

Reaching beyond the value chain

How sector governance can improve the performance of agricultural commodity sectors

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Executive Summary

The last two decades have seen an increasing emphasis on company and supply chain driven approaches to promote sustainable production and trade of agricultural commodities. Large food and commodity traders, processors and brands – sometimes supported by development donors – have congregated around the value chain as the locus for interventions in support of legality, sustainability, productivity and quality. These initiatives have sometimes achieved remarkable success with benefits to both farmers and commercial partners. However, there are many situations where the successes of individual supply chain projects are limited by the wider sector dynamics and consequently do not improve the overall performance or resilience of a sector.

Dynamics which undermine supply chain approaches include price volatility, poor quality management, weak organization of small-scale producers and poor service provision. There is increasing awareness that to reach scale and sustainability, inclusive chains need to be part of more inclusive and stable sectors. The sector rules and governance create the context in which more inclusive value chains can operate and succeed (or fail). Relatively little attention has been paid to how to proactively create sector structures and mechanisms that support more sustainable livelihoods for farmers sector-wide. To bridge that gap in understanding the role of sector governance in the 21st century, IIED and Aidenvironment, in partnership with the Sustainable Food Lab, have conducted a scan of existing sector governance models in thirteen case studies to better understand how these sectoral models work to improve sector performance.

Sector governance refers to a more coordinated approach to improve the performance of a sector as a whole (i.e. sector transformation). It comprises the institutions, policies, rules and strategies congregated around one or more commodities. It has four core functions:

1. **Alignment, coordination and accountability:** the capability of a sector to set a vision for its development, align the key stakeholders behind it and organize accountability around investments and commitments.
2. **Revenue generation and re-investment:** the capability to generate revenues at sector level (rather than looking to donors or lead firms) and to re-invest in the sector.
3. **R&D and service provision:** organize research and sector-wide service provision to ensure short-term and long-term development.
4. **Market management and promotion:** the management and promotion of markets with mechanisms that determine the basic rules on trade, prices, quality, traceability and sustainability.

The first core function—alignment, coordination and accountability— requires a well-functioning sector platform or coordination body. Multi-stakeholder sector platforms can promote voluntary action through alignment of vision, projects, strategy development, learning, and sector-relevant tool development. The case study analysis provides key insights into how such a platform or body can promote alignment, coordination and accountability and use it to strengthen the sector. Setting a common vision and strategy promotes member buy-in to such platforms. Combining short-term results in the field with the pursuit of long-term systemic change strengthens member commitments. Sector platforms can also inform public policy. For example, the guidelines on environmental management practices developed by the palm oil consortium (PASH) have been endorsed by the Honduran government and have become a condition to obtain a legal permit for new plantations. A drawback of voluntary platforms is that they generally do not have the mandate or capabilities to raise revenues at a sector level, making them highly dependent on donor funding. Sector coordination bodies usually have a more formal mandate to manage sectors, which favours revenue collection, sector-wide investments and market management. For example, in the cocoa sectors of Ghana and Ivory Coast, coordination bodies raise levies, invest in service provision and set cocoa prices.

Both sector platforms and coordination bodies can be placed within governments or managed at arm's length from the government. Regardless of the management approach, sector governance requires a certain level of political capital and facilitation capacity. Some of the cases show that a strong government role facilitates the introduction of more extensive and far-reaching reforms (e.g. cocoa in Ivory Coast). Other models, such as coffee in Costa Rica and tea in Kenya suggest that one success factor has been the design of a management model which exists at arm's length from government. Nonetheless these models still need a clear mandate from the government and need the government to consistently respect the given mandate and not interfere politically. In a weak institutional environment, sector governance appears to be more effective when placed at arm's length from the government, providing more opportunities for inclusive and transparent processes. But even then, some government mandate and buy-in is necessary.

