



# BRUSSELS RURAL DEVELOPMENT BRIEFINGS

## A SERIES OF MEETINGS ON ACP-EU DEVELOPMENT ISSUES



### SMEs

Resources on the opportunities  
and challenges for SMEs in the  
agricultural sector of ACP countries<sup>1</sup>

Compiled by Isolina Boto (Head of CTA Brussels Office) and  
Camilla La Peccerella (Young Researcher at CTA Brussels Office)

Revised version by Ronalee Biasca (Young Researcher at  
CTA Brussels Office) September 2012





## **Briefing n. 13**

# **Upgrading to compete: what opportunities and challenges for SMEs in the agricultural sector of ACP countries?**

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Compiled by Isolina Boto (Head of CTA Brussels Office) and Camilla La Peccerella (Young Researcher at CTA Brussels Office)

Revised version by Ronalee Biasca, Young Researcher at the CTA Brussels Office. September 2012

This Reader is not intended to exhaustively cover the the opportunities and challenges for SMEs in the agricultural sector of ACP countries but to provide some background information and selected information resources. Most text of this Reader has been directly taken from the original documents or websites. For additional inputs, kindly contact Isolina Boto ([boto@cta.int](mailto:boto@cta.int)).

The Reader and most of the resources are available at <http://brusselsbriefings.net>.

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## 1. Some background concepts

### Defining SMEs

There is no single agreed definition of an SME. A variety of definitions are applied among OECD countries, and employee numbers are not the sole defining criterion. SMEs are generally considered to be non-subsidiary, independent firms which employ less than a given number of employees. This number varies across countries. The most frequent upper limit designating an SME is 250 employees, as in the European Union<sup>2</sup>. However, some countries set the limit at 200, while the United States considers SMEs to include firms with fewer than 500 employees. Small firms are mostly considered to be firms with fewer than 50 employees while micro-enterprises have at most ten, or in some cases, five employees.

Financial assets are also used to define SMEs. In the European Union, a new definition came into force on 1 January 2005 applying to all Community acts and funding programmes as well as in the field of State aid where SMEs can be granted higher intensity of national and regional aid than large companies. The new definition provides for an increase in the financial ceilings: the turnover of medium-sized enterprises (50-249 employees) should not exceed EUR 50 million; that of small

enterprises (10-49 employees) should not exceed EUR 10 million while that of micro firms (less than 10 employees) should not exceed EUR 2 million. Alternatively, balance sheets for medium, small and micro enterprises should not exceed EUR 43 million, EUR 10 million and EUR 2 million, respectively. In addition to satisfying the criteria for the number of staff and one of the two financial thresholds, an SME must be independent; to this end, the new definition distinguishes between autonomous enterprises, partner enterprises and linked enterprises. Finally, the new definition, introducing precise financial thresholds for micro-enterprises, thus recognises the essential role of the latter in the economy<sup>3</sup>.

### Defining entrepreneurship

Entrepreneurship has typically been referred to as an action, process, or activity, in which creativity, risk-taking and innovation play a significant role. Substantial entrepreneurial behaviour can occur among existing entrepreneurs and existing firms, including longer established firms, and the systematisation of innovation and commercialisation within existing firms. The recent Green Paper on Entrepreneurship in Europe by the European Commission defines it

as follows: “entrepreneurship is the mindset and process to create and develop economic activity by building risk-taking, creativity and/or innovation with sound management, within a new or an existing organisation”. Despite the definitional differences, it is commonly agreed that entrepreneurship is a driving force behind SMEs<sup>4</sup>.

### Value chains and upgrading

A value chain is a sequence of target-oriented production factors which combine to create a marketable product or service - from conception stage through to the final consumption. This includes activities such as design, production, marketing, distribution and support services to the consumer at the end of the line. The value chain approach is a methodology used to analyse and upgrade clusters or sectors. It is a methodology based on the assumption that economic performance and competitiveness of clusters or sectors largely depend on how these clusters or sectors are related to other actors both up and down the value chain. The methodology starts with an analysis of the value chain. On the basis of such an analysis, a number of possible scenarios for upgrading or developing clusters or sectors are identified and subsequently implemented.

The concept of a global value chain (GVC) is a commonly used framework for analysing the sequence or stream of interrelated activities performed by firms, organizations or individuals in different geographical locations, necessary for bringing a product or service from production stages to final customers.

**Figure 1 - Definition of micro-, small- and medium-sized enterprises**

Enterprise category	Headcount	Turnover	Balance sheet total
medium-sized	< 250	≤ € 50 million	≤ € 43 million
small	< 50	≤ € 10 million	≤ € 10 million
micro	< 10	≤ € 2 million	≤ € 2 million

Source: Report on Support to SMEs in Developing Countries Through Financial Intermediaries. 2011

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In the case of agriculture, a typical or generalized agribusiness GVC includes the production of inputs (such as seeds and fertilizers) feeding into agricultural production and leading onto trading and logistics, processing and ultimately to retailing, and thence to final consumers in the downstream part of the chain. GVCs help understand how activities performed at different stages of the chain are coordinated and the complexities of the governance structure.

In terms of the power of companies at different stages of GVCs, chains can be typified as either “producer driven” (e.g. during the colonial era, ownership of a plantation was key in delivering fresh produce to industrial or final customers), or “buyer driven” (e.g. in the post-war era, ownership of brands or distribution, among others, means that the lead firms in GVCs are more often companies such as traders and supermarkets, depending on the commodity);

Five basic types of relationships (or patterns of governance) between firms in GVCs can be distinguished. They are:

- Arm's length (pure market): relations where there is no close relationships between buyer and supplier firms. In the case of agriculture, manufacturers and other downstream firms buy commodities on the international market. There is no direct participation by such Trans National Corporations (TNCs) in agricultural production.
  - Modular networks (market-like, but inter-firm linkages are tighter than simple markets): firms develop information-intensive relationships, frequently dividing essential competences between them. Suppliers produce to the customer's specifications, which, in the case of agricultural production involves farmers meeting standards such as those related to quality control or safety. Lead firms may support farmers or other agricultural producers, for example through technical training, funding and provision of seeds. TNC involvement with farmers through modular networks can be considered an indirect form of TNC participation in agricultural production.
  - Relational networks: these involve mutual dependence between firms, regulated by trust, which may derive from, among others, reputation, family and between Indian agricultural TNCs and parts of East Africa.
  - Captive networks: the buyer exercises a high degree of control over other, less powerful and usually smaller firms in the chain. In the case of agricultural production, this can take the form of contract farming. Contract farming can be regarded as a non equity form of TNC participation in agricultural production.
  - Hierarchy: governance is characterized by vertical integration and managerial control (i.e. foreign direct investment). Transactions are internalized within firms, and affiliates (which may be joint ventures) produce for the parent firm and other parts of its network. This represents an equity form of TNC participation in agricultural production. In addition, there may be instances where a TNC does not own the farming land, but has a long-term lease<sup>5</sup>.
- The concept of “upgrading” implies making better products, making them more efficiently or moving into more skilled activities<sup>6</sup>. It therefore is a multi-dimensional process which helps to increase the economic competitiveness of enterprises and their clusters, and at the same time to create a positive impact on the affected workforce, community and society at large.

### The cluster concept: focusing on the spatial dimension

Value chains, or important parts of them, are often spatially concentrated. As pools of labour with sector-specific skills evolve, spatial concentration is further enhanced.

Clusters are characterized by sector specialization and geographic concentration. Extensive research on enterprise clusters has shown that clustered firms often perform better than spatially dispersed firms. This is due to the fact that geographic proximity facilitates what Schmitz call “collective efficiency” emanating from

- forward and backward linkages between firms inside the clusters;
- intensive information exchange between firms, institutions, and individuals in the cluster, which gives rise to a creative milieu;

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- the existence of a local pool of skilled labour and the attraction of buyers;
- joint action (e.g. joint purchases or marketing efforts);
- the existence of a diversified institutional infrastructure supporting the specific activities of the cluster;
- a sociocultural identity made up of common values and the embeddedness of local actors in a local milieu which facilitates trust.

The cluster concept thus also highlights the embeddedness of firms in complex inter-firm relations. The cluster concept emphasizes geographic proximity, and it draws the attention to additional elements which are usually not addressed in value chain analysis, e.g. the role of local socio-cultural milieus with shared values, the relevance of local labour pools, formal and informal mechanisms of knowledge transfer as well as the dynamics of joint action of firms at the same stage of the value chain. Combining both concepts thus helps us to better understand two interrelated sources of technological learning and upgrading opportunities: those transferred through buyer-supplier relations and those stemming from other elements of the local milieu. Research shows that clustered firms tend to increase their extra-regional sales and purchases. In other words, global value chain integration gains importance whereas cluster coherence has a tendency to erode. Nevertheless certain agglomeration economies persist which limit dislocation and

stabilize local business networks. This has important implications for policymaking. The trend towards increasing local integration into global value chains, especially the growing role of global buyers, obliges policymakers to reorient local economic development and cluster initiatives towards linkage building with external markets. In fact, both academic research on clustering in developing countries and practical cluster promotion in the past tended to exaggerate local interactions and understate the relevance of external agents as facilitators of market access and innovation. On the other hand, it may be promising to combine linkage building with lead firms with policies for local economic development and SME networking which help mobilizing local synergies<sup>7</sup>.

## **2. SMEs in developing countries: setting the framework**

The SME sector is the backbone of the economy in high-income countries, but is less developed in low-income countries. The Organisation for Economic Co-operation and Development (OECD) reports that more than 95% of enterprises in the OECD area are SMEs. These enterprises account for almost 60% of private sector employment, make a large contribution to innovation, and support regional development and social cohesion<sup>8</sup>.

The contribution of small and medium-sized enterprises (SMEs) to employment, growth and sustainable development is now widely acknowledged. Their development can deepen the manufacturing sector and foster competitiveness. It can also help achieve a more equitable distribution of the benefits of economic growth and thereby help alleviate some of the problems associated with uneven income distribution. The available evidence suggests that SMEs have played a major role in the growth and development of all the leading economies in Asia. The Asian experience clearly shows that it is mainly the growth-oriented medium-sized enterprises among the SMEs that have a high propensity to apply technology and training and serve specialized niche markets. Among the factors that have contributed to the success of such SMEs is a high incidence of cooperative inter-firm relationships, which have rendered individual firms less susceptible to risks, fostered mutual exchanges of information and know-how between firms and created a rich pool of collective knowledge.

A key factor has also been the provision by Governments to SMEs of technological extension services (such as quality assurance, research support and information on sources of technology).

However, a similarly robust and dynamic SME sector is absent in many developing countries, particularly in the least developed countries (LDCs). The enterprise sector in many LDCs shows a distinct dual structure. At one extreme there exist a few large modern capital-intensive, resource-based, import-dependent and assembly-oriented enterprises, while at the other extreme there are small and informal sector (micro) enterprises that use very simple and traditional technologies and serve a limited local market. This structural imbalance in many developing countries has arisen despite their implementation of SME promotion programmes for many years. The industrialization policies pursued by developing countries in the past are identified as having contributed to a bias in favour of larger scale enterprises by encouraging premature movements of resources into large capital-intensive businesses rather than promoting the gradual and organic growth of enterprises. This bias persists in many developing countries, rendering their SME promotion strategies largely ineffective. Furthermore, efforts focusing on SME development are often frustrated by the absence of a favourable macroeconomic framework. In addition, repressive legal and regulatory regimes can impose disproportionately high costs on SMEs, which often results in a

polarization of business size and the phenomenon of the “missing middle”.

