Success factors for lead firms to shape inclusive procurement

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Partner organisations

Oxfam is a globally recognised aid and development charity. Its aim is to find lasting solutions to poverty and related injustices around the world. Oxfam engages with the private sector in different ways, including working in partnerships to develop solutions to poverty through new business models.

Unilever is a multinational consumer goods company. Its offerings include food, beverages, cleaning agents and personal-care products. Learning from the collaboration with Oxfam is contributing to how the company can enhance the livelihoods of smallholders in its supply chains.

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Photo credit: Black soy beans being sorted by a women's group in Kulonprogo, Indonesia (August Sjauw-Koen-Fa).

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The Sunrise programme

This research was commissioned by the Oxfam–Unilever 'Sunrise' programme, which was established to explore innovative smallholder-based sourcing models for food ingredients, bringing together the development aims of Oxfam with the sustainable sourcing efforts of Unilever.

The research will feed into the development of guidance for lead firm procurement operations on working with, and engaging suppliers on, smallholder inclusion.

For further details about Sunrise please contact Justin Tait, Sunrise Programme Learning Manager: justin.tait@unilever.com.

Many lead firms in food manufacturing and retailing are looking to open their supply chains to smallholder farmers. Lead firms are rarely, if ever, in a direct trading relationship with smallholders; the relationship is mediated by one or more levels of trader and supplier. The question then arises of how lead firms can support suppliers to trade with smallholders, and in doing so reconcile inclusion of smallholders with commercial drivers. This report has set out to answer that question, based on interviews with lead firms, suppliers and those working to support suppliers to trade with smallholders.

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Summary

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This report has set out to answer that question, based on interviews with lead firms, suppliers and those working to support suppliers to trade with smallholders. The report is presented as five success factors. These in turn can be summarised as three main elements: (1) the business case; (2) enablers; and (3) checks.

1. A clearly defined business case makes the difference between inclusion of smallholders via ad hoc projects, and inclusion through the commercial operations of the company. A clear business case exists when value is generated for the lead firm, supplier and smallholder. For the lead firm, the value proposition may be security of supply (when smallholders are key to future security of supply and there is no alternative large farm option), or brand and reputational value (when smallholders present a compelling message to communicate to consumers around the integrity of ingredients).
2. The research revealed that, once that business case is established, the following key enablers can make a huge difference in whether lead firms help or hinder inclusion:
    - Embedding the 'inclusive procurement' strategy into the core procurement function, and aligning policies with this strategy, to ensure consistency of messages to suppliers
    - Full supply chain visibility for lead company buyers right through to primary production, to understand the consequences of buying decisions
    - Collaboration and co-investment with suppliers, supported with buyer education and incentives, even when dealing with preferred suppliers
    - Transparency and risk sharing all along the chain, including producer organisations
    - Giving pilot interventions time to be successful, with patience, persistence, access to know-how, learning and adaptation.
3. Even with enablers in place, getting from pilot to commercialisation can be hugely challenging, and failure is under-reported. The research uncovered a number of reality checks for new inclusive business initiatives with smallholders. The role and importance of market and sector organisations is often overlooked; inclusive procurement works much better when a receptive business connects with a well organised sector. And more fundamentally, a better outcome for rural poverty reduction may be achieved through better deals for smallholders who are already supplying the company, or for workers, rather than 'greenfield' projects to bring more smallholders into a company's supply chains.

Introduction

1

Modern food manufacturers and retailers like Unilever and Walmart are being encouraged to use their market power to reduce rural poverty, by bringing smallholder producers into their supply chains. The thinking is that these companies, which have the power to exert control over their supply chains (called a 'lead firm' or 'chain governor' in value chain parlance), can get their commercial operations working better for small-scale farmers and the rural economy, and link it to a 'win' for their business.

Guidance on 'inclusive procurement' is often presented as if the lead firm had direct control over trade with small-scale producers or service providers. That is rarely the case. Lead firms are rarely engaged in direct trading relationships with small-scale producers. Trade is usually mediated by at least one and often more levels of trader and supplier, and it is their actions that will make or break attempts at inclusive business. In real life the capacity of lead firms to influence procurement at the beginning of the supply chain is limited by their remoteness from primary production, as well as shortages of appropriate knowledge, skills, and incentives.

There are therefore big questions about what lead firms can do to influence the trading relationship between primary producers and their direct buyers, and what it takes for such approaches to succeed. This report explores 'success factors' based on desk research and interviews, especially in terms of what is possible for lead firms and where/how they can leverage their influence with suppliers.

The potential rewards are substantial. A change in procurement policy by a lead firm the size of Unilever, if done well, can achieve more far-reaching and durable impacts on small-scale farming compared to temporary project-scale interventions, which are still too often the limit of inclusive procurement.

The report is structured as follows. The bulk of the report (Section 3) describes five success factors for inclusive procurement that were identified through the desk research and interviews (the process for which is outlined in Section 2), describing the rationale for the success factors, as well as tensions, where they exist. Tactics, strategies and recommendations that arose from the interviews also point to what can be done to implement strategies and tackle challenges. The words of the interviewees are woven through the section with anonymised quotes that bring real-world experience to ideas embodied in the success factors. Section 4 is cautionary – taking a step back from individual value chains and looking at the bigger picture of inclusive procurement. It is a reminder that value chains operate in a broader (and ever-changing) system, which cannot and should not be ignored. Finally, Section 5 recognises the role of inclusive value chain facilitators, including NGOs, as well as the role of donors and governments, and derives learning for them from the success factors and interviews.

