Smallholders are the centerpiece of a “pro-poor” agricultural growth agenda. Empowered through producer organizations and made more competitive by both institutional and technological innovations, small farmers can become greater market participants, both domestically and globally. The World Bank has gained considerable experience in this field through its support to several projects in Latin America and Asia.

Globalization and telecommunications (internet) have created new opportunities for small farmers to enhance their position in the international marketplace. Niche markets, and the increasing demand for high-value organic, specialty (e.g., coffee, cocoa) and “fair-trade” products, have shortened the distance between producer and end-market, permitting small farmers and processors to link directly with retailers (and even consumers). Such opportunities, although growing, are still only a fraction of the global market. Free trade agreements with the USA, Europe, and Asia also open the door for expanded exports, particularly fruit and vegetables, which can be produced cost-effectively by small farmers.

However, with its focus on competitiveness, globalization favors larger-scale operations in the quest for increasingly higher trade volumes to counter ever tighter margins. Large companies dominate international agricultural trade: the market share of the four largest companies in the coffee, cocoa and tea sectors is 40, 50 and 80 percent, respectively. Bananas, citrus fruit and flower markets show similar concentration patterns. Large companies prefer large suppliers; they are generally more reliable as business partners and generate lower transactions costs. Moreover, the food trade requires standardization, favoring products of certain dimensions, variety or quality. Phytosanitary and health requirements impose hefty costs of inspections and laboratory analyses. These factors contribute to an increasing business concentration on the supply side in value chains.1 Thus, the challenge facing small farmers is how to gain greater access to markets, enhance their value chain position and increase their value-added so as to boost incomes and reduce poverty. In agriculture, livestock and fisheries, small farmers are most often at the bottom of the value chain: their produce is often a small fraction of the value of the end-product. Without some specific support (and depending on the type of value chain), small farmers may be at risk of being marginalized. This is the case in some value chains at the international level and where agribusinesses have local or regional trading or processing monopolies. For instance, coffee-producing countries retain, in general, only ten percent of the value of the coffee retail sales.

1 A value chain is a sequence of production, processing and marketing activities: products pass through all activities of the chain in a certain order and, with each activity, the product gains value. In a well-managed value chain, the value of the end-product is often greater than the sum of valued-added (Porter, M. 1985)
Policies to Enhance the Value Chain Position of Small Farmers

The public sector can undertake the following policies to enhance small farmers’ integration in value chains:

**Improve infrastructure and telecom networks**: Good roads, ports, airports and rail infrastructure as well as telecommunication reduce transport and intermediation costs and cut the distance between farmers and markets as has been demonstrated in the Peru Rural Roads Program. Phones and the internet (Nicaragua) increase access to market information for remote, rural communities.

The perishability of agricultural products requires careful handling, special facilities (e.g., packing, cold storage, and refrigerated transport) and rapid delivery to customers to maintain quality and reduce physical and nutritional losses. Government or municipalities can help reduce marketing costs in value chains by investing in efficient wholesale markets, joint packing and refrigeration facilities at markets and airports. Such investments have a positive impact on domestic food prices eliminating marketing bottlenecks.

**Stimulate private market information systems**: Privately-managed information systems have been shown to provide more relevant and up-to-date information more cost effectively than public systems. For example, the wholesale market in Medellin, Colombia uses text messaging and the internet to inform farmers about prices and marketed quantities. Such information also serves as a reference in forward or long-term marketing contracts.

**Promote commodity exchanges**: The creation of commodity exchanges by trader (export) associations and farmer organizations (e.g., Dominican Republic-BOLSAGRO) expedites the participation of farmer associations in bulk commodities markets (e.g., cereals, tubers, export crops). Commodity exchanges have a price stabilizing effect, allowing farmer associations to hedge against price risk. Banks can use them as a credit collection mechanism.

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Integrate marketing and value chain aspects into existing extension systems: Extension services have traditionally focused on production aspects. Extension services that integrate marketing aspects are generally more successful in introducing productive changes on small farms. The Peru Irrigation Project has, since 1999, introduced a program focused on the marketing potential of the produce rather than on its productivity.

Introduce and enforce standard marketing contracts: Minimum standard contracts between small farmers and purchasing agents can build mutual trust and enhance their willingness to establish longer-term contract farming relationships.

