organizations. The alliances aim to increase incomes and employment for rural producers through their participation in modern supply chains, sometimes with a particular emphasis on lagging regions or indigenous populations. Producers overcome market barriers and gain stability through consistent, higher prices while buyers receive a consistent, reliable supply of goods meeting their quality standards. Alliances are initially funded through grants for technical assistance (in production, management, and marketing) for the producer organization, along with infrastructure and equipment. Grant recipients in some organizations repay a share of the grant to the organization to create revolving funds that will provide credit to members when external funding ends. Projects to support rural productive alliances can build upon lessons from earlier projects by, for example, involving financial institutions such as commercial banks from the beginning; working with buyers to sustain and scale up activities when project funding ends; analyzing producer organizations' ability to use a grant productively; and assessing the risk that a buyer or producer organization may leave the alliance. Producer organizations need to build marketing skills and may benefit from a third-party agent or broker to enter particular high-value markets. Buyers can improve the alliance through sensitization to the benefits and transactions costs of working with small-scale producers and through support to optimize the marketability of niche products. Projects require a handover strategy so that domestic actors can fund, implement, and scale up activities when project support ends.

CONTEXT

Whether they are selling to domestic or export markets, smallholders worldwide find it increasingly challenging to enter into and benefit sustainably from modern agricultural value chains. The "supermarket revolution" has changed the parameters of market demand: Exporters, agribusinesses, and supermarkets require large quantities of consistently high-quality goods that meet sanitary and phytosanitary standards and arrive on time. Owing to the scale of their production, high transaction costs, and inability to provide goods of consistent quality, small-scale producers often are consigned to selling in less demanding but less rewarding markets, such as open-air markets, or through intermediaries. Smallholders' lack of information regarding markets, especially their poor knowledge of distribution channels and prices (in relation to product characteristics and timing of delivery), undermines their ability to negotiate with buyers.

PROJECT OBJECTIVES AND DESCRIPTION

A rural productive alliance is an economic agreement between formally organized producers and at least one buyer. The agreement specifies: product characteristics, such as size and varieties to be produced; quantity to be produced/bought; production modalities, such as how a product will be delivered, by whom, and when, as well as grading and packing requirements; payment modalities and price determination criteria; and the buyer's contribution, such as technical assistance, specific inputs, and arrangements for input reimbursement (for example, at the time of sale).

The project cycle

The project cycle begins with a call for proposals, often from the agriculture ministry to producer organizations and their commercial partners. The producer organization starts the process by preparing a basic profile of a potential business plan, which if selected is developed into a full-fledged business plan with the help of a private service provider. The private service provider also produces feasibility studies, which are reviewed by a multistakeholder committee to determine the business plan's feasibility. Plans with satisfactory technical, financial, and market feasibility receive funding.

Who funds rural productive alliances?

World Bank project funds are transferred to producer organization accounts in installments, based on evidence that the organization has used the previous installment according to the business plan and that expected outputs have been achieved. Grants from the project are matched with contributions from the producer organization and the buyer (in the form of technical assistance and inputs) and possibly funding from public and/or private institutions, such as municipal governments or commercial banks.

What do the grants finance?

The grants finance technical assistance in production, management, and marketing for members of the producer organization. The technical assistance mitigates risks for the buyer and builds trust between partners, which is essential to maintaining and sustaining the relationships. The grants also cofinance infrastructure or equipment such as irrigation equipment for individuals or collective storage and packing facilities. In certain instances, project grants fund seed or startup capital for inputs to help smallholders overcome initial financial barriers when dealing with commercial banks.

Creating savings and sustainable funding

In several countries, members of producer organizations agree to repay to their organization a share of the grant they receive from the project. (Technical assistance is typically not reimbursed.) This repayment creates a "revolving fund" that the producer organization will use to provide credit to its members when project support is over.

Implementing the rural productive alliances

For each alliance, a business agreement is signed between the agency in charge of project implementation, the commercial partner, the technical service provider, and the producer organization. An Alliance Management Committee is formed, which includes representatives from each actor, with the objective of monitoring implementation of the business plan. The committee facilitates communication between buyer and seller.

Types of alliances

Alliances can be balanced fairly evenly between producers and buyers. They may also be dominated by either producers or buyers.

In well-balanced alliances, buyers compete to source from organized producers. Producers can meet the buyer's demands and accrue individual benefits from collective efforts. Producers in this situation improve their bargaining power with the buyer. Success comes from the productive use of technical assistance and the buyer's ability to market the product based on its particular characteristics, such as whether it is organic or has been produced for a specific niche market.