The research was targeted at smallholder inclusion, in line with the focus of the Sunrise programme. Only a relatively small proportion of those living in rural communities, however, are smallholders who trade within formal value chains. While there is potential for these numbers to rise through inclusive business approaches, lead firms and value chains also have an enormous impact on the livelihoods of farm labourers, who represent the majority of the rural poor. Many of the approaches and recommendations described under the success factors can apply to a broader inclusive procurement agenda which comprises workers as well as smallholders, though a few areas of tension are drawn out in the discussion.

Research process

2

This research brings insights from the literature and from practitioners on critical success factors for inclusion of smallholders. The way in which lead firms influence the trading relationship between primary producers and their buyer was also explored by other research teams in three different Unilever value chains – tea (in Kenya), tomatoes (in India) and black soy (in Indonesia). The two research streams will be being integrated into the guidance for lead firms, as well as, suppliers and NGOs to make it easier for them to work successfully with smallholders.

The first step was to review relevant literature to understand what is already well known about the role of lead firms in supporting smallholder inclusion. This included literature and good practice guides on value chain management and governance, trading relationships, inclusive business and examples and case studies. This provided the initial basis for the identification of four success factors.

These success factors were then tested through a modified Delphi approach, whereby they were shared with stakeholders – especially suppliers and lead firms, including Unilever, but also researchers, advisors, and NGOs – over 20 individuals and organisations in total, and refined until an approximate consensus on the key success factors was reached. Through this process, the initial four success factors grew to six and then were consolidated to five across different iterations, and a significant amount of detail was added to each one.

Sorting black soy beans, Kulonprogro, Indonesia (August Sjauw-Koen-Fa)

The success factors

3

The result of the desk research is five interrelated success factors (SFs).

SF1	A clear business strategy for inclusive procurement
SF2	Alignment of the lead firm procurement practice with strategy
SF3	A relationship-based procurement model
SF4	Tailoring the approach to the product and supply chain structure
SF5	Pilots that are implemented with a view to scale and mainstream business

These are now presented, along with their rationale, opportunities for intervention, contradictions and trade-offs. Most of the analysis is based closely on the words of the interviewees. The headline message of these success factors will look rather straightforward to readers, but their application requires careful consideration of strategy and practice.

SF1. A clear business strategy for inclusive procurement

Rationale

A clear and well-communicated strategy for inclusive procurement along with a clear set of metrics and targets sets the company direction, demonstrates a company's intentions to staff, suppliers, investors, and others, and sends clear and consistent signals that build trust in the company's approach and allows mainstreaming.

Interviewees stated that a clear strategy is critical to frame company direction, especially the role and contribution of buyers but also finance departments, towards a company's top line (brand value and market share) and not just the bottom line (cost saving). The strategy gives buyers the rationale for doing things differently. It can also contribute to the value of the business. For example, corporate access to finance is increasingly linked to being a safe pair of hands regarding supply chain traceability and sustainability.

What can be done?

Embed inclusive procurement strategy into the business

Many interviewees stressed the importance of embedding an inclusive procurement strategy into the business in order to achieve scaling and mainstreaming. The business rationale for investing in and sourcing from smallholders centres on securing supply, especially for smallholder-based products such as cocoa, coffee, tea and spices. The availability of good quality materials could increasingly be a strategic pinch point, and unless smallholders get a better deal, processors and manufacturers won't be able to secure their supply.

But it was noted that retail has less at stake. There is a wealth of suppliers to take up the slack. At best, retail tends to take a 'do no harm' approach of risk management rather than 'do more development'.

'Retail does not have the same dependency on its supply base as manufacturers, therefore has less at stake.'

Reach beyond top management

Strategy needs to be backed up by top management but many interviewees stressed that there must be broad understanding through the business, so that buyers, finance departments, suppliers and others know why there is a strategy, and see how to translate it into practice.

'In Procurement everyone is clear on the strategy, but not on how to translate it into day-to-day practice' especially the people in the middle who need to keep the business going'.

Strategy is not just about systems, and corporate culture is as important as policies. The same applies to suppliers. Many companies have very detailed policies, but there are big differences between those companies with a short-term focus on the bottom line and a very narrow mandate given to its staff, and those that are focused on the bigger picture and give their staff the freedom to act based on their personal motivation. Companies need to recognise the role of intrapreneurs to lead, drive and deal with risks, as well as personal leadership at all links along the chain.

Better strategic goals

It is possible to confuse means and ends in setting the strategy. If a company's inclusive procurement goal is looking to improve rural livelihoods, then including more small-scale farmers into supply networks may not be the most efficient or effective approach.

'Talking to those in the business about fairness or sharing value or positive socio-economic impacts is much better than talking about 'smallholder inclusion'. This is not just about smallholders but about better impacts, e.g. for workers and for mid-size farms too.'

Are there better strategic goals than 'smallholder inclusion'? There are two important sets of options here.

- Focus on improving trade with existing smallholders, or hunt for new smallholders to bring into the supply chain? The decision makes a huge difference in emphasis. The majority of literature on inclusive business with smallholders is about 'greenfield' interventions where smallholders are supported to enter the supply chain, with all the challenges of pilot 'projects' (SF5). But once the real numbers of existing smallholder suppliers are exposed, it may be much more effective to focus attention on the welfare of these suppliers, to achieve better productivity and higher producer share of value. Of course, in crops that are predominately produced by smallholders, this is the only option. Principles of inclusive business can be helpful here (Seville *et al.*, 2011) as they apply just as well to existing suppliers as to new ones.
- Focus on smallholders, or wage labour? Lead firms may have a far bigger connection to the rural poor through employment (on suppliers' large farms and plantations, and in processing units) than they ever could through smallholder sourcing. Considering the importance of wage labour for many of the rural poor, particularly women who often lack access to the land, credit and markets that would enable them to be smallholders, should we focus more on workers? A useful reference here is the 'Poverty Footprint' study of Kenyan export horticulture (Wilshaw, 2013). Here the poverty 'footprint' was found to be overwhelmingly about wage labour, not smallholders.[1] Median wages for the 2 million workers (60 per cent of them women) involved in export floriculture was approximately half the calculated living wage, and wages in the green bean sector were even lower. Through its procurement policies a lead firm can directly influence the wages paid to its suppliers' employees, and other conditions of employment such as childcare, which is central to the welfare of women workers.