Linking small farmers to value chains

Urban markets, especially supermarkets, and export markets in LAC have become more sophisticated and now require higher-value, higher-quality produce. Rising household incomes also favor consumption of high-value products (e.g., meats, fruit, and vegetables) and processed foods. Supermarkets -- heavily concentrated at the national level and sometimes foreign-owned (e.g., Wall-Mart, Carrefour) -- dominate food sales, capturing 50 percent of the total LAC retail food market. Public policy to enhance small farmer participation in urban markets, supermarkets and commodity markets could include the following:

Promoting partnerships between small producers and agro-businesses or commodity wholesalers: Such partnerships -- in which the commercial partner agrees to purchase the produce of small family organizations at a certain reference price and in accordance with agreed specifications -- formalize value chain participation for small farmers, strengthen their business acumen and market orientation, develop their negotiation skills with the private sector and facilitate new market-driven technology adoption. Programs to promote such partnerships are under implementation in several LAC countries (Box 1). They generally contain a grant element to allow small farmers to adapt more easily to market requirements.

Box 1. Colombia: Rural Productive Partnerships Project

Productive Partnerships have been promoted in Colombia since 2002. The Colombian Government provides grants to farmer associations to adapt their production technology to market demand, including for health and organic certifications. More than 150 partnerships have been created in the oil palm, dairy, fruit, coffee, cocoa, cereals and domestic food sectors. Over the next five years another 300 partnerships are to be created. The partnerships have increased the revenue of the participating farmer families by more than 20 percent and employment by more than 10 percent. Moreover, the project shows important multiplier effects on non-participating farmers in the vicinity. This successful example is being followed in many other LAC countries and Asia: Panama, Peru, Bolivia, Honduras, Guatemala, and Vietnam. However, future challenges remain, such as establishing partnerships with supermarkets over an extended period of time.
Help small farmers to comply with market standards and supermarket requirements: Supermarket or distribution center procurement systems differ from country to country and product type (e.g., centralized procurement, dedicated wholesalers, or direct contracting with processors and producers). All systems introduce specific standards regarding size, quality and product safety. In general, the systems favor asset-rich farmers. Supermarkets prefer to buy from larger farmers and/or farmers with important assets such as: good road access, irrigation, green houses, vehicles and packing sheds. Farmers lacking such assets, particularly small farmers, are marginalized.

Several countries (e.g., Colombia, Panama, Honduras, Guatemala, Dominican Republic, and Peru) have initiated or are implementing grant programs (sometimes combined with loans) to finance small farmer investments in drip irrigation, green houses and packing houses to facilitate their insertion into the value chains of supermarkets, large wholesalers and exporters. Such programs are more successful where they are combined with technical assistance to enhance cooperation between small farmers.

Enhancing the management capacities of small farmer associations: The above measures will help small farmers to better integrate into the value chain and markets. Such integration will, however, be difficult without strong farmer associations and rural institutions that can support such associations.

Acting alone, small farmers cannot produce the volumes necessary to satisfy buyers who want to reduce transaction costs, increase economies of scale and obtain a reliable supply. Only sufficiently large associations of small farmers can provide the quantities required by the domestic and international markets (Box 2). Moreover, to obtain a larger part of the value added in the value chain, producers have to gain bargaining power with the commercial private sector. Such bargaining power can only be obtained sustainably by organizing, and producing in both volume and quality.

Box 2. Guatemala: Cooperative Cuatro Pinos

The Guatemalan Cooperative Cuatro Pinos (Sacatepequez - Guatemala) represents more than 4,000 small farmers across 120 associations. Specializing in thirteen fruit and vegetable products (e.g., French beans and peas), Cuatro Pinos functions as a purchasing, packing and refrigeration station and imposes rigorous quality standards on its suppliers. Such large cooperatives (which really operate as businesses) can reliably provide export markets with produce that complies with SPS and other standards.

Governments have an important role to play by making it easier for farmers to legally form associations, by introducing the “rules of the game” in terms of transparency and accountability and through capacity-building programs. But an even larger role belongs to the producer organizations (gremios) and NGOs in providing institutional support to the emerging and existing associations. The field is wide open: (1) helping the associations with resolving the conflicts between business efficiency and equity and dealing with their heterogeneous memberships; (2) financing training and capacity building for association managers; and (3) accompanying the associations over long periods to develop into viable businesses.