Badly conceived SME promotion strategies are equally to blame. The degree to which the State regulates, supports or inhibits SME growth requires a delicate balance: overly protective SME development policies have proved ineffective in promoting a robust and dynamic SME sector. The outcome of such policies is a small-scale sector with low productivity, insufficient opportunities for dynamic growth and powerful vested interests.

The structural adjustment programmes (SAPs) of the 1980s, and in recent times, the general move to liberalize domestic markets, were expected to rid economies of market distortions and pave the way for vibrant private sector growth. However, experience shows that the process of policy reform in developing countries which suffer from imperfect market conditions must go beyond the elimination of price distortions and a mere adherence to market principles.

There is thus a growing recognition of a need for micro-level approaches that address the specific problems facing small-scale entrepreneurial activity and that are compatible with the general direction of industrial and macroeconomic policy. In the prevailing climate of globalization, developing countries urgently need to ensure that they have a critical mass of domestic enterprises in the middle range, which are internationally competitive and capable of penetrating global chains of production.

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The East and South-East Asian experience with export orientation shows that the majority of small enterprises perform poorly on the world market. Those most likely to survive are the ones with export potential, and which, in addition, grow from small into efficient medium-sized firms. Given the inherent difficulties of small enterprises, it is also quite clear that a dynamic SME sector cannot be established without external assistance. In their pursuit of open investment and trade policies, as dictated by the new global economic environment, Governments of developing countries and LDCs need to integrate measures aimed at SME development into their general industrial and economic policy. The combination of intensified competition and technological progress means that countries have to examine how best to use their available scientific and educational resources to enhance domestic technological capabilities as an integral part of industrial policy, in a changed global context<sup>9</sup>.



## **3. Current challenges to SMEs development in developing countries**

### **3.1 SMEs and the global economic crisis**

The global economy is experiencing its greatest slowdown since the Second World War. Due to the increased integration of goods, services and financial markets, the crisis has spread from housing and credit sectors in the U.S. to other markets and countries around the world. There are few, if any, economies that been left untouched by the crisis. The collapse of Wall Street investment banks and American mortgage lenders has had serious knock-on effects for commercial banks and non-financial companies around the world.

Credit everywhere is tight as lenders seek to shore up their financial positions and increase their precautionary reserves. Borrowers have become suspect as creditworthiness is difficult to assess. Businesses in the real economy have found it hard to survive, resulting in increased layoffs and closures. Retrenchment translates directly into a decline in the opportunities for women and men to engage in decent work. Thus, the credit crisis has developed, via weak demand, into a full-blown economic crisis. Many developed countries slipped into recession in the last quarter of 2008 and many developing countries have seen their growth rates plummet.

The crisis is affecting firms of all sizes. While large firms grab headlines when disclosing layoffs and dramatic declines in sales and earnings, many micro, small and

medium sized enterprises (MSMEs) are also trying to cope with weak demand, tight credit and reduced orders from larger companies. Small businesses across a range of sectors and organizational types have been affected, although preliminary evidence suggests that the cooperative form of enterprise is managing particularly well and many are adding new members.

The overall result is an absence of a well-functioning SME lending market, and SMEs are impeded in their growth, with negative consequences for innovation, economic growth and macro-economic resilience in developing countries<sup>10</sup>.

MSMEs, which account for over 90% of enterprises in all countries, are an important source of output and employment. They employ 33% of formal sector workers in low-income countries and 62% of such workers in high-income countries. Because poor countries have large informal economies, dominated by micro-businesses, the MSME portion of total employment is much higher. In India, for example, 86% of the labour force is employed in the informal sector, including farming. The crisis has not only hit Wall Street and Main Street, but it has affected the side streets, the dirt streets and the markets where many small retailers and producers thrive.

The MSME sector is highly varied, both within a country and between richer and poorer countries. Formal sector firms, working within the framework of formal credit institutions, tax regulations and social security programs can

benefit from changes to the policy environment that are designed to assist enterprises during the downturn. Micro enterprises, notably those operating in the informal sector, constitute the vast majority of businesses in most developing countries. They include what are often called own-account workers, the self-employed and small family operations. They are unlikely to benefit directly from changes to the formal policy environment and from efforts to expand credit through banks and other formal lenders. They will only benefit from procurement and infrastructure programs if they are consciously included. In addition, small and medium firms engaged in export-related industries, producing either final products or components in a value chain, are being affected as recession hits importing countries<sup>11</sup>.

#### **New trends in value chain formation**

Increasing globalization is changing the business environment of SMEs and agricultural producers in developing countries in different ways. It is worth summarizing some developments which impact on the structure of value chains before discussing their likely positive or negative implications for pro-poor growth:

- Liberalization of global markets increases competitive pressure and enhances the role of economies of scale. This has furthered concentration processes, e.g. in manufacturing and retailing.
- Increased international competition reduces returns



to firms that fail to innovate and distinguish their product. Continuous product changes and branding strategies therefore gain importance as a market differentiation and upgrading strategy.

- International competition also rewards reliable and timely delivery. Error-free production, smooth supply chain logistics and short time-to-market thus become increasingly important for the success of companies.
- Greater consumer awareness has given rise to higher and more differentiated consumer standards.
- New transportation, information, and communication technologies have driven down the cost of accessing information and trading products and facilitate the spatial division of value chains. This has implications for the choice of locations for different phases of the production process. Nations and their firms can more easily specialize by subsector or even activity within an industry. Lead firms divide the activities associated with their industry into ever more differentiated segments and locate their affiliates at the optimal location anywhere in the world, respectively source from independent suppliers at the optimal locations.
- Some firms increasingly dominate their business partners upstream and downstream in the value chain, imposing their own rules and acting as gatekeepers to the market. Their dominance arises

from specific capabilities, mostly the capabilities to innovate, to create brands, or to coordinate the whole production process. Their privileged position implies a shift in power that usually translates into increasing rents. Given these trends, the sourcing and outsourcing strategies of large industrial and commercial corporations as well as their efforts to define and enforce more demanding standards are becoming key determinants for the integration of developing countries and their firms into the world economy. Access to OECD markets increasingly depends on their ability to enter into global production networks of lead firms. This entails both threats and opportunities<sup>12</sup>.

### Threats for pro-poor development

A first threat results from the fact that those large corporations that are able to create powerful brand images, influence fashion trends, set and enforce standards and coordinate comprehensive logistics networks rarely originate from developing countries. With the exception of some emerging TNCs from newly industrialized Asian countries, 51 lead firms are almost exclusively based and embedded in OECD countries. If lead firms become more important as innovators, coordinators and governors of global production networks, and subordinated companies become standard-takers which are excluded from important processes involved in creating intangible values, this process will shift power, and probably value added, away from developing countries.

Second, the growing importance of knowledge-intensive, intangible factors (including design and branding) may enlarge imbalances between developing and developed countries as well as within these countries. Successful product innovations and branding strategies tend to shift rents and bargaining power to the innovator or brand owner. In poor countries and regions only very few differentiated industrial clusters or “knowledge hubs” exist that are able to provide strategic complementary service support for knowledge-intensive production.

Third, increasing scale requirements and market consolidation raise entry barriers for smaller firms and reduce the number of markets where they can sell their products. Small, less efficient firms will often be crowded out or face the challenge to specialize in areas with lower scale requirements and specific comparative advantages.

Fourth, as lead firms (but also governments and consumer organizations) impose more rigid standards even for the subordinate functions of the value-adding process, barriers to entry again tend to rise. Firms in developing countries have to meet ever higher and more costly minimum technological standards. To give a few examples, additional investments are required to establish software for electronic data interchange and traceability systems; to meet higher standards in terms of (depending on sector) hygiene, safety, electromagnetic compatibility etc., suppliers have to bear the costs of compliance with social, environmental, hygiene and other standards plus the necessary

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certification procedures and customer audits. Crowding out of smaller, less competitive suppliers and locations is likely to occur <sup>12</sup>.

### Opportunities for pro-poor development

As TNCs systematically subdivide their functions, reorganize their internal corporate structures, concentrate on core competencies, and outsource marginal tasks and functions, new opportunities present themselves to developing countries which fulfil the minimum conditions for performing these tasks at lower costs. According to some authors, the spatial dislocation of production processes according to the specific requirements of each stage of production “is actually good news for developing countries, because today an economy does not have to be able to do everything in a production chain or an industry in order to participate. The key is finding the specialization, finding the niche, finding the activity in which the nation can compete, and creating links into the world economy sufficient to participate. New ICT technologies for example enable developing country firms to acquire contracts in new areas such as back office services.

Moreover, since lead firms are ever more interested in assuring smooth, error-free production flows and compliance with all sorts of standards, more knowledge transfer is required. Even though we have mentioned increasing entry barriers as a risk, they constitute an opportunity as well. If lead firms want to exploit factor cost advantages in less developed countries or regions, where

“advanced” production factors such as testing facilities, standardization and certification bodies, consultancy firms etc. are in short supply, the lead firms are likely to put more effort into the transfer of technology. Empirical evidence shows a variety of relevant learning processes among Third World suppliers in global production networks. For example, the dissemination of business concepts and standards such as ISO 9000, ISO 14000, “good manufacturing practice” (GMP) and “good agricultural practice” (GAP) among firms catering to international customers has largely been triggered by a combination of pressure and support from international lead firms. Successful adoption of such standards is an important means of industrial upgrading, one that in part protects firms from lower-cost competitors who are not able to comply with these standards.

Although the development literature often paints a stylized picture in which trade takes place between factor-cost-based developing country locations and knowledge-based OECD locations, this dichotomy obviously does not hold in reality. Investment decisions in the real world have to bear in mind a number of different production factors that entail different economies of scale, externalities, and transaction costs, and this means that in selecting locations it is necessary to take into account a variety of different elasticities and trade-offs. In order to exploit factor-cost advantages or gain access to product markets of developing countries, investors usually have to put up with certain deficiencies of the local production system. This is

why some, especially larger, firms are willing to invest in creating and deepening local linkages. Every single investment in this direction helps the respective location to move up the technological ladder.

### The complexity of trade-offs

All in all, the enhanced role of lead firms has far-reaching consequences for the poor in developing countries, involving both threats and opportunities. Empirical evidence suggests that threats are much greater and opportunities more limited were the competitiveness of the domestic business sectors lags far behind international standards. However, defining the net effects of changes in value chain organization is not an easy undertaking because these tend to create both winners and losers. For example,

- shifting from in-house production to external suppliers may reduce relatively well paid wage labour in the lead firm and increase lower quality jobs in supplier firms;
- inducing foreign firms to adopt local small-scale suppliers may be favourable for local technological learning but lessens the efficiency of the supply chain;
- holding back concentration and internationalization in the retailing business may protect small enterprises but lead to higher consumer prices;
- interventions aimed at increasing social or environmental standards in a given industry may lead to the exclusion of poor informal suppliers;



- increasing environmental and social standards may raise costs and jeopardise competitiveness vis-à-vis competitors with lower standards<sup>12</sup>.

### 3.2 Challenges of Agribusiness and Agro-Industry Development

Dramatic changes are taking place in food and agricultural systems worldwide. Although the nature and pace of change is different between and within countries and regions, a common characteristic in developing regions is the transition to market driven systems associated with greater reliance on input markets and growth of post-production enterprises. In essentially all developing and transition countries, the role of the private sector is increasing, smallholder farming is becoming commercialized, and agribusiness and agro-industry are increasingly impacting on economic and social development<sup>13</sup>.