To find a clear path through these options, a company that sets out to improve rural livelihoods can, perhaps with the help of an NGO, (a) map and understand where the business impacts rural livelihoods especially for low-income women and men (Small-scale production? Farm and plantation labour? Processing?); (b) Rank the most potent leverage points, incentives and drivers for improving the livelihoods of the poorest; and (c) incorporate these into the metrics to track lead firm and supplier performance.

'You need to map where smallholders are, product by product, and identify where there are opportunities to support them. Developing groups in communities that were neglected in the past may be the key to the supply in future.'

Better metrics

With the call for better goals comes a call for care with metrics. Indicators need to go beyond numbers of smallholders included or trained, to reflect outcomes such as improved trading relationships (Fearne *et al.*, 2012) and improved livelihoods (Sustainable Food Lab, unpublished). Simple methodologies are preferable to costly surveys that will not work beyond the initial pilot and into commercial operations. But there were also calls from interviewees for care with metrics for 'sustainable production' expressed as the percentage of certified supply. While certification schemes may be a means to strengthen relationships as lead firm and supplier work together on internal control schemes and traceability, the risk is that certification becomes an end in itself. The emphasis of certification on compliance can then actually detract from a broader focus on relationship-based procurement and efforts to make supply chains achieve socio-economic impacts over the long term. The focus should be on measuring a baseline and identifying clear indicators of success (KPIs) from the outset, shared through the entire chain, with clear dialogue between lead firms, suppliers and producer organisations on the impact of strategies and interventions.

'There is much more utility from the transparency of the chain, not just accepting 'sustainable' material as the end.'

Allow for scaling of smallholder suppliers

There was another fundamental challenge to a goal of smallholder inclusion. If the lead firm's ambition is not to have smallholder suppliers stay small but to succeed and grow over time, then companies need to be careful with idealising small-scale farming in strategies. Some level of scaling is needed to make smallholder agriculture attractive for the next generation of entrepreneurial farmers, and to ensure that family-scale agriculture – especially in sub-Saharan Africa – can provide a viable alternative to plantation-scale agribusiness.

'This is not about seeing smallholders as having to be protected and 'included' at all costs. Some amalgamation and mechanisation is inevitable, along with a focus on yield improvement, for the lives of descendants of smallholders to be better.'

[1] We note, however, that smallholders who produce cash crops are increasingly employing wage labour without the normal range of benefits offered by larger plantations. These workers may be the poorest and most marginalised of the rural poor.

Review procurement policy

For lead firms there will be a temptation to operationalise inclusive procurement through a blueprint approach, with buyer checklists and delegation of responsibility to suppliers. But this research has pointed to the underlying tensions in procurement that can make or break inclusive business (SF2). Those tensions – between cost and risk reduction on one side, and inclusiveness on the other – will always exist. But they are heavily influenced by corporate procurement policy and culture, as the environment that facilitates or supports inclusive procurement strategy implementation.

Reviewing procurement policy may lead to the introduction of principles of mutuality and transparency in trading strategy (SF3).

SF2. Alignment of the lead firm procurement practice with strategy

Rationale

Aligning procurement practice with the inclusive procurement strategy allows a lead firm to send coherent signals and joined up sets of incentives to suppliers. Such alignment is currently hindered by many unresolved tensions between procurement policy (driven by flexibility, cost delivery and risk management), and sustainable procurement goals linked to improved rural livelihoods (driven by the need to secure supply).

'This is the fundamental success factor. The others have solutions or solutions are being worked out, but this remains an unresolved and fundamental tension.'

This leads to mixed signals, whereby companies preach inclusion while excluding in practice. This can be witnessed in the use and misuse of buyer power, where a lead firm's payment terms, duration of commitment, and persistent purchasing below cost of production all preclude suppliers from trading inclusively with smallholders. Lines of communication between lead firm and supplier often don't come together. With a lack of oversight of supplier contacts and different parts of the lead firm pulling in different directions, price will rank higher in the scale of importance.

'If suppliers need to say 'this sustainable procurement requirement will cost more', they are often talking to the wrong person – whose incentives are around cost but not strategy. There needs to be a joined-up conversation and a joined-up set of incentives.'

Firms' de-risking activities also come at the expense of smallholder inclusion, according to a number of interviewees. The strategy for many companies in food production is to get out of smallholder agriculture, because of unreliability in compliance, supply and quality, unless their products depend on smallholders. Most companies are about 'do no harm' rather than 'do more good'. De-risking in the form of audits, food safety standards like GlobalGAP and sustainability standards end up weeding out suppliers that don't have systems and economies of scale to implement them, especially on higher risk products. Firms push through commitments and onerous documentation requirements to the beginning of the supply chain without paying and with no guarantee to buy.

'Lead firms preach inclusion but in practice their activities lead to exclusion due to de-risking strategies which push out smallholders.'

What can be done?

For buyers there is much that can be done to support their suppliers in trading more inclusively.

Build knowledge and skills

Buyers with full visibility of the supply chain, beyond the transaction that they usually see through to primary production, better understand sustainability issues, producer perspectives, how price is formed between farm gate and factory gate, and the implications of buying decisions. For lead firms this is first and foremost an educational task. They should encourage buyers to track – together with their suppliers – the chain 'upstream' to the point of production. More and more companies have a quality person in their procurement teams, and now there is a growing justification to have as a part of the buying team someone with sustainable development knowledge.