Sanitary and phytosanitary standards and their costs

Sanitary and phytosanitary standards (SPS) govern international trade to address food safety and health risks associated with pests (e.g., fruit flies), food-borne and zoonotic diseases (e.g., foot-and-mouth disease, mad-cow disease) and microbial pathogens and other contaminants (e.g., mycotoxins, pesticides). These standards vary widely across countries. The capacities of governments and farmers to deal with these standards also differ widely.

Many governments and private sector actors have introduced additional standards related to the environment, social management (e.g., child labor) and commercial aspects. Moreover several importing countries have introduced traceability and certification requirements. The up-front cost to small farmers of compliance with these multiple standards and traceability requirements (including inspection systems – for instance mangos in Haiti) can be substantial, while the markets often remain quite volatile. The benefits in terms of productivity, environmental protection, reduced wastage and competitiveness are rather long-term. Local consumers may also benefit.

Both the public and private sector have a role to play in facing SPS and other quality management challenges. The public sector can: (1) adopt food safety legislation and standards consistent with local conditions and preferences, WTO and other trade obligations; (2) strengthen the domestic systems for pest, animal disease and market surveillance; (3) support research on food safety and agricultural health; (4) promote good practices through extension programs; (5) invest in laboratory infrastructure or accredit private laboratories; and (6) improve water and sanitation and market facilities.

*The old co-operative principle of “one person, one vote” is not conducive to successful business practices.
Extending and Deepening Rural Financial Services

Relatively higher transactions costs, lower population density, and increased risk premiums vis-à-vis the urban sector have historically blunted expansion of financial services to the rural sector, particularly small farmers. In rural Honduras, Nicaragua and Peru, the credit-constrained population constitutes 40 percent of all agricultural producers; compared to unconstrained producers, they use only 50 to 70 percent of the purchased inputs and earn only 60 to 90 percent as much net income (Fig. 1). Smallholders are asset-poor and “risk-rationed”—unwilling to risk forfeiture of their already limited asset base. Weather risk further reduces the attractiveness of lending to smallholders, particularly in the absence of developed insurance markets.

Rural Finance Institutions (RFIs) can leverage social capital and peer monitoring in both stimulating and deepening rural financial markets. Using a value-chain approach, FUNDEA in Guatemala finances inputs and outputs for small farmers, accepting standing crops as collateral. Furthermore, public policy can support pilot testing of technological innovations that reduce costs and risks of offering financial instruments to rural small-scale producers. Just as cellular phones can speed market and price information to producers, so-called “mobile or m-banking”, now being piloted in Brazil, can also dramatically reduce transactions costs for rural financial transactions.

Where necessary, financial regulations should be reformed to remove interest rate ceilings and permit RFIs to mobilize savings deposits, perhaps via branchless banking, taking advantage of existing post offices, gas stations and other retail outlets as conduits for rural financial transactions. Stimulating data collection via credit-reporting bureaus can also reduce the current risk premium associated with rural lending, due to information deficits to gauge behavioral risk of potential borrowers. Rural finance for smallholders would also benefit from the creation and expansion of insurance instruments to protect against losses. Weather-indexed insurance shows promise in taking advantage of climatic data on rainfall and temperature to calculate payout amounts.

**Fig. 1. Effects of credit constraints on agricultural producers**

![Diagram showing the effects of credit constraints on agricultural producers in Nicaragua, Peru, and Honduras.]

**References**

Adapted from the World Development Report 2008 Agriculture for Development with additional information from regional studies and anecdotal evidences.

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The 2008 World Development Report (WDR) “Agriculture for Development” characterizes agriculture as vital development tool for achieving the Millennium Development Goal that calls for halving by 2015 the share of people suffering from extreme poverty and hunger. The report provides guidance to governments and the international community on designing and implementing agriculture-for-development agendas that can make a difference in the lives of hundreds of millions of rural poor. This brief is part of a series prepared by LCSAR that summarizes and interprets the principal messages of the WDR 2008 and discusses region-specific implications for Latin America and the Caribbean (LCR). The series comprises the following topics: (i) Agricultural Innovations in Science and Technology, (ii) Value Chain Development and Integration of Small Farmers, (iii) Agricultural Trade Policy, (iv) Land Administration and Access, and (v) Territorial Development.