#### Sectoral Trends and Impacts

The broad changes taking place in agrifood systems worldwide are driven by increases in per capita incomes, changing technology, trade liberalization and urbanization. Higher incomes, changing diets and increasing numbers of women in wage employment mean greater demand for high-value commodities, processed products, and pre-prepared foods.

There is a clear trend towards diets that include more animal

products such as fish, meat and dairy products, as well as fruits and vegetables. Although growth rates are high for fruits, vegetables, meat and dairy products, production of staple crops is still the main source of agricultural value addition in many countries. But even staple foods are becoming differentiated products because of industry requirements to meet quality and delivery standards.

Reflecting changing consumer and agro-industry demand, the 1990s witnessed a diversification in developing countries into non-traditional fruits and vegetables. Developing countries' share in world trade of non-traditional fruits and vegetables increased to 56 percent.

Despite the growing relative importance of non-traditional exports, their significance for most developing countries in agricultural and economic development is limited. Overall, developing countries export less than 10 percent of fruit produced and less than five percent of vegetable production.

Prices for many traditional agricultural commodities have recovered or at least stabilized since 2000. It is important, however, not to be complacent. There are no significant demand factors, other than perhaps a rapid growth of biofuel industries, which suggest that the long-term decline in agricultural commodity prices has ended or that an agricultural growth strategy based on expanding primary commodity production is more viable now than it has been over the past two decades.

The prospects in developing countries for further expansion

of food manufacturing appear to be greater than for the supply of primary commodities. Over the past 25 years, the percentages of global manufacturing value addition for food, beverages, tobacco, textiles and leather products – the main agro-industry manufacturing product categories tracked by UNIDO – generated by developing countries have nearly doubled. For textiles, developing countries accounted for 22 percent of value addition in 1980 but more than 40 percent in 2005. The increase was the greatest for tobacco, reaching 44 percent of global value addition in 2005. The EU countries together accounted for the largest share of manufacturing value addition for foods and beverages in 2005 as was the case in 1980, but by 2005 the developing countries together reached 23 percent compared to 21 percent from Japan and 19 percent from North America.

There is tremendous regional disparity among developing regions in the distribution of formal sector agro-industry value addition. For food and beverages, Latin American countries accounted for nearly 43 percent of value addition in 2003 and countries of South and Southeast Asia for 39 percent. In contrast, African countries contributed less than 10 percent of value addition. There are similar disparities and patterns in value addition for tobacco products, textiles and leather products, although South and Southeast Asia provide a higher share of value addition for these product categories than does Latin America.

Corresponding to the above trends, substantial organizational and institutional changes have been

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taking place in the agricultural sector of most developing countries. Growing concentration is taking place at all levels, particularly in the retail and processing sectors.

Agribusiness enterprises are getting larger as firms seek economies of scale in food manufacturing, marketing and distribution. Private sector standards for food quality and safety are proliferating. Increasingly, exchange is arranged through the use of contracts. More large-scale retailers and manufacturers are relying on specialized procurement channels and dedicated wholesalers. Food is increasingly being “pulled” into formal sector retail outlets such as supermarkets rather than grown for sale in local markets.

Changes in the retail sectors of developing regions have been particularly notable, becoming significant at different times in different developing regions. Structural transformation of the retail sector took off in Central Europe, South America and East Asia outside China in the early 1990s. The share of food retail sales by supermarkets grew from around 10 percent to 50 to 60 percent in these regions. By the mid to late 1990s, in Central America and Southeast Asia, the shares of food retail sales accounted for by supermarkets reached 30 to 50 percent. Starting in the late 1990s and early 2000s, substantial structural changes were taking place in East Europe, South Asia, and parts of Africa. Here supermarkets’ share approached five to 10 percent in less than a decade, and is growing 20 to 40 percent a year.

The changes in agrifood systems have significant implications for growth, poverty and food security. On the positive side, trends show that there is a rapid increase of value addition opportunities through agribusiness relative to primary production. Agro-processing enterprises are increasing demand and the effective size of market for farmers’ products. Exporters and agro processing enterprises are furnishing crucial inputs and services to the farm sector for those with no access to such inputs. This is inducing productivity and product quality improvements. Agroindustries also are stimulating market induced innovation through chains and networks. Domestic and export systems are becoming more mutually supportive.

While agribusiness and agro-industry development can increase competitiveness in international and domestic markets, the benefits are not automatic and will not be shared by all.

The changes in agrifood systems pose particular risks for small-scale farmers, traders, processors, wholesale markets and retailers. For the small farmer there will be short-term difficulties to meet agro-industry standards and contractual requirements. Small processors increasingly will have to compete with larger scale food manufacturers that can benefit from economies of scale in processing technologies. Traders and marketers in local markets will be squeezed by the growing importance of specialized procurement practices and certified products. It has long been understood that traditional farming and marketing systems would have to change as farming became

more commercialized and integrated into national markets. What is new is the extent and rapidity of the changes in traditional agrifood systems being driven by global and national trends in agribusiness and agro-industries and foreign direct investment (FDI) flows<sup>14</sup>.

### 3.3 Future developments

Meeting the market requirements for agribusiness products has become more challenging in recent years for three reasons:

- Global agricultural trade in general has been characterized by the increasing importance of standards. Satisfying the food safety requirements of importing countries has become more complex as both the range of items covered by mandatory standards and the stringency of standards increase. At the same time, demonstrating compliance with standards has become more complicated because of a shift from product standards, largely enforced through testing at borders (of exporting and importing countries), towards controls over the way that products are grown, harvested, processed and transported. At the same time, public, mandatory standards have increasingly been complemented by collective private standards such as EurepGAP and Safe Quality Food (SQF);
- Some of the most dynamic sectors in agricultural trade have to satisfy the requirements of demanding



global buyers. These requirements may include large-volume supply, speed and reliability of delivery, customization of products through processing and packaging and guarantees about product safety. The importance of these requirements has increased with the overall tendency towards concentration at multiple points in agribusiness value chains;

- There are opportunities for product differentiation strategies in sectors such as tea and coffee. In the words of a World Bank report on coffee, they are part of a strategy to move “outside of the commodity box” as a means of adding value to agricultural commodities and offsetting declines in prices. Typically, strategies for adding value to such products involve certification (for example, organic produce) or closer links with traders, processors or retailers. The process of adding value requires that the identity and distinctiveness of the product is established at the point of origin and maintained as it moves along the value chain. In other words, adding value to traditional agricultural export commodities often involves the same types of challenges as seen in the production and trade of non-traditional agricultural exports<sup>15</sup>.

There is no broad agreement on how the changes in agrifood systems will influence traditional players (i.e. wholesale markets, small traders and small businesses) in the long run.

Indications to date suggest that there will be significant sectoral

differentiation in impacts. For example, many traditional processing activities, especially in grains, oil and sugar have reached levels of scale and automation that offer limited space for small and medium enterprises (SMEs). The dairy sector seems to be advancing in this same direction. On the other hand, prepared fruits and vegetables are based on labour-intensive on- and off-farm activities and the possibilities for participation by SMEs appear to be much higher.

There is agreement that the development of agribusiness and agro-industries will be context-specific: depending on the product sector, market needs, the stage of development of a particular country and area, agricultural sector policies, institutions and services, and the actions taken or not taken by governments to promote agro-industries and agricultural value chains. If agribusiness development is to play a key role in reducing rural poverty, then governments will need to understand and have the capacity to create enabling conditions for agribusiness while also monitoring and taking necessary steps to protect and enhance the livelihoods of small scale farmers and others members of rural and urban communities likely to be affected by agribusiness and agro-industry development<sup>16</sup>.

Meeting these challenges means organizing agribusiness value chains so that they are able to deliver what is required by global buyers and food safety regimes. The organizational trend is frequently referred to as “vertical coordination”. Some authors argue that “agribusiness researchers generally agree that the growing

number of complex contractual arrangements replacing spot markets is a defining characteristic of the agro-industrialization phenomenon”, while others suggest that “integrated supply chains are one of the most powerful competitive tools in today’s globalizing business economy”.

The application of GVC analysis to agribusiness allows the causes and consequences of vertical coordination to be explored further. Firstly, it analyses the role of lead firms in value chains in the competitive positioning of the chain and in the governance of inter-firm relationships along the chain. Secondly, it theorizes the determinants of different forms of vertical coordination. Thirdly, it provides insights into the consequences of value-chain dynamics for productive structures in developing countries and the distribution of incomes between enterprises at different points in the chain<sup>17</sup>.

## **4. Policies and support programmes with an impact on the structure and development impact of value chains**

Almost any private sector policy and economic programme somehow impacts on value chains, their competitiveness and their influence on the livelihoods of the poor. The following paragraphs highlight some of the effects of general economic policies on value chains.

Creating an enabling environment for the private sector. Both developing country governments and donor agencies increasingly acknowledge the influence the business environment has on the dynamism of the private sector and its ability to create employment and income opportunities for the poor. If, for example, property rights are not guaranteed or contracts cannot be enforced due to deficiencies in the legal system, entrepreneurs will reduce inter-firm transactions as far as possible. If, in contrast, investors are reasonably protected and courts work comparatively well, it is less risky to outsource production. Furthermore, unnecessary bureaucratic procedures and high administrative costs for the registration of small business may exclude the poor from doing business or induce them to stay informal which makes it difficult to take up business linkages with formal sector enterprises. Policy interventions aimed at making the business environment more reliable, more transparent and less bureaucratic may therefore contribute largely to value chain integration. Value chain analysis can be employed to identify concrete policy constraints that affect competitiveness at the subsector

level and assess their relative importance.

Trade and investment policies and export promotion programmes. Trade and investment policies, including trade-related capacity building, export promotion and the like, affect the linkages between domestic and foreign markets. The level of import tariffs and bureaucratic non-tariff trade barriers, the treatment of foreign investors, the quality of export promotion programmes, the competitiveness of ports and airports as well as the road and rail system therefore all strongly impact on the degree of integration in international value chains.

Firstly, trade and investment policies largely determine to what extent developing countries benefit from offshoring. Enterprises in industrialized countries tend to move activities offshore when operating cost differentials are sufficiently great to offset tariff, transport and other transaction costs. Hence it is not only operating costs that have an effect on offshoring decisions but the cost of trading as well. In order to become competitive, any location interested in attracting international offshoring investment needs to keep both costs low. To put it differently: countries can afford relatively higher wage levels if they have a competitive edge in tariffs and the trading infrastructure. Secondly, export promotion may facilitate the integration of developing country firms in global supply chains. These include market intelligence, export financing and guarantee schemes

for SMEs, subsidies for trade fairs and trade delegations, and many other traditional export promotion activities. Some interventions are explicitly designed to promote subcontractors, e.g. indirect exporter financing schemes, whereas others aim at helping firms to upgrade into higher-value activities, e.g. grants for financing the promotion of brands overseas. Thirdly, trade and investment policies also affect the competitiveness of local enterprises and value chains vis-à-vis imports and market-seeking foreign investment. In recent years, cheap imports especially of light manufactures such as garments and shoes have ruined local industries in many developing countries around the world. Likewise, the global expansion of large retail chains is expected to impact severely on local value chains. Although protectionist trade policies tend to hold back innovations and productivity growth, there is a strong case for careful timing and sequencing of liberalization. Especially in very disadvantaged least developed countries safeguards may be required to protect economic activities which are highly important for the livelihood of the poor.