'The lead firm needs to have visibility beyond the transaction that they usually see. To ensure fair remuneration – or intervene or influence.'

Put the right incentives in place

Lead firms should ensure that incentives are in place to resolve the misalignment between strategy and operations. Probably the clearest signal is to house the budget for smallholder development within the commercial function (rather than CSR or corporate relations) so that buyers view those funds as investments in the supply base. Companies can also ensure that cost targets for buyers are flexible, and allow savings in one product category to compensate for lower initial revenues from smallholder-based supply chains (that may require several years for benefits of interventions to accrue). Lead firms and suppliers should leave space for individuals to lead and drive initiatives.

'The budget for smallholder development and where it resides is crucial. The commercial business needs to see these efforts as investments.'

Improve buying practices

Lead firms should drive best practice in buying, especially stabilisation of order volumes, transparent pricing, and timely payment.[2] These can support suppliers to employ trading practices of their own that drastically reduce smallholders' exposure to risk in terms of unsold product, selling below cost of production, and sporadic cash flow, and thereby also reduce the risk of smallholders breaking their contracts and side-selling. Sharing risk is as important as sharing cost.

'Companies need to respect existing contracts (including payment terms agreed) before moving on to adapt processes for more/better inclusion.'

As with buyers, suppliers can make adjustments to their procurement practices to avoid transference of undue levels of risk to smallholders, including payment terms (rapid payment and avoiding delays), stabilisation of order volumes and commitment to volume, and a transparent pricing formula.

Side-selling is a real barrier for suppliers to invest in training and trade with smallholders. There are different strategies for suppliers to reduce side-selling and its impacts, including blending sourcing from small and big farmers to avoid dependence, and using contract pricing so smallholders can plan. But for suppliers contracts may be counterproductive and create false security. Suppliers' security is usually founded on building relationships with farmers. If it's a success, the farmer's return will be better and they will want to continue to supply. Also, side-selling can be viewed differently, as an important secondary market without which smallholders would be highly dependent on one chain. A certain degree of flexibility for farmers to use that secondary market can be built into trading agreements.

Co-invest in smallholder capacity

Buyers can support suppliers through targeted co-investment in smallholder capacity in the form of training (especially in driving productivity at the farm level, but also training on markets, pricing models and risk sharing), producer organisation and product aggregation, which can take out cost and risk from smallholder procurement (SF3). Those further 'downstream' from producers often don't understand the need for more 'boots on the ground' to engage farmers in early stages of investment, or for investing to create an organisation – such as an 'ethical agent/value chain connector' (Buxton and Vorley, 2012) – that does this on behalf of the lead firm. However, this initial investment can bring returns in time and counter perceptions among buyers that smallholder procurement costs more. Some interviewees felt that things are headed in the opposite direction, however, with global competition squeezing out the room for investment in making supply chains work.

SF3. A relationship-based procurement model

Rationale

A supply chain that secures supply through development of smallholder agriculture works best when founded on relationship-based procurement models, where the interdependence of all supply chain actors provides a natural guarantee for cooperation.

Relationship-based procurement involves (1) stability in commercial relationships and reliability of lead buyer, allowing suppliers to invest in long-term programmes with assurance that the lead firm will be there for the long haul; and (2) sharing benefits and risks at each step of the chain. These are stronger trading models that bring the lead firm closer to where materials come from, support both partners in ups and downs, and allow a lead firm and its suppliers to take on bigger themes. It can support suppliers to rethink their strategies, with a stronger commitment from lead firms.

'The only way to make sure inclusion happens is by sharing benefits; otherwise the costs at the beginning of the chain make it too difficult.'

What can be done

Transparency and communication

The name of the game is sharing benefits and risks all along the chain, which can be supported by greater communication and transparency between chain actors – sharing clear and reliable information on the market, on problems and challenges faced, and on benefits such as premiums or secured markets from new ways of working with smallholders.

[2] For a manufacturer that sells to retailers on 100-day payment terms, there is resistance to not passing on similar terms to their suppliers. To ensure that payment terms at the start of the chain are adapted to smallholders, there are two basic options. The first is for the lead firm to absorb the difference and make special provision for smallholder-based supply chains, either unilaterally or through aligning all actors along the chain to commit to short payment terms. The second is to help suppliers to line up value chain finance for their smallholder suppliers.

Transparency must also extend to the producer organisation, whose leaders can be supported through training in governance and transparency.

Build in innovation

Relationships should include innovation systems. Stability in commercial relationships does not mean that partners stop negotiation on price – which can be a driver not only of supply chain cost savings but also innovation. It is notable that the potential for innovation in smallholder sourcing and sustainability is often higher when driven by suppliers compared to initiatives that are driven by lead firms. But to make these innovations a business reality, interviewees conceded that suppliers may need to reach beyond buyers to those involved in lead firm strategy, with a story that they can transmit to employees, investors and customers. They saw buyers and their fixation on price as barriers to that communication, whatever the lead firm's managers say about inclusiveness.

'Relationships should drive innovation continuously, providing incentives for cooperation along supply chains (including on climate change adaptation).'

'If you don't keep pressure on prices, you don't get innovation. We will need massive investment – in crops, genomics, varieties – to avoid starvation in 2040. Investing in smallholders' yield potential after years of neglect is part of this.'

'Buyers are usually only concerned with price. Suppliers must reach beyond buyers to those involved in strategy – with a story that they can transmit to employees, investors and customers… Lead firm senior managers need to reach beyond buyers to have dialogue directly with suppliers. It works both ways.'

Make preferred supplier schemes work better for inclusion

A common tool for relationship-based procurement is preferred supplier programmes, whereby deeper collaborations are formed with a subset of suppliers around closer communication and data sharing, in pursuit of higher levels of service, lower transaction costs, and especially the more intensive partnerships that are required to implement an agenda for sustainability, legality and traceability. Unilever's 'Partner to Win' programme[3] is a case in point. Interviewees observed, however, that preferred supplier programmes are proving less useful for leveraging smallholder inclusion than would be expected.