In Quindio, Colombia, plantain producers have a strong foothold in determining the prices of their products. The buyer provides technical assistance as needed, and both the buyer and producer organization are more competitive at their respective stages in the plantain value chain than before.

In alliances dominated by a single buyer, the producer organization has limited room to negotiate, even if both parties benefit from being in the alliance. In instances where the buyer is the dominant actor, the buyer helps the producers access the market. The added value of collectively organizing and creating the alliance will probably go to the buyer, however, unless special efforts are made to help producers develop negotiating skills to increase their leverage. In other situations, with a diversity of marketing possibilities for the producers, there is a risk that producers will circumvent the buyer and sell directly to alternate markets.

One alliance of this type is Agrìcola Cafetelera Buena Vista, a coffee alliance in Bolivia. The buyer provides producers with technical assistance to ensure that the coffee is certified organic. In this instance, the buyer is very involved with the producer organization and works to ensure good quality conditions for the producers. Given the high costs of organic coffee production and lack of marketing capability, the single buyer corners the market, however, leaving producers with little room to negotiate.

THE INNOVATIVE ELEMENT

In summary, rural productive alliance projects enable producer organizations to overcome the problems faced by individual, small-scale producers in accessing markets (buyers) in a *sustainable* way. A well-functioning producer organization is key to the success of the model. Working through their own organization, producers achieve economies of scale and can ensure product quality and traceability as required by the market. The revolving fund managed by the producer organization enables the organization to develop financial management skills as well as seed capital to secure future credit for members, thereby providing a means to maintain competitiveness after the project has ended.

BENEFITS, IMPACT, AND EXPERIENCE

Benefits to producers include the following:

- Around 600 rural productive alliances have been established in the four countries that have already begun implementation (Colombia, Bolivia, Panama, and Guatemala), benefitting around 32,600 rural families.
- Members of producer organizations and the organizations themselves have increased their technical and management skills and improved their market intelligence, even if the alliance between the commercial buyer and producer organization is not sustained.
- In some countries, producer organizations and their members have improved their access to private financial markets.
- Women producers benefit. In Colombia, for example, 22 percent of the beneficiaries are women producers.
- The overall result is higher agricultural incomes and increased rural employment, especially for agricultural workers and women working in postharvest activities.

Benefits to buyers include the following:

- Buyers secure access to products of consistently high quality. They meet the sanitary and phytosanitary standards that are applicable to international markets and increasingly important for domestic markets. In addition, by providing improved inputs (seed, in particular) and training, buyers can obtain raw materials of the quality they require.
- Through the alliance, private companies invest in a community, which is a time-tested way for companies to secure producer loyalty.
- Companies that buy locally, from local small-scale producers, enhance their image of being socially and environmentally responsible. This image helps them to differentiate their products from mainstream products while meeting new consumer demands.

LESSONS LEARNED AND ISSUES FOR WIDER APPLICATION

The lessons from unsustainable alliances have been useful in developing recommendations to increase the likelihood that other rural productive alliances will be implemented successfully and become sustainable. The recommendations focus particularly on actions to ensure that alliances remain strong and can continue even after external support ends.

Lessons

A main risk of *any alliance* is that either the producer organization or commercial buyer will default from the partnership. Of the 170 alliances implemented through the first phase of the Colombia project—the oldest of the rural productive alliance projects in Latin American and the Caribbean—39 have not received World Bank financing for at least two years. Of these, 26 have maintained commercial agreements with their buyers or have identified new ones, representing a success rate of 67 percent.

Other alliances have not endured, for several reasons. Often more than one factor contributes to the demise of an alliance.

- *Producers revert to previous practices.* Producers have defaulted because there is a net benefit for them in returning to their traditional markets, despite having secured the buyer's partnership. The default arises when producers, owing to technical or managerial problems, cannot sustain the stringent requirements of high-value markets (see below).
- *Producer organizations lack social cohesion.* Producer organizations can be dysfunctional in various ways. The failure of representatives and members to communicate, poor management, lack of capacity to manage conflicts, and lack of social cohesion will all negatively affect the functioning of an alliance. In Colombia, lack of social cohesion and inability to manage conflicts were perhaps the main reasons that alliances failed. This situation often occurred when the producer organization was encouraged to include more smallholders to make the proposed alliance more socially or economically justifiable. Because the strength of the producer organization is a prerequisite for a successful alliance, it is important to identify such weaknesses early on and provide support to

improve organizational and management skills. In some cases, there is a need for additional support after subproject implementation.