Tax policy. In most developing countries only large corporations pay taxes whereas a huge proportion of the small and micro-enterprises evades taxation. Firms that are not registered with the revenue authorities however usually do not qualify for regular supply chain relations. Broadening the tax base while keeping taxes for micro and

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small firms low is therefore an important step to legalize informal firms and make them eligible as supply chain partners.

Moreover, tax systems are often based on sales taxes which are levied on the basis of total turnover rather than value-added taxes because administration of the former is easier. Sales taxes however act as a disadvantage to inter-firm specialization because they do not allow for deduction of taxes which already been paid at the previous stage of the value chain. Value added taxes are thus more conducive to inter-firm specialization.

Policies and programmes for skills development and innovation. The most important constraint for vertical business linkages, especially with large-scale processors, wholesalers and exporters, is the generally low capacity of local SMEs to produce at a competitive cost, supply reliably and comply with standards. Strengthening the supply capacity of local SMEs is therefore probably in most cases the key challenge for value chain initiatives in developing countries. This requires the entry barriers of value chains. In addition continuous advancement of skills is essential to upgrade in the value chain and capture economic rents. Beyond a certain stage of technological sophistication upgrading furthermore requires innovation capabilities. In addition to its own publicly financed skills development and innovation programmes governments may create tax incentives for firms to invest more in skills development and innovation.

Financial and non-financial business services. Difficult access to finance is another major growth constraints for SMEs in developing countries. Integration in modern value chains often requires substantial investments to acquire new production technologies and logistics systems, to increase economies of scale, to invest in human capital, or to certify newly required standards. The cost and availability of capital to small enterprises is therefore a decisive determinant of linkage formation. In addition to finance, the modernization of SMEs entails incorporation of external know-how and thus the availability of providers of nonfinancial business with specialized competencies in different fields. Activities aimed at strengthening such service supply thus help to make SMEs partnership-ready and thereby indirectly impact on value chains.

Support of local economic development. Local economic development and cluster initiatives are among the most popular government and donor activities in the field of private sector development. The main purpose is to increase the competitiveness and inclusiveness of enterprise networks in a given locality. Most initiatives place their emphasis on horizontal linkages and collective action among firms of the same stage of production and within the same territory. While vertical linkages (within the region and beyond) are usually addressed, they are not the main concern. By enhancing the competitiveness of local business networks, however, cluster initiatives make them more attractive for

extra-regional business partners. At the same time policymakers need to recognize potential conflicts of interests between local communities and lead firms in value chains.

Marketing. End-market demand is generally exogenous but can sometimes be influenced through branding and product differentiation. Governments and donors may help to introduce brands or quality labels (“certified organic product”, “free of child labour”, “fair trade”) that add value to the product of targeted enterprises and industries. Thereby they improve the capacity of firms or industries to differentiate themselves from competitors and to develop a profile which increases the willingness of consumers to pay a higher price. For example, USAID’s competitiveness project in Sri Lanka helped the gem industry establish a niche market for the “Ceylon sapphire.”

Access to value chain finance  
Difficulties to access credit are among the most important constraints for SME development. Value chain integration may facilitate access to credit through two mechanisms:

1. Directly, by receiving credit from business partners in the value chain, such as buyers or input providers. Direct credit occurs especially often in agriculture, where seed and fertilizer companies advance inputs (thus supplying credit in-kind) or traders or agroprocessors provide loans and often take payment in the form of produce. Credit supply by buyers is especially frequent in outgrower schemes, where



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relationships between farmers and buyers are captive and loans can be tied to purchase agreements. In manufacturing, machinery producers often supply credit (or leasing arrangements) for the acquisition of their products.

2. Indirectly, by making the firm creditworthy to financial institutions, e.g. because secure sales channels are accepted as collateral. Public programmes can help to improve both direct and indirect value chain finance. Support agencies may, for instance, provide soft credit lines and credit guarantees to development banks in order to stimulate linkages. The Small Industry Development Bank of India (SIDBI) has established several SME funds and credit guarantee corporations. The South African Department of Trade and Industry has rolled out a cash grant programme for black owned or managed SMEs which covers 80% of the cost involved in business development services that are deemed necessary for meeting the requirements of becoming and approved industry supplier. Donor agencies may also promote outgrower schemes as a form of improved value chain coordination, thereby facilitating direct credit supply from buyers (direct value chain finance).

Moreover, they may contribute to developing financial products which support value chain integration (indirect value chain finance). The following kinds of financial products seem especially suitable to improve access of suppliers to bank loans:

1. Factoring. Serious problems arise for many suppliers if their customers pay large orders weeks or even months after delivery. This is customary where buyers have sufficient market power. For the suppliers it often creates severe liquidity problems and may force them to solicit costly short-term credits. To alleviate this problem, financial institutions in some countries offer factoring schemes whereby the buyer upon receipt of the merchandise issues a document which the bank accepts as collateral and disburses the respective amount of money, thus helping SMEs to bridge the time between delivery and debt settlement. The bank then claims the credit back from the buyer.
2. Warehouse receipts. Such receipts are issued to depositors of commodities by secure warehouses. Banks accept the deposited inventory for collateral. This instrument is especially suitable in the case of commodities with clearly specified standards and grades and transparent markets. Supporting this kind of financial products to the benefit of suppliers may be complemented with legal provisions to avoid abusive behaviour by powerful buyers. India for example has legislated an "Interest on Delayed Payments to Small Scale and Ancillary Industrial Undertakings Act" to ensure that large companies make prompt payments to their small suppliers. The practical usefulness of this legislation however is doubtful as small firms are often

reluctant to pursue cases against major buyers fearing strained relationships with the latter<sup>18</sup>.

### Intervention strategies: some caveats

Policy decisions are complex and need to take context-specific factors into account:

- Although market prices may be obtained for homogeneous commodities, most markets are highly segmented, with strongly diverging prices and profitability in different niche markets.
- Even if gross output values can be determined for different chain links, it will be almost impossible to measure the profitability of each activity – for obvious reasons firms will usually not share this information. Mapping the distribution of rents in the chain and drawing conclusions for upgrading strategies is therefore not a realistic undertaking.
- Make-or-buy decisions, and thus the structure of value chains, depend on industry specific technicalities. Key variables are the complexity of transactions, the possibility to codify and transmit the necessary information, and the capability of potential suppliers to deal with these issues in a way that is more efficient than in-house production. Effective proxies of these variables are not yet available and would require a comprehensive understanding of industry-specific technical processes.
- Even within the same industry lead firms behave differently.



Their competitive strategies reflect specific values, different time-horizons of planning, etc. Comparative studies on TNC sourcing behaviour, for example, reveal very different patterns according to the nationality of ownership. Moreover, some lead firms take Corporate Social Responsibility more serious than others. As a result, their attitudes towards suppliers are different, resulting in differences with regard to knowledge flows and learning opportunities for local suppliers.

- In the global economy different chains compete with each other. Policy interventions aimed at inducing changes in one particular chain thus affect its position vis-à-vis competing chains. If policies for example increase the margins for SME suppliers or the labour standards in the chain, this may result in declining market shares (unless these changes also result in increased productivity). Such indirect effects may even thwart the original policy goals<sup>19</sup>.

## **5. The business environment role: some data**

Although many countries have implemented major policy reforms over the past two decades, the business environment often is still far from being conducive for agribusiness and agro-industries. Many countries continue to have complicated systems of business regulations, ineffective systems for enforcing property rights and rules, inadequate commercial services, lack of infrastructure, ineffective local government, and weak information and communication systems.

The evidence shows that there are large and growing disparities among regions and countries in progress towards creation of enabling business climates. The World Bank cost of doing business indicators show the large gap that continues to exist between the OECD countries and all developing regions with respect to procedures, time required and costs for enforcing contracts, starting a business, dealing with licenses, and trading across borders. Particularly with respect to licensing, business start-up and trade, the procedures, time required and costs are higher in sub-Saharan Africa than other developing regions – with the straightforward implication that farms and firms have to be much more efficient and better run than their counterparts in other regions just to overcome extra costs of operating in poor business investment climates.

The policies, institutions and support services that establish the setting in which enterprises are started and grow constitute what is often referred to as the enabling environment for doing business. The business environment

represents one of the most important drivers of competitiveness for domestic and export oriented agro-enterprises and agro-industries. The business environment is critically important for reducing the cost of doing business and attracting investment. It also affects risks and opportunities resulting from competitiveness emulation and the progressive refinement of successful business models<sup>20</sup>.

The “Ease of Doing Business Rank” from the World Bank’s Doing Business project captures information on a number of dimensions relevant to trade. It measures several aspects of regulation and processes required to start and operate businesses, to enforce contracts, and to trade across borders, among others, and ranks countries along all these categories. The latest rankings are based on surveys conducted in 2007. A higher ranking in the Doing Business database denotes worse institutional/business environments.

The figures on the following pages indicate that countries having better institutional environments also tend to have a higher share of manufacturing exports and lower export concentration. In fact, worse performance on institutional rankings tends to go along with a higher share of mining exports<sup>21</sup>

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## African countries – Ease of Doing Business rank<sup>22</sup>

Economy	Ease of Doing Business Rank	Starting a Business	Dealing with Construction Permits	Employing Workers	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Closing a Business
Mauritius	1	1	3	8	20	7	2	1	1	10	7
South Africa	2	2	5	17	10	1	1	3	25	13	8
Botswana	3	8	23	12	1	4	3	2	27	17	1
Namibia	4	16	4	3	21	3	11	18	28	2	3
Kenya	5	14	1	10	16	2	14	36	26	19	10
Ghana	6	23	29	30	2	14	3	13	5	5	16
Zambia	7	7	32	26	11	6	11	5	30	15	12
Seychelles	8	6	6	22	4	39	6	6	8	7	34
Swaziland	9	30	2	4	33	4	46	7	31	24	4
Uganda	10	21	14	1	41	14	20	15	24	21	2
Ethiopia	11	18	7	15	34	16	17	4	29	12	9
Nigeria	12	10	34	2	46	7	6	25	23	16	13
Lesotho	13	20	33	7	24	7	26	8	22	18	6
Tanzania	14	14	42	28	27	7	14	21	9	1	19
Gambia, the	15	12	12	5	15	19	43	44	4	8	22
Malawi	16	19	37	16	14	7	11	11	39	27	26
Rwanda	17	5	16	13	5	27	43	10	40	4	34
Mozambique	18	26	35	35	30	16	3	16	21	22	24
Cape Verde	19	37	13	39	18	16	20	23	2	3	34
Madagascar	20	4	17	32	28	45	6	17	10	35	34
Sudan	21	13	26	29	3	19	32	14	20	30	34
Burkina Faso	22	17	18	6	29	27	26	29	44	20	18
Senegal	23	11	22	37	38	27	42	41	3	31	11
Gabon	24	27	8	33	37	19	32	19	14	32	25
Comoros	25	35	9	36	12	39	20	9	15	33	34
Sierra Leone	26	3	41	41	39	27	6	37	17	29	29
Liberia	27	9	45	18	44	19	26	12	13	38	30
Zimbabwe	28	38	44	25	9	7	17	35	36	11	33
Mauritania	29	25	29	23	6	27	26	43	33	14	31
Côte d'Ivoire	30	39	39	19	26	27	32	31	32	22	5
Togo	31	44	31	34	35	27	26	30	6	34	14
Cameroon	32	40	36	24	25	19	17	42	19	43	15
Mali	33	36	18	14	13	27	32	34	38	37	20
Equatorial Guinea	34	41	15	45	7	19	26	38	18	9	34
Angola	35	32	24	42	45	7	6	27	43	46	28
Benin	36	28	25	21	16	27	32	39	15	45	23
Guinea	37	42	40	20	36	39	43	40	11	25	17
Niger	38	34	38	38	8	27	32	25	41	26	27
Eritrea	39	43	46	9	40	45	16	20	37	6	34
Chad	40	45	11	27	22	27	20	27	34	39	34
São Tomé and Príncipe	41	22	21	46	31	39	32	32	7	42	34
Burundi	42	24	43	11	19	39	32	22	42	41	34
Congo, Rep.	43	33	10	40	43	19	32	46	46	36	21
Guinea-Bissau	44	46	20	44	42	27	20	24	12	28	34
Central African Republic	45	29	27	31	23	19	20	45	45	40	34
Congo, Dem. Rep.	46	31	28	43	32	39	32	33	35	44	32