Consolidation of supply to fewer suppliers and fewer regions constrains smallholder procurement to a limited number of localities, while building the relationship around achieving indicators for sustainability tends to consolidate supply around those suppliers with the capital, scale, and systems in place to deliver certified and traceable supplies. There is much that can be done to make preferred supplier programmes work better for inclusion, but the reality for companies will be a restriction on smallholder procurement to a limited number of localities.

Choose the right supply chain

Relationship-based procurement is not always viable – it comes with costs. The 'glue' for relationship-based procurement is mutual benefit for both sides, around quality and safety, for example, and particularly creating added value for brand and consumer. If that 'glue' is missing, the driver is also missing and there will not be enough value in the supply chain to cover the extra costs. This is further discussed in SF4.

'For mutual benefit both sides must have a fundamental need, which creates a strong driver for partnership… If you see odd things like farmers being paid to do training, then it's clear that this mutual driver is missing.'

SF4. Tailoring the approach to the product and supply chain structure

Rationale

Companies and their suppliers need to adjust and tailor their strategy based on specific factors related to the product and supply chain.

As pointed out in SF1, a corporate strategy lines up a company in one direction. But internal and external influences on lead firms and markets can be either a block to progress or can fast-forward an initiative. Quite special (and admittedly rather rare) commercial drivers involving often niche products with high value where the risk of side-selling is low, are big motivators and will greatly accelerate inclusive procurement interventions. For undifferentiated commodities without a compelling business rationale there is likely to be greater resistance from suppliers and buyers because of higher costs and fewer, more uncertain or longer-term returns. Development of inclusive procurement will be much slower.

Other forms of intervention may be needed when (1) there is no direct trading relationship and visibility is missing, for example when a government marketing

[3] www.unilever.com/aboutus/supplier/partnertowin

Tomatoes grown by smallholder farmers in the Nasik district of Maharastra State (Michelle Bruni)

institution blocks traceability along the chain; (2) working with smallholders presents a risk to the smooth operation of the chain, for example a risk of factories operating below capacity; (3) the product has a high risk profile or complex quality specifications; or (4) there is a dynamic local / regional market, with a lot of competing buyers.

'Including smallholders in an equitable way can be difficult in some chains, in terms of how much of the value can be returned to the producer. There is a big difference if you are buying via a parastatal and price is set by the government, vs buying via a private company.'

What can be done?

Select the right products, tailor interventions

The likelihood of success of an inclusive procurement initiative is contingent on the selection of a suitable product. Directly investing in and tailoring procurement from smallholders pays off for a lead firm under certain quite particular conditions:

- When there is a clear business case and value proposition for the lead firm, such as when smallholders are key to future security of supply with no alternative large farm option, and buyers can see high value;
- When there is an intersection of business interests/ objectives for all parties, and everyone therefore has a stake in its success;
- When there is a compelling message to communicate to consumers, for example, around the authenticity of ingredients, and the brand managers see brand value.

So lead firms and their suppliers should look for internal interest and 'pull' from key company departments. They should also look for products that provide a mutual benefit to both lead firm and smallholders, that 'glues' the relationship, such as around price premium for high quality (SF3).

On the other hand, lead firms should look out for structural factors that may prevent smallholders from benefitting from supply chain investments or which prevent traceability, such as a marketing board, which will require alternative approaches (see below). Note, however, that not all institutions block traceability, and may actually be very powerful trading partners. Effective government marketing institutions can also play a vital role in bringing improved price stability and greater producer share of value.

Lead firms and their suppliers should also avoid the temptation to establish contract farming and outgrower schemes where there are dynamic local or regional markets, and many competing buyers. Domestic, regional and 'south–south' trade is growing. The reality in the field is often chaotic and much of it informal, with many traders ready to buy without questions. Growth in competition for farm produce can fundamentally undermine inclusive procurement approaches based on contract farming. Under these competitive market circumstances firms need to tailor their approach to secure supply through good trading, making a strong enough case for farmers to trade with them, to be the trader/buyer of first choice.

'The growth in the number of buyers, especially from emerging economies, and competition for farm produce can fundamentally undermine inclusive business approaches, enticing farmers to break contracts. This questions the whole viability of contract farming approaches, shifting the market back to a straight economic model.'

Explore pre-competitive and multi-stakeholder approaches

For commodities like rice and cotton where there is a preponderance of smallholders and where there is no direct trading relationship, then multi-stakeholder entities or pre-competitive alliances have a role in getting numerous actors involved.

'Pre-competitive platforms can create a level playing field between buyers and companies in a country, to move beyond every company waiting for others to move.'

While all companies agree in principle on the value of pre-competitive alliances there is much disagreement on how to actually work pre-competitively – and many multi-stakeholder platforms do not get far beyond talking. Collaboration is particularly difficult among direct competitors, and where short-term value for inclusive procurement approaches is based on brand differentiation. There is no one solution to these challenges. For those who directly compete in the same product category, for example tea, collaboration is likely to be more difficult than for companies that buy the same raw material, such as sugar, for very different products. Even for direct competitors, the opportunity can lie in working together around improving the overall supply base and then competing on brand.

Involving other partners like government bodies and NGOs is another way to help overcome some of the challenges in pre-competitive alliances. When done well, such coalitions can drive change beyond what any one company or group of companies may be able to justify, driving real transformation in a commodity stream. Their presence also helps deal with concerns of company collaborations leading to cartels.

SF5. Pilots that are implemented with a view to scale and mainstream business

Rationale

The way that pilots are set up has a huge impact on whether insights can work at a commercially viable scale, or stay at the margins of core business.