- *The producer organization cannot provide services to its members.* Producer organizations are often under social pressure from the rural community at large to make services accessible to nonmembers. Producer organizations should provide services, but only to members. This strategy keeps membership attractive and encourages producers to market through the organization so that it can continue complying with contractual arrangements made with the buyer. Otherwise the organization is likely to fail.
- *The producer organization lacks adequate commercial or professional skills.* Producer organizations also require management, organizational, and marketing skills to provide services of good quality, such as the capacity to manage a revolving fund. In Colombia, alliances that continued for at least two years after the project ended often involved two-tier producer organizations: grassroots organizations and their union. The first-tier grassroots organizations are involved in managing production. At the union level, the organization deals with procuring inputs, marketing, and financing, with paid professional staff.

Recommendations

After nearly a decade of implementing rural productive alliances in Latin America and the Caribbean, it is possible to identify several recommendations to ensure successful implementation and sustainability of the alliances:

- Projects should emphasize cofinancing from commercial credit sources in addition to matching grants to fund business plans. Involving commercial banks means that the issue of collateral and guarantees must be resolved. Some projects establish guarantee funds to spread the risks to commercial banks and encourage them to partner in funding rural alliances. Involving financial institutions at the beginning of the project can also build their trust in producer organizations and help producer organizations learn to deal with commercial banks. This learning on both sides is important to ensure that smallholders can access credit and partnerships can be sustained.
- More thorough and realistic feasibility studies of business plans must analyze the ability of the producer organization to use the matching grant productively and the risk that a buyer or producer organization may default from the alliance. Feasibility studies look into the market and technical aspects of the alliance, but often they fail to analyze how the organization functions and its capacity to manage a partnership with a buyer.
- To sustain participation in high-value markets, the producer organization needs to build its marketing skills. For example, the organization could benefit from a third-party market agent or broker to assist in breaking into particular markets. Productive alliance projects should consider establishing such brokers, whose role would be to scout the market for opportunities and identify the producer groups that can take advantage of them. These brokers should be private sector agents.
- Three key areas of support could help buyers improve the sustainability and productivity of the alliance:[1] (1) sensitization to the benefits of working with small-scale producers; (2) support to optimize marketability of niche products; and (3) sensitization to the transaction costs associated with working with small-scale producers. Initially buyers need support to manage their relationship better with small-scale producers. An example is being aware of smallholders' cash constraints and the difficulties they face in managing deferred payments, especially with supermarkets.
- During implementation, projects need to address the constraints to sustainability that alliances may face after project support ends. As discussed, a well-functioning revolving fund is fundamental for ensuring that alliances can be sustained. It enables producers to access credit within their own organization and to demonstrate to financial institutions their ability to manage savings and credit. It needs to be promoted more forcefully during project implementation.
- Projects need to include a handover strategy so that domestic actors can fund, implement, and scale up activities when project support ends. At the moment, only the Colombia project is concerned with these issues. By focusing on scaling up its activities through the public sphere, however, the project is likely to face serious obstacles, such as the lack of technical capacity, budgetary pressures on public officials, and political problems (changes in government easily lead to changes in people, priorities, and policies). An alternative would be to work on the side of the buyers. Producer organizations constitute one source of procurement for an agricultural good that buyers need for their business, and they may be the main source if it is produced mostly by smallholders. Once the project has demonstrated the potential that

producer organizations represent, buyers should be interested in continuing to invest in producer organizations, providing technical support, and prefinancing inputs.

ROOM TO INNOVATE IN RURAL PRODUCTIVE ALLIANCES BY SUPPORTING VALUE CHAINS

Future rural productive alliance projects should build upon the lessons of earlier projects, especially lessons about involving commercial banks from the start and working on the side of buyers and agribusinesses to sustain and scale up activities when external funding ends. Scaling up is an issue, as rural productive alliances are still relatively small-scale interventions; another issue is the need to improve the competitiveness of supply chains that benefit smallholders. In the future, a good approach may be to combine the focus on producer/buyer partnerships with a value chain approach. The objective would be to create better productive conditions—for example, by improving the quality of services provided to actors in the chain; improving the capacity of agencies that control compliance with sanitary and phytosanitary standards; supporting research, development, and innovation; addressing the administrative and institutional aspects of certification; promoting organic production or access to other high-value niches; and improving market intelligence. Productive infrastructure, trade facilitation services, and the business environment are additional areas that a value chain approach could address. This emphasis could promote opportunities for promising subsectors and can help roll out the alliance model on a national scale.