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### Caribbean countries – Ease of Doing Business rank<sup>23</sup>

Economy	Ease of Doing Business Rank	Starting a Business	Dealing with Construction Permits	Employing Workers	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Closing a Business
St. Lucia	1	5	4	2	8	19	4	2	11	26	8
Antigua and Barbuda	4	8	6	10	16	27	4	21	4	6	10
Bahamas, the	6	8	18	9	28	13	19	3	6	21	5
Jamaica	9	2	10	4	19	19	14	30	20	22	1
St. Vincent and the Grenadines	10	6	1	8	24	19	4	11	10	17	28
Kitts and Nevis	11	12	3	1	29	19	4	14	2	18	28
Dominica	13	3	7	13	17	13	4	7	12	28	28
Belize	14	25	2	3	21	19	22	6	25	30	3
Trinidad and Tobago	15	11	16	6	32	3	2	5	5	29	28
Grenada	17	7	5	11	31	13	4	10	9	27	28
Dominican Republic	18	15	15	21	18	13	24	9	3	9	24
Guyana	19	17	9	15	6	30	14	17	24	6	21
Suriname	29	31	19	12	26	29	32	1	18	32	25
Haiti	31	32	27	5	23	30	29	13	31	10	27

### Pacific countries – Ease of Doing Business rank<sup>24</sup>

Economy	Ease of Doing Business Rank	Starting a Business	Dealing with Construction Permits	Employing Workers	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Closing a Business
Fiji	5	10	11	11	8	4	7	11	19	10	14
Tonga	6	3	7	3	17	12	16	7	9	7	10
Vanuatu	8	13	6	18	18	11	12	4	22	11	6
Samoa	10	19	9	7	10	16	5	10	16	13	17
Kiribati	11	16	14	9	9	18	7	3	13	12	21
Solomon Islands	14	14	8	12	20	20	10	9	14	15	12
Palau	15	9	10	5	3	24	21	16	20	20	8
Marshall Islands	17	4	2	1	21	20	20	18	10	9	16
Papua New Guinea	18	11	21	10	11	18	7	17	17	23	11
Micronesia	19	7	3	6	21	12	21	14	18	21	20
Timor-Leste	24	20	16	16	21	23	18	12	15	24	21



## 6. Latin American and Caribbean (LAC) countries: the role of private sector in financing Agricultural Research

### Financing Public Agricultural Research-Involvement of the Private Sector

Data indicate that, overall, the involvement of the private sector in agricultural research in LAC is comparatively high compared with other developing regions, such as Africa and the Middle East, but low compared with a number of countries in the Asia-Pacific region, such as Indonesia and the Philippines.

Aspects of LAC agriculture are technologically advanced by world standards, as well as being serviced by a sophisticated system of private input supply, postharvest handling, and processing. Private firms now supply much of the improved animal genetics and seeds used by LAC farmers. Furthermore, some of the region's countries have legislated tax relief for privately performed R&D, and many countries stipulate private-sector involvement in research projects under competitive funding mechanisms. The private sector in Chile, for example, is well known for its considerable expansion of fruit, salmon, and wine production in recent decades. This progress has been achieved with substantial public support, not for direct private research but for the importation of foreign technologies and the subsidization of agribusinesses.

Most private for-profit companies still outsource their research to government agencies or universities, or they import technologies from abroad. Only a limited number of private companies operate their own research programs, and the

companies that do so often employ only a handful of researchers. Examples of national companies conducting agricultural R&D in the region include Floramerica, a Colombian flower grower and exporter, and Unimilho, a Brazilian seed company. Many multinational seed and agrochemical producers—such as BASF, Dupont, Monsanto, Novartis, Pioneer, and Syngenta—actively conduct agricultural R&D in the region, as do multinational fruit growers such as Chiquita, Delmonte, and Dole.

Little information could be accessed on capacity or expenditure trends in the private agricultural R&D in LAC. Some authors estimate that in 1996 privately conducted research represented only 4.4 percent of all public and private investment in agricultural R&D that year, and that more than half of those investments were made in Brazil. Nevertheless, no (quantitative or qualitative) information is available on the private sector's role in agricultural R&D in the region since the mid-1990s. Private for-profit agencies are, therefore, excluded from further analysis in this report. Substantial empirical evidence supports the argument that investment in agricultural research and development (R&D) has contributed to economic growth, agricultural development, and poverty reduction in LAC over the past 50 years. New technologies resulting from R&D investments have enhanced the quantity and quality of agricultural outputs, while at the same time enhancing sustainability, reducing consumer food prices,

providing rural producers with access to market opportunities, and improving gender-based allocations and accumulations of physical and human capital within households.

Nevertheless, agriculture in LAC is highly complex and dynamic, with farm households, traditional production systems, and sophisticated enterprises operating side by side. Nonetheless, all sectors are challenged by emerging threats like climate change, inequality, changing consumption patterns, natural resource management, food safety demands, and increased urbanization.

Strong forward linkages to the agribusiness and food services sectors exist in many of the region's countries; examples include soybean oil and derivatives in Argentina, Brazil, and Paraguay; fruit and salmon in Chile; cut flowers in Colombia and Ecuador; beef production in Uruguay; and bananas in Ecuador<sup>25</sup>.

### Regional Agricultural R&D Spending within a Global Context

In 2000, LAC's \$2.8 billion agricultural R&D spending represented 12 percent of the \$23.2 billion global total that year (Beintema and Stads 2008b), slightly less than the 1981 share of 14 percent.

The contraction is largely attributable to the increasing role of agricultural R&D in the Asia-Pacific region, where total public agricultural R&D spending grew by an average of 3.6 percent per year from 1981 to 2002 in inflation adjusted terms.

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Most of this growth took place in China and India, where public spending more than tripled over this timeframe.

In 2006 the LAC region as a whole invested \$1.14 in agricultural research for every \$100 of agricultural output, which is high compared with other developing regions of the world, such as Africa (0.65) and the Asia-Pacific (0.42). Nevertheless, as has been emphasized throughout this report, LAC's diversity must be taken into consideration, given that the intensity ratios of individual countries in the region vary from as little as 0.2 to as high as 2.0, which is close to ratios reported in the developed world<sup>26</sup>.



## 7. The case of Africa

### 7.1 The SME Sector in Africa

Private sector development varies greatly throughout Africa. SMEs are flourishing in South Africa, Mauritius and North Africa, thanks to fairly modern financial systems and clear government policies in favour of private enterprise. Elsewhere the rise of a small business class has been hindered by political instability or strong dependence on a few raw materials. Between these two extremes, Senegal and Kenya have created conditions for private sector growth, but are still held back by an inadequate financial system. In Nigeria, SMEs (about 95% of formal manufacturing activity) are key to the economy, but lack of security, corruption and poor infrastructure prevent them from becoming motors of growth.

Africa's private sector consists of mostly informal micro enterprises operating alongside large firms. Most companies are small because of policy-induced obstacles and a poor business environment that discourages investment, entering the formal economy and more broadly private sector activity. Between these large and small firms, SMEs are very scarce and constitute a "missing middle". Even in South Africa, with its robust private sector, micro and very small enterprises provided more than 55% of all jobs and 22% of GDP in 2003, while large firms accounted for 64% of GDP. SMEs are weak in Africa because of small local markets, undeveloped regional integration and very difficult business conditions, which include cumbersome official procedures, weak legal enforcement

and protection of property and creditor rights, inadequate financial systems and unattractive tax regimes. Poor transport and communication infrastructure contribute to limited access to input and output markets domestically, regionally and internationally. Many firms stay small and informal, and use simple technology. Their smallness also protects them from legal proceedings (since they have few assets to seize in bankruptcy) and allow them to survive and adjust to uncertain business environments. Large firms have the means to overcome legal and financial obstacles since they have more negotiating power and often good contacts to help them get preferential treatment. They depend less on the local economy because they have access to foreign finance, technology and markets, especially if they are subsidiaries of bigger companies. They can also make up more easily for inadequate public services<sup>27</sup>.

#### Despite its comparative advantage, the share of Africa in world agricultural trade is declining

African countries participate in the expansion of world agricultural trade but their contribution is relatively small. Looking at the evolution since the mid 1980s, the share of African products in world agricultural imports has actually declined from 5.4 per cent in 1985 to 3.2 per cent in 2006.

Moreover, agricultural exports are highly concentrated in a small number of countries. Over the 2002-05 period, the largest exporter was South Africa followed by Côte d'Ivoire and Ghana, and these three countries accounted for about 56 per cent of total exports from sub-

Saharan Africa. Trade in agricultural products represents less than 20 per cent of Africa's total intra-regional trade, although this figure is likely too low, given the high levels of informal, non-recorded cross-border trade in food products.

Africa's small share in world agricultural exports may be partly explained by the fact that world agricultural trade is no longer dominated by bulk commodities. Trade in processed food and horticulture (e.g. flowers, fruits and vegetables) has grown twice as fast as bulk commodities over the last 25 years, attaining an export growth comparable to the growth of non-agricultural products. In contrast, trade in bulk commodities has been least dynamic and its relative share in total agricultural exports has declined substantially. Such broad patterns of the evolution of world agricultural trade suggests that a significant part of global agro-food trade has become less dependent purely on natural resource endowment and has moved downstream along the value chains. On the other hand, most developing countries that remained commodity-dependent in 2003-05 have been struggling to defend historical positions in the international market. Africa is home to about two-thirds of such commodity-dependent developing countries.

Africa's specialisation in agricultural trade, although slowly changing, is overwhelmingly in bulk and horticulture, i.e. products whose production is related to geographical conditions. Achieving vertical diversification towards processed, higher value-added products has



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proved more difficult for Africa than for other developing countries. None of the countries from sub-Saharan Africa is among the world's leading exporters of processed products. This suggests that Africa today has a competitive disadvantage in agro-processing, since the proportion of transaction costs over total costs is higher in this segment of the agro-food sector because of poor logistics, red tape and the high cost of capital. While this is certainly a problem for Africa, better policies can help solve it through the improvement of the business environment and the creation of the conditions necessary for higher private investment in agri-business.

The rise of China and India represents a new and potentially very significant opportunity for Africa's agricultural exports. In their search for commodities, these countries have already strengthened their trade links with the continent. Rapidly growing incomes in these two giants are likely to fuel a strong surge in their demand for food, including through imports. In fact, their agricultural imports from Africa have increased rapidly over the past ten years, although from a small base. Today they represent one of Africa's most important export markets for agricultural products, accounting for about 7 per cent of its exports.