Pilots are very important for testing a concept, but interviewees commented that there are plenty of examples of projects and few examples of real pilots that are structured and budgeted with a view to commercialisation.

'We see plenty of examples of "projects", but few examples of real pilots.'

What can be done?

Ensure a business logic; involve buyers and the local procurement team from the start

Procurement staff – including the local procurement team – understand the markets and users of the products, and can ensure a business (rather than project) logic from the start, in order to move from ad hoc project work to a more programmatic approach. Sometimes pilots are driven by individuals with real vision, but it's important for those individuals to invest in getting wider buy-in from the outset.

Work with others; build on strengths of value chain connectors

NGOs, donors, governments and other value chain connectors have an important role in getting things off the ground and in developing and managing collaborations between lead firms and smallholders (Lusby, 2008). Agricultural input companies may have well-developed farmer support functions, and can be important allies. Many companies work with NGOs to help them link to smallholders – though NGOs are not the only parties that can act as connectors; there is a largely unexplored role for specialist connectors who can iron out issues and align business models along the entire chain, and then gradually withdraw (Buxton and Vorley, 2012).

That said, the right NGO can build smallholder capacity to organise and bargain effectively with companies – which other more technical chain connectors might not do. And while that can be challenging for companies in the short term, it may lead to greater stability and a better trading partnership in the long term. To avoid reliance on NGOs, however, there is a strong hands-on role for the local procurement team, even seconding the procurement person into the NGO for a while then bringing them back to the business after the pilot phase.

Avoid unsustainable investments of management time

Individual managers from lead firms may invest a lot of work and enthusiasm, but when they withdraw the initiative may be dropped or not scaled. While up-front investment and 'boots on the ground' are important and individual leadership has been crucial in many successful pilots (SF1), leaders need to focus on creating structures internally and externally that can operate sustainably once the pilot has concluded.

'There is a worrying level of embedded extension in company approaches. This is fine when commodity prices are high, but when the price dives it's going to be tough to cover the cost.'

Give pilots time to be successful

Pilots need persistence, patience, access to know-how, learning and adaptation. A push for immediate results and inflexibility in targets and timelines will often end in failure. Pilots are usually hard work for the first 2–3 years, but then there is a tipping point when you gain the trust and commitment of farmers, generating momentum. These timescales demand strong leadership, clear and transparent communications within the value chain, and mechanisms that allow adaptation to happen.

'For vegetables you might need a couple of years to select the right variety but other crops can take longer. Tree crops that need replanting may take five years or more for initial results, and will require the company to be more engaged with the supply chain.'

Improve the chances of success

A pilot that depends on developing and integrating many unknown quantities in the supply chain creates a huge bar to overcome in order to succeed. As described in SF1, working directly with the poorest and most marginalised of farmers, despite appealing to donors and NGOs, will work against successful integration of smallholders into the supply chains of modern food business. The chances of success will be raised when working with

- a **known farm/bigger farm or processor** who can **aggregate production,** and then add in smallholders; or
- a **motivated and established Producer Organisation** that can aggregate production**,** and is ahead of others in terms of organisation/communication. Businesses don't have resources to organise farmers (which can be very costly and time consuming); therefore they tend to work with established groups.[4]

The risk of this approach for rural livelihoods is that it creates 'islands of success' including only the most well-off smallholders, mostly men – although starting with a known/bigger farm and then adding in smallholders may help. It is also important to recognise the crucial role of governments in going beyond individual value chains and improving the performance and inclusiveness of whole sectors, and creating a more vibrant operating environment which can deliver broader inclusiveness.

Beware tokenism

The world is getting wise to lip service on sustainability. Companies that commit only as far as small projects for 'stakeholder communication' are likely to be challenged sooner or later. Worse still, projects that position smallholders as top-up suppliers may do more harm than good, by exposing smallholders to greater volatility and risk.

Recognise the limits of business mandate, responsibilities and capacities

Lead firms may invest substantially in smallholder capacity building in a start-up phase, and then realise that embedding extension in company approaches can be hard to maintain at commercial scale, especially when commodity prices fall. Some interviewees questioned if it is it really companies' responsibility to develop smallholders and cover the cost of extension. They are asking who shares the risks (start-up costs, low rate of return, long payback time), and what is the role for governments and other public money to de-risk private investments. There were mixed feelings about public–private partnerships, however, and an awareness of the risk of entering into these collaborations unless there is a clearly defined need. Otherwise there was a view that it's better to walk on your own.

'Is it really companies' responsibility to develop smallholders? If there are start-up costs, or if rate of return is below what is viable, or payback time is too long – who shares the risks?'

[4] Donor funding is available for capacity building of farmer organisations. Businesses do not have resources to organise farmers but they do have the business and financial skills that farmer groups need.

Challenges and contradictions of pursuing more inclusive business models for procurement

4

We have described the importance of a clear business case and have presented a number of factors as enablers of success. Beyond these success factors, the research and interviews exposed some broader 'reality checks' that inclusive procurement initiatives should seriously consider.

Is our theory of change up to the task?

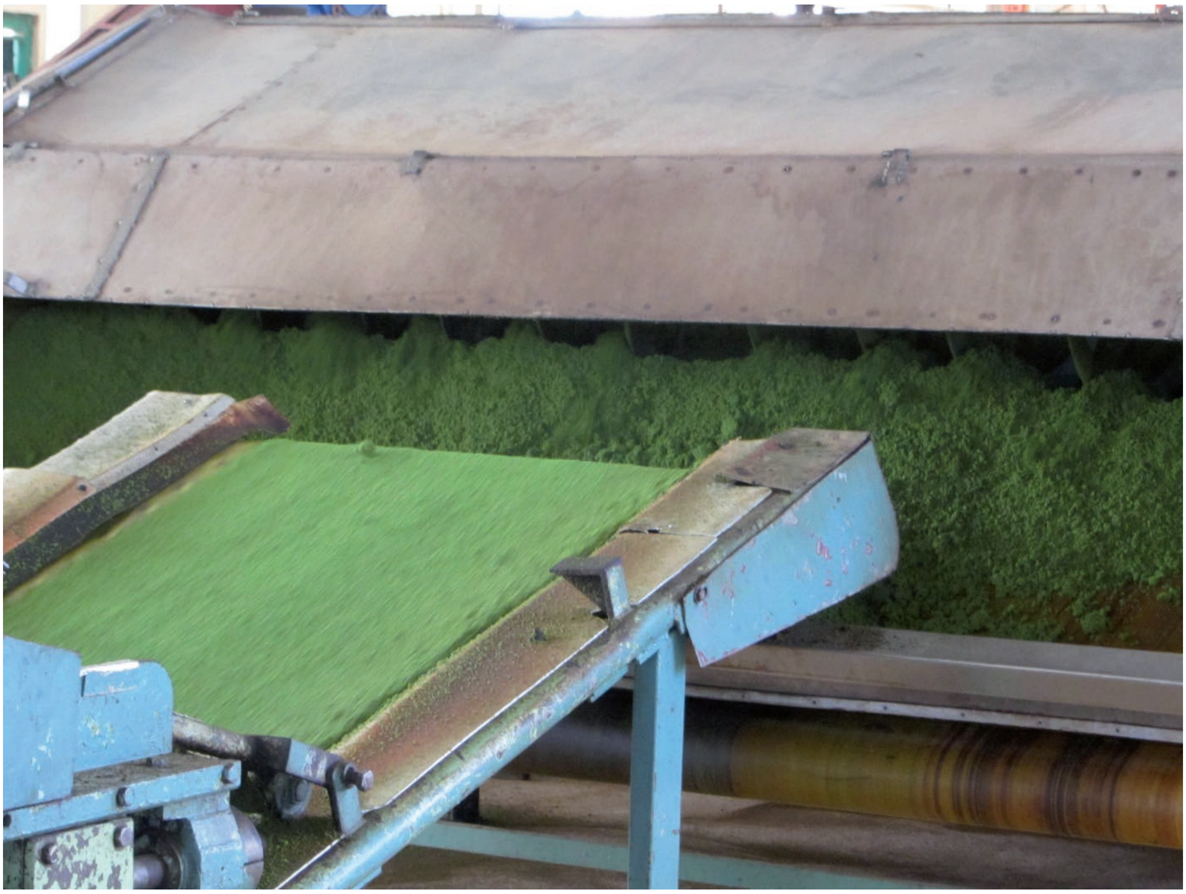
The research was conducted through consultation with people with a stake in success of the model of securing supply for modern agroindustry through smallholder development. But that theory of change, of 'upgrading' smallholder producers to supply modern markets, was challenged. One of the interviewees, commenting on an earlier version of the framework, found the document as reading like a business agenda that believes that this is *the* right way, and is just looking for proof to support it. It highlighted important challenges and then seemed to wish them away through the success factors rather than challenging the overall direction, or learning from continuing instances of failure.

Failure is indeed substantially under-reported in case studies of inclusive business and value chain development. The numbers of farmers 'included' are often way below expectations, and there is little evidence of actual impacts in terms of farmer wellbeing and livelihoods. The lack of successful long-term inclusion can provide just as important insights as cases of success, though research is badly lacking here.

Inclusive business needs inclusive markets (and vice versa)

Inclusive business focuses on collaboration in individual chains. But inclusive markets have a sectoral dimension that raises the performance of a sector rather than a chain, which is especially important for poorer producers. This is often overlooked in the inclusive business agenda, but came across very clearly from this work. Inclusive procurement works much better when a receptive business connects with a well organised sector. This is clearly shown in the example of Kenyan tea, and the institution of the Kenya Tea Development Agency (KTDA), which provides a level of sector organisation that greatly improves the prospects for inclusive procurement at scale:

- It generates surplus (via a levy applied at point of processing) to invest in infrastructure, future processing capacity and quality. Thus Kenyan smallholder tea maintains quality and premium in the world market.



Tea being processed in the Kenya Tea Development Agency factory in Kagwae (Gertjan Bexc)

- It provides farmers with a fair return. Farmers are shareholders in their tea factory companies. There is a transparent pricing mechanism and monthly payment followed by a significant annual bonus. Farmers receive a good share of made tea prices – 75 per cent – compared with 25–35 per cent in Rwanda, Uganda and Tanzania. A dense network of buying centres ensures that farmers are not penalised by remote location.
- It allows for greatly reduced transaction costs for area-wide adoption of technologies such as new varieties or certification, and provides initiatives with a point of contact.
- It provides buyers with an assured product. Traceability is maintained to the buying centre.

The link with Unilever, and its ability to invest and leverage funding, has also benefited KTDA, in helping to significantly improve its extension services and drive certification through the whole smallholder sector.

And yet many buyers try to bypass these institutions and buy direct ('side-buying') in order to have more direct control over the value chain.[5] Companies should think very carefully before bypassing a sector organisation that is delivering for value, quality, farmer empowerment and livelihoods.

Other aspects of inclusion

Creating 'islands of success' based on integration of a relatively small number of smallholders into formal value chains is a narrow definition of 'inclusion'. It makes an important but relatively specific contribution to rural livelihoods, smallholder development and long-term supply security, and often excludes more marginalised groups, including women, that are not organised and do not have access to land, finance, training or market information.