In assessing the scope for further expanding agricultural and food trade with Asia, it is interesting to note that agriculture accounts for about 10 per cent of India's imports from Africa, but it represents less than 4 per cent of Chinese imports from the continent. The

product composition differs too, with bulk commodities dominating China's agricultural imports from Africa, while horticultural products account for roughly two-thirds of India's agricultural imports from the continent.

The trading opportunities in agriculture would increase further if both developed and developing countries were to reduce import tariffs and cut domestic subsidies globally and regionally. Agricultural policies of OECD countries, by supporting their farmers through cash transfers or market price supports, have been blamed for preventing developing countries, including those in Africa, from further developing their agricultural sectors. However, more recent analysis questions this conventional wisdom as many countries in Africa are net food importers. At the same time, there might be dynamic effects, where higher prices arising from trade liberalisation could trigger investment, resulting in more production and competition and lower prices in the longer term. How countries will be affected following a successful conclusion of the Doha Development Agenda depends obviously on how ambitious the final agreement will be, but also on the net trade positions and other supply-side particularities of the individual countries.

At the same time, reducing import tariffs may not result in a strong rise in exports, since non-tariff barriers play a major role in agricultural trade, especially for processed products. In addition, many African countries lack the capacity and infrastructure to meet the international standards required for them. In fact, the most

valuable and dynamic segments of the agricultural sector are subject to increasingly stringent scrutiny under both international food and health regulations and private standards imposed by supermarkets. Adjusting to the new trading and regulatory environments governing agriculture poses a major challenge for Africa. This is an area where technical assistance from donors and international agro-food corporations would prove very useful<sup>28</sup>.

### [Africa is appearing on the radar screens of agro-food multinationals and becoming more involved into global agro-food value chains](#)

The agro-food sector, spanning the range from input supply (e.g. seeds and fertilizers) to retail, has experienced a strong drive towards globalisation, both in terms of the reach of its sourcing — suppliers in many developed and developing countries participate in global value chains, co-ordinated by buyers and supermarkets — and in terms of the degree of internationalisation of major corporations. A relatively small group of very large multinational corporations (MNCs), spreading their reach across the globe, dominate the sector.

To what extent is Africa involved in the global agro-food system? Who are the major corporate players operating in the continent's agricultural sector today? Very little is known about private enterprises in the agro-food sector in Africa. The up-to-date company information based on Fortune Global 500 and Jeune Afrique Les 500, published in 2007, provides a starting point to map Africa's corporate landscape in this sector.

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African countries are gradually appearing on the radar screens of large MNCs in the agro-food sector. Of the 49 corporate giants from this segment listed in the Fortune Global 500, 25 have activities on the continent. Activities of these selected firms in the continent include wholly owned subsidiaries or, in the majority of cases, non-equity linkages such as franchises and licensing. These corporate giants are also present through sales offices and marketing representations.

These very large MNCs have entered the most dynamic markets by concentrating their activities in North and Southern Africa but have largely ignored the countries in between. North Africa has been gaining ground thanks to strong ties and proximity to the European Union, progress in economic liberalisation and improvements in infrastructure. Not surprisingly, in 2006 the region received about two-thirds of foreign direct investment (FDI) inflows to Africa. In the Southern region, South Africa accounted for the bulk of investments.

Meanwhile, indigenous African agro-food companies are slowly emerging on the continent as relevant players. Of the 500 companies listed in the Jeune Afrique ranking, 111 are active in at least one segment of the agro-food value chain. The range of income among them is extensive, from revenue of more than \$11 billion to a minimum of \$90 million.

The beverage sector appears as the most dynamic and developed, with a sizeable presence of both foreign

and African companies, sometimes operating in partnership. These collaborative arrangements are mainly based on local licensing and franchise agreements. For instance, the internationally leading beverage company, the Coca-Cola Company, is present in the majority of African states through franchises with local firms which provide bottling and distribution services. Interestingly, African enterprises have started internationalising themselves. Large companies, in particular retailers, are making inroads in the continent to escape saturated domestic markets.

Internationalisation takes place in many forms: firms export their products through partners (e.g. Lesieur Cristal), establish their own sales representation on the spot (e.g. Nigerian Breweries) or even relocate production sites to different countries (e.g. Illovo Sugar). South African companies have been the enterprises pursuing the most proactive internationalisation strategies. Only four of the 24 South African firms present in the Jeune Afrique ranking are not engaged in some kind of international operations. Although they are still small in number, these examples underscore the large business opportunities available in the African agricultural sector.

The emergence of the indigenous agro-food private sector and the interest of non-African multinational corporations in Africa highlight that government efforts to improve the business environment are starting to pay off. Much more remains to be done, however. Private investment in the sector is still small and African producers take part in the agro-

food global value chain in a rather passive way, capturing only a small share of the value generated along the chain<sup>29</sup>.

### Aid to Agriculture is back on the donor agenda, with a stronger focus on trade and private-sector development

Faced with limited financial resources and an increasingly complex trade negotiation agenda, African countries have shown strong interest in "Aid for Trade" as a mechanism to help build trade negotiation capacities, strengthen productive capacity (particularly, but not exclusively, in the agro-food sector) and improve trade-related infrastructure, thereby realising their export potential.

Total Aid for Trade support to Africa is estimated at \$6.1 billion a year (on commitment basis) over the period 2002-05, representing almost one-third of global aid for trade. Support to trade-related infrastructure accounts for over half this amount. Overall, the European Commission and World Bank/International Development Association are by far the largest donors to Africa in all Aid for Trade activities, followed by the African Development Bank/African Development Fund in supporting trade-related infrastructure and building productive capacity. Altogether, these three multilateral donors accounted for over half of the total Aid for Trade commitments to Africa during 2002-05.

In Africa, more than half the support for building productive capacity goes to the agricultural sector and covers a wide range of activities. Donor support to this area averaged about

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\$1.4 billion a year in real terms over 2002-05. However, until recently aid to agriculture in Africa had been on the decline. Over the last 15 years, the volume of aid to agriculture in Africa decreased both in absolute terms (from \$2.6 to \$2.0 billion), and as share of total official development assistance (ODA) (from 11 to 5.4 per cent). This trend reflected a worldwide pattern. Limited success of aid to agriculture and a shift towards structural adjustment lending (connected with a stronger focus on economic liberalisation), led to a sharp decline in aid to agriculture since the early 1990s.

Also, an increased proportion of ODA has flowed to social infrastructure and services. Assistance to health and education offers development agencies a number of attractions. Aid can be channelled through large public-sector entities, either as programme support to ministries or as general budget support. Transaction costs are therefore minimised. More importantly, assistance can be clearly linked to increased delivery of basic services, which in turn can be relatively easily associated with progress towards achieving internationally agreed development targets such as the Millennium Development Goals (MDGs). On the other hand, aid to agriculture (and indeed to other productive sectors) often has long gestation periods and lacks the same clear relationship between aid expenditure and outcomes.

Since the beginning of this century, there has been a renewed awareness among both African policy makers and donor agencies of the vital contributions of agriculture to long-

term growth and poverty reduction. African countries have come to realise that the underperformance of agriculture has been a major drag on their economic and social development. The donor community, too, has begun to refocus policy attention on the vital contribution that trade and private sector development, especially in the agricultural sector, can make to development.

However, aid to agriculture varies considerably across countries in the region in terms of policy focus, the mode of delivery and the nature and degree of donor harmonisation<sup>29</sup>.

### 7.2 Unleashing the Potential of Agriculture: Lessons Emerging from Five Countries

In order to gain a more accurate picture of aid to African agriculture and to assess what is actually working on the ground in terms of donor-assistance programmes, OECD has conducted five country case studies between 2005 and 2007. Ghana, Mali, Senegal, Tanzania and Zambia were selected because of the particular importance of agriculture in their economic development and their governments' commitment to promote agricultural modernisation and diversification. Moreover, they are among the largest recipients of agricultural aid in Africa and offer a wide spectrum of donor-supported programmes<sup>29</sup>.

#### In the five countries the structural transformation of agriculture has yet to occur

Although they have been on the policy agenda of the five countries almost since independence, the transformation of agriculture and the development of agro-based industries have yet to materialise. The agricultural sector is characterised by a dualistic structure, with few commercial farmers and a large majority of smallholders, engaged in subsistence or quasi-subsistence agriculture. Food crop productivity has been stagnating and even countries that could be food secure, such as Ghana and Tanzania, continue to experience food security problems. While the Senegalese agro-processing industry is quite active, it nevertheless generates little value added and is only weakly linked to the rest of the economy because of its high dependence on imported inputs.

On the other hand, horticultural exports have emerged as a new driver of agricultural growth. Contract farming (e.g. outgrower schemes) has proved to be an effective mechanism for involving smallholder farmers in export crop production and achieving economies of scale.

These interlocking arrangements have proved to be more difficult to set up for staple food crops, mainly because of widespread free-riding on the side of contracted growers<sup>29</sup>.

#### New approaches to support agricultural commercialisation are delivering encouraging results ...

Donors are increasingly adopting a value chain approach to promote private sector development in



agriculture and are trying to tackle various bottlenecks simultaneously. Previous interventions mainly focused on production, and did not pay adequate attention to the development of market linkages and the role of support entities. Many new projects now rely on value-chain mapping to identify competitiveness bottlenecks and make sure that all relevant segments are dealt with, including support actors. Some promising examples include projects focusing on demand-driven agricultural services (e.g. veterinary services in Zambia) and other supportive industries (e.g. packaging in Senegal and Mali). This represents a significant improvement on the past, even though projects remain limited to specific export commodities or areas.

Nonetheless, some segments of the agricultural value chain still receive little donor attention. In particular, more consideration needs to be given to the role of input suppliers, the involvement of market intermediaries (including small-scale traders) and the specific needs of agribusiness companies. In this respect, donor efforts seem more advanced in Senegal than in the other four countries. Also key areas for market access, such as marketing and quality standards (e.g. sanitary and phytosanitary standards), receive little attention.

An important lesson emerging from the application of the value-chain approach is that the promotion of private sector development in agriculture goes well beyond the sector itself and cuts across several policy domains. For instance, the promotion of outgrower schemes

cannot be separated from the improvement of the overall business environment, in particular contract enforcement, and the development of business service providers<sup>29</sup>.

### ... the challenge is to scale up these successful projects ...

In the five countries, donors still tend to privilege stand-alone, area-based projects, which are often executed outside government structures, through local or international non-governmental organisations (NGOs). These projects have met some success in raising production volumes and facilitating market access, mainly in export-oriented commodities, although their longer term impact and sustainability remain to be assessed. While these projects are important sources of experimentation and innovation, the challenge is to scale them up in terms of both resources and geographical coverage and to mainstream them into government strategies and structures.

Scaling up and mainstreaming require a thorough assessment of local implementing capacities, both within government and in the private sector. Persistent capacity weakness may call for a gradual approach to transferring management responsibilities. Meanwhile, the NGOs executing donor projects (e.g. supporting outgrower schemes) must play a facilitating role and should not become competitors to private providers of business services or undermine the commercial viability of processors<sup>29</sup>.