A wider notion of inclusion comprises development of less formal and even informal markets and services on which most poor communities rely. Yet these markets are more distant or totally disconnected from lead firms and inclusive procurement approaches. Lead firms will be focused on their key raw materials whereas the farmer may be growing several crops (staple foods). Government policy and budgets are crucial to ensure that the majority of producers, who are not part of formal value chains, have access to extension services, credit, inputs and infrastructure; that locally relevant research and development is taking place; and that the performance of the agricultural sector in general is raised.

These issues may seem a step removed from the roles and interests of lead firms, suppliers and inclusive value chains. However, broad upgrading and development of the agricultural sector requires investment and resources from government, which is funded by tax revenue. Lead firms and suppliers have a role in paying taxes at source in the host country, in line with international best practice, and supporting local value added. Conversely, tax avoidance, for example, through transfer pricing, cannot be undone by CSR and 'inclusive business' approaches.

[5] See, for example, 'Multinational processors threaten Kenya Tea Development Agency' http://www.standardmedia.co.ke/?articleID=2000093210&story_title=multinational-processors-threaten-tea-ktda

Guidance for NGOs, facilitators and value chain connectors

5

While this document focuses on the role and actions of buyers and suppliers involved in inclusive value chains, this is not the whole story. Most of the examples described by the interviewees rely on NGOs, facilitators or other 'value chain connectors' to make inclusive procurement models work – through supporting the organisation and training of smallholders, for example. NGOs and facilitators enter into these collaborations driven by developmental rather than commercial aims. However, the success factors and tensions described by the interviewees also suggest some recommendations for them.

Focus on the end goal

Despite often being mission-driven organisations, value chain connectors too can lose clarity on the specific objectives being sought and become focused on the means rather than the end. It is important for these organisations to be clear around the end goal, the barriers that are preventing progress towards it, and whether and how working with companies and more inclusive business models can provide a solution. It is also important not to let a focus on smallholder inclusion stop other equally important means of poverty reduction, such as the creation of good quality jobs on agricultural plantations.

Understand there will be both shared and separate objectives in working with companies

Collaboration involves shared goals, along with clear roles, responsibilities and indicators of progress towards those goals. At the same time, it should be acknowledged that each partner will have their own specific objectives that need to be met. NGOs will want to see broader impacts beyond the value chain, tackling underlying causes of poverty, and at the same time need to understand that companies will be focused on commercial objectives.

Make procurement work better for development

NGOs should be asking companies and procurement departments whether they know where their key commodities come from and under what conditions they are produced. This can be an effective tool to raise awareness and create pressure for change.

NGOs should also be working as 'honest brokers', helping to make inclusive value chain connections but also supporting farmers to improve their skills and preparation for negotiation around trade and contracts. NGOs can also help ensure that transparency and other good supply chain practices reach right down to farmer level by supporting and improving the functioning of producer organisations, including through better internal governance and transparency.

Support farmers to manage risk

Working with formal value chains presents real opportunities for farmers to improve incomes, but international markets can also be risky and volatile. Value chain connectors can help ensure farmers understand the risks of engaging in more formal value chains, and develop resilience strategies to manage risk, such as through crop and market diversification. They can also help ensure that contracts that set out good buying practices and fair sharing of risks are respected. Training of producer organisations can improve preparation for negotiation around trade and contracts with the buyer, as well as build knowledge of alternative crops and markets, which influences choice and negotiation and reduces dependency on one lead firm buyer.

Support pre-competitive alliances

In many circumstances, pre-competitive alliances may have greater positive impacts for a wider group of smallholders and communities than inclusive value chains. Yet, pre-competitive collaboration is not easy. NGOs and others can play a role in overcoming some of the challenges in pre-competitive alliances by acting as a neutral third party, for example, aggregating information that would individually be commercially sensitive, and helping to avoid the risk that collaboration between competitors is perceived to be collusion.

Avoid 'projects' – focus on pilots

For all the reasons set out in SF5, inclusive procurement initiatives that have real impact and sustainability are likely to be strongly driven by an inclusive procurement strategy and linked to the commercial business. Before engaging with a company, look for evidence that the initiative is strongly linked to the core procurement function, asking which part of the business key staff come from and where the relevant budgets sit.

Understand too the complexity of smallholder inclusion. NGOs play an important role in supporting and pushing companies to be more inclusive and have a stronger development impact, and this should not change. At the same time, there needs to be some recognition that it will be the more organised smallholders who can successfully work with formal value chains, and the more established businesses that can best manage the initial costs and risks of working with smallholders.

Government policy and investment is crucial for reaching less organised farmers and creating broader 'inclusion', by upgrading the informal sector or strengthening land rights.

Looking forward

Through the Sunrise collaboration it is the intention of both Unilever and Oxfam to use the learning from this research to inform and influence the debate with other companies and the wider sector on what it means to have an inclusive approach to procurement.

For Unilever this research has also informed the development of guidance for procurement staff on how to engage suppliers on smallholder development and enhancing livelihoods. A public version of this guidance will be available by the end of 2014. For further details please contact justin.tait@unilever.com.

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Many lead firms in food manufacturing and retailing are looking to open their supply chains to smallholder farmers. Lead firms are rarely, if ever, in a direct trading relationship with smallholders; the relationship is mediated by one or more levels of trader and supplier. The question then arises of how lead firms can support suppliers to trade with smallholders, and in doing so reconcile inclusion of smallholders with commercial drivers. This report has set out to answer that question, based on interviews with lead firms, suppliers and those working to support suppliers to trade with smallholders.

IIED is a policy and action research organisation working to promote sustainable development – development that improves livelihoods in ways that protect the environments on which these are built. Based in London and working on five continents, we specialise in linking local priorities to global challenges. In Africa, Asia, Latin America, the Middle East and the Pacific, we work with some of the world's most vulnerable people to ensure they have a say in the decision-making arenas that most directly affect them – from village councils to international conventions.

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