### ... and to ensure sustainability

Positive project results can be found in all countries, but their long-term

sustainability is at stake. Evaluations suggest that donor interventions have often paid inadequate attention to local capacities. In fact, few projects have an explicit exit strategy to facilitate the handover of the project to local counterparts and to ensure that services continue to be supplied to farmers in a sustainable manner. Where impact assessments have been conducted, the observed results on income levels and business sustainability are mixed. Sustaining achieved benefits at the farm level after the withdrawal of donor support remains a challenge which should already be receiving more consideration during the project design.

In fairness, governments have not always been coherent with respect to their commitments, both in terms of counterpart financing and in terms of policies to promote private sector development in agriculture.

### Governments need to invest more on agriculture and spend more effectively

- Despite the political commitment to agricultural development, actual government funding to agriculture has been on a declining trend over the last two decades. Limited and unstable public resources for the sector are undermining the implementation of agricultural strategies. None of the countries, except Mali, is close to achieving the target of 10 per cent set by the CAADP.

However, reversing the trend will not be enough to achieve higher agricultural growth. Governments also need to improve the allocation of resources within the agricultural sector and to set more resources

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aside for productivity-enhancing investments. For instance, evidence from Zambia suggests that the decline in resources has disproportionately affected capital equipment and recurrent departmental charges, resulting in lack of equipment and personnel to conduct research and provide extensions services and training to farmers.

**Strengthening public sector capacity is crucial** - Government structures in charge of agriculture suffer from significant capacity weaknesses, which reduce their ability to play a leading role in the sector, co-ordinate with other ministries and effectively oversee donor projects. Outflows of high-qualified staff moving to private sector positions or donor projects is frequent, reflecting not only low salaries but also the absence of proper human resource development policy to keep qualified staff in-house.

Capacities are particularly limited at the local level. All five countries have embraced decentralisation strategies to make public sector interventions more responsive to local needs. But so far the decentralisation of responsibilities has not been matched with a corresponding endowment of financial and human resources at district and village level. Not only national but also local capacity building needs to receive more attention to make demand-driven public service delivery a reality.

**Donor co-ordination needs to be improved** - Although improving, donor harmonisation and alignment to government priorities in the agricultural sector is less advanced

than in the social sectors. The predominance of stand-alone projects and the involvement of several line ministries (e.g. agriculture, infrastructure, land, trade) dealing with agriculture make progress difficult. This holds true even for countries which are considered to be quite advanced with respect to donor harmonisation, such as Ghana and Tanzania.

Donor co-ordination is mainly taking place at the central level, and primarily concerns policy-related issues. Operational co-ordination, especially at field level, occurs only on an ad hoc basis. It is quite common to observe different projects being implemented in the same area within a country, sometimes with the same farmers participating in more than one project. Co-ordination on the ground should be ensured by the government authorities, but they often lack resources and capacity to do so.

A co-ordinated, sectoral approach could help tackle more effectively the multiple constraints that are hindering agricultural commercialisation. However, the experiences of Zambia in the late 1990s and more recently of Tanzania highlight the challenges of setting up multi-donor sectoral programmes. The establishment of sector-wide programmes in agriculture requires significant political will and patience, as well as strengthened government capacity<sup>29</sup>.

### **Ways forward: setting more balanced action programmes**

The over-reaching objective of donor and government assistance

to the agricultural sector is to lift smallholders out of poverty and create more off-farm rural employment. In this regard, the market potential of staple foods should not be overlooked. Traditional food crops are often better adapted to local agro-ecological conditions, and rising local and regional demand presents a great opportunity to expand production and develop food-processing industries. Currently donors and governments tend to put too strong a focus on export crops and too little on staple foods.

While contract farming schemes have been successfully established for export crops, examples of such commercialisation programmes are still rare for staple foods. Greater involvement of the private sector in designing and implementing commercialisation programmes may be more demanding for food crops, but this is necessary to develop and sustain local food industries. More donor support for innovative approaches to commercialisation programmes in this segment of the agricultural sector is needed.

Increasing the productivity of food crops is a top priority for Africa today, given the strong prospect of world food prices. This requires sizeable investments in irrigation, storage, transport infrastructure, as well as access to input markets (fertilizers, seeds, planting materials and credit). It also requires better functioning markets and stronger linkages to buyers and processors<sup>29</sup>.

There is a growing body of experience showing that “win-win” outcomes are possible through commercially viable business

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models – ways of creating value within a market network of producers, suppliers and consumers – which involve small farmers and SMEs. These business models for small farmers and SMEs must deliver essential services to producers and ensure reliable supply to buyers, while also addressing the high transaction costs and risks that buyers face when purchasing from large numbers of fragmented, cash-strapped small farmers and SMEs. This brief gives an overview of lessons learned about business models for including small farmers and SMEs in modernizing markets and agro-industries<sup>30</sup>.

SMEs are a fundamental part of the economic fabric in developing countries, and they play a crucial role in furthering growth, innovation and prosperity. However, they are strongly restricted in accessing the capital that they require to grow and expand, with nearly half of SMEs in developing countries rating access to finance as a major constraint. With targeted interventions International Financial Institutions (IFIs) play an important role in closing this gap<sup>31</sup>.

Targeted support from IFIs, such as guarantees or technical assistances, helps to build up the knowledge and expertise of intermediaries with respect to SME lending, thus helping to catalyze an independently sustainable SME lending market. IFIs are often better places to support SMEs than local governments, whose support schemes are often less cost-efficient and more susceptible to political capture. Increased research and empirical evidence will help to further strengthen the case for SME support and the effectiveness of specific interventions<sup>10</sup>.

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Africa Enterprise Challenge Fund (AECF)

[http://www.aecfafrica.org/index.php?option=com\\_frontpage&Itemid=1](http://www.aecfafrica.org/index.php?option=com_frontpage&Itemid=1)

CDE – Centre for the Development of Enterprise

<http://www.cde.int/>

CTA – ACP-EU Centre for Agricultural and Rural Cooperation

[www.cta.int](http://www.cta.int)

Brussels Briefing

<http://brusselsbriefings.net>

Brussels Briefing SMEs

<http://brusselsbriefings.net/past-briefings/n13-smes/>

CTA – Value Chains

<http://makingtheconnection.cta.int/>

*CIRAD – Centre de Coopération Internationale en Recherche Agronomique pour le Développement:*

*[www.cirad.fr](http://www.cirad.fr)*

*Centro Latinoamericano para el Desarrollo Rural*

*[www.rimisp.org](http://www.rimisp.org)*

Rural Agroindustries Development Project (PRODAR)

<http://infoagro.net/prodar/about.cfm>

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DG Enterprise and Industry – SME Definition

[http://ec.europa.eu/enterprise/enterprise\\_policy/sme\\_definition/index\\_en.htm](http://ec.europa.eu/enterprise/enterprise_policy/sme_definition/index_en.htm)

DG Development – Private sector development

[http://ec.europa.eu/development/policies/9interventionareas/trade/private\\_sector\\_en.cfm](http://ec.europa.eu/development/policies/9interventionareas/trade/private_sector_en.cfm)

### FAO

Agribusiness Development portal

<http://www.fao.org/ag/ags/subjects/en/agribusiness/index.html>

Strengthening Services in Agrifood Systems

[www.fao.org/ag/ags/index\\_en.html](http://www.fao.org/ag/ags/index_en.html)

Investment Centre

<http://www.fao.org/tc/tci/>

Global Value Chains

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IFAD

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ILO

<http://www.ilo.org/global/lang-en/index.htm>

NEPAD/CAADP

<http://www.nepad-caadp.net/>

OECD Centre for Entrepreneurship, SMEs and Local Development

[http://www.oecd.org/department/0,3355,en\\_2649\\_34197\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/department/0,3355,en_2649_34197_1_1_1_1_1,00.html)

UNIDO – Agro-Industry Support Unit

[www.unido.org/doc/5070](http://www.unido.org/doc/5070)

UNDP – Growing Sustainable Business (GSB)

<http://www.undp.org/business/gsb/about.htm>

Valuechains4poor

<http://www.valuechains4poor.org/>

### World Bank

Trade Costs and Facilitation: The Development Dimension portal

[http://econ.worldbank.org/projects/trade\\_costs](http://econ.worldbank.org/projects/trade_costs)

Rural private sector development

<http://go.worldbank.org/GG5U2LZ7H0>

Enterprise Surveys

<http://www.enterprisesurveys.org/>



## Glossary of terms used in value chain development <sup>32</sup>

### **Approche filière**

One approach to study commodity chains. The francophone filière tradition was developed by researchers at the Institut National de la Recherche Agricole (INRA) and the Centre de Coopération Internationale en Recherche Agronomique pour le Développement (CIRAD).

### **Benchmarking**

The process of comparing own performance parameters with the performance parameters of businesses or value chains considered the leaders in the field. Parameters can refer to various aspects. Important benchmark parameters are productivity, cost of production or product quality. Benchmarking is used to identify gaps in the performance of the value chain promoted.

### **Broker**

A broker is a market intermediary who brings buyers and sellers together and is paid a commission by either party.

### **Business environment / investment climate**

Business environment means the broad legal, regulatory and infrastructure conditions under which enterprises operate in a country. These are conditions at the macro level. They include macroeconomic and political stability, an effective governance and judicial system in general, as well as the regulations specifically relevant for doing business, such as well-defined property (e.g. land and water) rights, business registration and employment regulations, financial institutions, the transport system, and the efficiency of

administrative procedures. There are general conditions of the business environment cutting across many sub sectors, as well as conditions specific for each value chain.

### **Business linkages**

Value Chains operators relate to each other both horizontally (among enterprises at the same stage of the value chain, pursuing the same type of activity) as well as vertically (between suppliers and buyers of produce). Vertical business linkages can range from accidental market exchanges to a full coordination of activities regulated by contracts (see market relationships). Horizontal business linkages range from informal networks to associations and business membership organizations.

### **Business matchmaking**

This is the activity to create and promote business contacts and sales opportunities of specific business groups or of the entire value chain community. It is a support service for the value chain.

### **Cluster**

A cluster is a geographic concentration of enterprises which are closely connected, along a value chain or as a network settling around an important buyer or industrial company (e.g. value chain actors in the cut flower export business all located close to an international airport). A simple definition says: A cluster is a value chain that is concentrated at the same location.

### **Certification**

Certification is a procedure by which a third party (the certifier or certification body) gives written

assurance that a product, process or service conforms to specified requirements – a standard. Being certified is an asset for producers.

### **Commodity**

Commodities are bulky (natural-resource based) product, that are internationally traded either as a raw product or after basic industrial processing. The most important agricultural commodities include grains (rice, wheat), green coffee, palm oil, cotton or white sugar. The value chains of commodities mostly are loosely integrated, although trade may be concentrated. In terms of increasing the value-added an interesting strategy is “decommodification”, that is the diversification of conventional commodities into high-value variants (e.g. specialty coffee, specialty rice, aromatic cocoa or organic cotton).

### **Competitiveness (determinants and indicators)**

The performance of an economy results from a series of variables: At the micro level, competitiveness is determined by “hard” comparative advantages such as the location, the availability of primary resources and the cost of labour, as well as by “soft” conditions, e.g. the entrepreneurial competence. Yet, competitiveness also is a function of value chain coordination and the existence of supporting agencies at the meso level. Finally, the business enabling environment determines the overall cost of business making. Taken together, competitiveness is expressed by measures indicating technical efficiency and profitability as well as innovation and investment rates.

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### **Contract Farming**

A form of production in which farmer and buyer enter into a contract in advance of the growing season for a specific quantity, quality and date of delivery of an agricultural output at a price or price formula fixed in advance. The contract provides the farmer an assured sale of the crop. Sometimes, the contract includes technical assistance, credit, services, or inputs from the purchaser (see embedded service arrangement).

### **Embedded service arrangement**

In an embedded service arrangement operational services are delivered in combination with a basic business transaction (sale of products or loans). The basic idea is to finance the service as part of the business transaction, e.g. linking technical advice to the sale of inputs. Embedded arrangement may include other business partners as the service providers, such as input dealers or processing companies, or professional service providers as third parties.

### **Facilitator / facilitation**

Facilitators are initiatives pursuing a public interest in economic development (such as the pro-poor growth goal). This includes government programmes for private sector development as well as development projects funded by international donors. Contrary to the value chain actors, such programmes and projects are funded publicly (by tax money). They remain outsiders to the regular business process and restrict themselves to temporarily facilitating a chain upgrading strategy. Typical facilitation tasks include creating awareness,

facilitating joint strategy building and action and the coordination of support activities.

### **Interventions (to promote value chains)**

Interventions are temporary actions of external facilitators aimed at mobilising and/or joining value chain actors and building their capacity thus promoting change in the value chain. The idea is that an external intervention triggers an internal change of the system, in this case the behaviour of value chain (VC) actors.

### **Lead company**

Lead companies are key traders or industrial companies assuming a coordination role within a value chain. Highly integrated value chains often depend on lead companies who are the main buyers of the produce (see value chain governance).

### **Leverage point**

An element in a system, where a small intervention or change can yield large effects in the overall system.

### **Macro level**

The macro level refers to the public agencies and institutions constituting the business enabling environment. Typically, the macro level of a value chain is made up of national, regional and local government, the judicial system and major providers of public utilities (especially roads and water supply). The macro level determines the general cost of doing business cutting across different value chains and sectors of the economy.

### **Markets / market relationships**

A market is the interaction of demand and supply (buyers and sellers) of particular types of

goods or services. The exchange rules differ depending on the character of the good traded (e.g. commodities, perishable products, investment goods or services). There are different forms of market relationships: The basic market transaction is a once-off purchase of a product displayed by a seller, e.g. in a traditional street market (so called arms-length market relationship in a “wet market”). Sophisticated forms of market relationships include order contracts or regular subcontracting.

### **Micro level**

In a value chain, the micro level includes the VC operators and the operational service providers taken together.

### **Meso level**

In a value chain, the meso level includes all chain-specific actors providing regular support services or representing the common interest of the VC actors. Functions at the meso level include, for example, public research and technology development, agreement on professional standards, promotional services, joint marketing or advocacy. They are taken by support service providers.

### **Operational services / operational service providers**

Operational services are those services that either directly perform value chain functions on behalf of the VC operators or are directly related to them. Operational services therefore are business-to-business (B2B) services. They include value chain specific services as well as generic business services such as, for example, accounting services.

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### Product

This is a generic category comprising physical, tangible products as well as services sold to customers. The value chain is defined by a product or group of products, e.g. a tomato value chain or a fresh vegetable value chain.

### Productivity

The amount of output per unit of input, e.g. the quantity of a product produced per working hour or per hectare

### Pro-poor growth (PPG)

Pro-poor growth is the most commonly quoted objective of value chain promotion. There is a relative and an absolute concept of pro-poor growth. The relative concept states that economic growth is pro-poor if poor people increase their incomes above the poverty line, even if their share in the national income does not improve (a positive growth rate for poor). The absolute concept states that growth is pro-poor, when the income of the poorest (e.g. of the lowest quintile in a population) increases at least equally or more than the average income. (such that inequality is reduced). PPG stresses the need to make the poor participate directly in the economic growth, and does not rely on social transfers.

### Public-private partnership (PPP)

Whenever private companies share the public interest in economic development, public agencies may realize certain development activities jointly with a company. PPP denotes a joint project of government and a private enterprise to realize certain upgrading activities. An important criterion for a public agency engaging in a PPP is that an

adequate proportion of the benefit accrues to the other VC actors or to the general public.

### Sector / Sub-sector

The economy can be divided into sectors following different criteria. Here, the term “sector” is defined according to broad product market categories. These include, for example, the “agri-food sector”, “forestry”, the “apparel sector” or the “tourism sector”. Each sector comprises the companies operating in the respective market as well as the specific market rules. Sectors can be further broken down into sub-sectors by differentiating into specific product or service markets, e.g. “horticulture”, “non-timber forest products” or “ecotourism”. Further differentiating these markets leads to the definition of a value chain. However, there is no generally accepted classification of sectors, sub-sectors or value chains. In practice, terms often overlap. The term sector (or economic sector) is a higher-order term than sub-sector and aggregates several sub-sectors.

### SMEs

There is no single agreed definition of an SME. A variety of definitions are applied among OECD countries, and employee numbers are not the sole defining criterion. SMEs are generally considered to be non-subsidiary, independent firms which employ fewer than a given number of employees. This number varies across countries. The most frequent upper limit designating an SME is 250 employees, as in the European Union. However, some countries set the limit at 200, while the United States considers SMEs to include firms with fewer than

500 employees. Small firms are mostly considered to be firms with fewer than 50 employees while micro-enterprises have at most ten, or in some cases, five employees.

In the EU context, according to the European Commission Recommendation 2003/361/EC, the category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding €50 million, and/or an annual balance sheet total not exceeding €43 million.

### Standards

Standards are a means of defining and regulating product quality by specifying the characteristics which a product or the process of making it must have. This regards intrinsic as well as ethical attributes. Business linkages in value chains have to observe product safety standards, as well as product quality standards and ecological and social standards wherever applicable. Once standards have been formulated and agreed upon, they still have

### Support services / support service providers

Contrary to the operational services, support services do not directly support (or perform) the basic functions in a value chain. Instead, they refer to general investment and preparatory activities benefiting all or at least several value chain operators simultaneously. Support services therefore provide a collective good shared by the VC actors. Typical examples are the setting of professional standards, provision of sector-specific information, joint

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export marketing, the generation of generally applicable technical solutions, or political lobbying. Support services are often provided by business associations, chambers or specialized public institutes.

### Supply chain / supply chain management

The basic concept of a supply chain is similar to the value chain. The difference is that the supply chain refers to sequence of (upstream) sourcing and (downstream) marketing functions of individual enterprises, mostly of lead companies. Therefore, supply chain management is a business management tool rather than a development concept. It is concerned with logistics rather than market development.

### Transaction cost

Apart from the cost of production and marketing at each stage of the value chain, the market relationships between suppliers and buyers engender “transaction cost”. They include the cost of search for business partners, for seeking information and screening the market, and for negotiating, monitoring and enforcing contracts. High transaction costs often are the result of market inefficiencies, such as low market transparency, lacking grades and standards or deficiencies in the business environment. They can be brought down by organizing markets and by improving value chain coordination.

### Upgrading / chain upgrading

The term upgrading denotes the development path of a value chain. Gary Gereffi distinguishes “product upgrading”, that is the innovation,

diversification or improvement of the final product, and “process upgrading”, which is the improvement of production and distribution technology and logistics. These forms of upgrading improve overall efficiency. “Functional upgrading” means the shifting of value chain functions from one VC operator to another (e.g. shifting primary processing to farmers). It leads to a different distribution of value added across the stages of the value chain.

Upgrading implies activities in different fields of action, that can be summarized as ‘improving business linkages, associations, and partnerships’, ‘strengthening service supply and demand’ and ‘introducing standards and improving policies and the business environment of the chain’. Another aspect is the expansion of productive capacity which enhances the volume sold.

### Upgrading strategy

An upgrading strategy is an agreement between chain actors on joint action to upgrade.

### Value added

Value added is a measure for the value created in the economy. It is equivalent to the total value generated by the operators in the chain (chain revenue = final sales price \* volume sold). The value added per unit of product is the difference between the price obtained by a VC operator and the price that the operator has paid for the inputs delivered by operators of the preceding stage of the value chain and the intermediate goods bought in from suppliers of inputs and services who are not regarded as part of the value chain.

In short: “The worth that is added to a good or service at each stage of its production or distribution” (McCormick/ Schmitz). Part of the additional value created remains in the chain (= value captured), another part is captured by suppliers external to the chain

### Value capturing / value captured

The additional value added as a consequence of value chain upgrading that remains with value chain operators.

### Value chain (VC)

A value chain is

- a sequence of related business activities (functions) from the provision of specific inputs for a particular product to primary production, transformation, marketing, and up to the final sale of the particular product to consumers (the functional view on a value chain).
- the set of enterprises (operators) performing these functions i.e. producers, processors, traders and distributors of a particular product. Enterprises are linked by a series of business transactions in which the product is passed on from primary producers to end consumers.

According to the sequence of functions and operators, value chains consist of a series of chain links (or stages).

### Value Chain actor

This term summarizes all individuals, enterprises and public agencies related to a value chain, in particular the VC operators, providers of operational services and the providers of support services. In a



wider sense, certain government agencies at the macro level can also be seen as VC actors if they perform crucial functions in the business environment of the value chain in question.

### **Value chain governance**

Governance refers to the way business activities in a value chain are vertically coordinated. Following the terminology defined by Gary Gereffi, we can distinguish different forms of governance, of which the most important are markets, modular value chains, captive relationships and vertical integration. While in a modular value chain an independent supplier makes products according to buyer specifications, captive relations describe a form of governance, in which small suppliers depend on a much larger lead company.

### **Value chain map / value chain mapping**

The value chain map is a visual representation (chart) of the micro and meso levels of the value chain. According to the definition of the value chain it consists of a functional map combined with a map of VC actors. Mapping can but does not necessarily include the macro level of a value chain.

### **Value Chain operator**

The enterprises performing the basic functions of a value chain are VC operators. Typical operators include farmers, small and medium enterprises, industrial companies, exporters, wholesalers and retailers. They have in common that they become owners of the (raw, semi-processed or finished) product at one stage in the VC. Thus, there

is a difference between operators and “operational service providers”, the latter being subcontracted by the VC operators. However, in a service value chain the VC operators include both the enterprise providing the service product to the final consumer (be it an individual client or a company) as well as other specialized providers of inputs and (secondary) services upstream.

### **Value chain promotion**

Promoting a value chains means supporting its development by externally facilitating a value chain upgrading strategy.

### **Value Chain supporter / support service provider**

Value chain supporters provide VC support services and represent the common interests of the VC actors. They belong to the meso level of the value chain.

### **Value creation / value created**

The additional value added as a consequence of value chain upgrading.

### **Vertical coordination / vertical integration**

As value chains upgrade the vertical coordination between the different stages of the value chain increases. This means that relationships are being regulated through agreements and written contracts. This coordination function is often taken by a lead company. At the extreme, the relationship between suppliers and buyers is “integrated” to the extent that the production and marketing functions of a supplier are entirely controlled by the buying company (also see value chain governance)

### **Vision / visioning (for value chain development)**

Value chain promotion needs a strategic perspective. The vision describes the aspired change of the value chain answering the question: How should the value chain in question look five years from now? It is very important to make sure that the vision is formulated and shared by the VC operators and supporters, so as to derive operational objectives and facilitate the coordination of upgrading activities.



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## Footnotes

1. This Reader is not intended to exhaustively cover the the opportunities and challenges for SMEs in the agricultural sector of ACP countries but to provide some background information and selected information resources. Most text of this Reader has been directly taken from the original documents or websites. For additional inputs, kindly contact Isolina Boto (boto@cta.int).  
  
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