A high performing sector is:

- **competitive:** in price and quality
- **resilient:** to price volatility and climate variability
- **profitable:** allows producers, workers and supply chain actors to capture a fair share of end value enabling re-investments in the sector and farm
- **innovative and adaptive:** to market trends
- **sustainable:** protects the environment and respects labour rights
- **inclusive:** to the most vulnerable to participate
- **resistant to rent seeking and elite capture**
- **transparent:** operates within legal frameworks with transparent or traceable supply chains

Coordination bodies can collect revenues at sector level, which is the second core function. This is usually done through export taxes or levies. The case studies show high variation in the magnitude of levies and the extent to which they are re-invested in the sector or support other budgetary needs. Sector investments include research, extension, input distribution, quality management, price management, price stabilization, social and environmental programs, market promotion and the functioning of the sector platforms or coordination bodies themselves. For example, ICAFE, the coordination body of the coffee sector in Costa Rica, raises an export fee which is reinvest in the body's own operations, as well as in coffee quality management, dedicated research, development and transfer of knowledge to the industry.

Other cases include examples of more coordinated investments in research and service delivery, the third core function. In the semi-privatised cotton sector in Burkina Faso, cotton companies are obliged to provide inputs and technical assistance to all their smallholder suppliers. Other cases show that sector-wide investments are often insufficient to reach out to all producers to provide high quality services. In particular, the transformation to higher yielding and more sustainable production systems, as well as the rejuvenation of tree crop plantations, can require significant investment. In such cases, sector platforms and coordination bodies have an important role to play in creating the alignment and tools necessary for other actors to co-invest in service provision.

Market management, the fourth core function, can include the policies and investments around quality management (specification and auditing systems), trade registries, product promotion, production and sustainability standards, producer organization protocols, market stabilization and more. These are pre-competitive functions at the sector level that can protect quality and reputation and promote market growth. Our research focussed on price setting and stabilization mechanisms, one of the most challenging and controversial aspects of sector management. Different variations of price setting mechanisms exist. For example, farmgate prices can be fixed throughout the season or be set as a fixed proportion of a daily reference price. Fixed seasonal prices are generally based on a combination of forward sales and market projections. Some models have set fixed margins for all supply chain actors until export. This is often combined with levies for specific purposes including research, social programs or the functioning of coordination platforms. In some cases a levy to capitalize a price stabilization fund has also been installed. This fund facilitates fixed price support throughout the seasons even in the face of declining market prices.

Stabilization can also contribute to compensation for producers in seasons when prices are below a certain threshold. The case studies show that price setting and stabilization mechanisms help in price discovery and can result in more stable and higher prices. They can also push for a transformation of supply chain relationships, for example as a result of fixed margins between producers and exporters. An important condition for success is that price setting and stabilization schemes set prices and contributions on a non-political basis. If this is not respected the whole system can be jeopardized. Another risk is that the stability of price mechanisms may be jeopardized by long-term declines in market prices. Of course price setting mechanisms cannot be set in isolation of supply and demand as intentional price management can risk supply stimulation of production beyond the market demand if improperly managed.

The case studies included other instruments. For example, commodity exchanges can support price discovery and transmission. They can support price setting and stabilization instruments by offering a reference price. Instruments that promote supply chain transparency, e.g. trade registries, can support the implementation of price policies at different nodes of the value chain. Sector-wide quality management is an important objective in various cases. This is promoted through a wide range of instruments, including quality standards, control mechanisms, research and extension. Active branding of the national sector can also promote perceived quality on the world market. Like quality, social and environmental performance is also promoted through service provision, community investments and the use of standards. A specific instrument is the spatial planning framework in the sugarcane sector of Brazil which regulates production activities according to environmental and agronomic suitability.

The organization of producers can facilitate the provision of services and market access as well as allowing producers to have a voice at sector level. In the Kenyan tea sector this is obtained through a state-sanctioned limited company with farmers as shareholders and in the Colombian coffee sector by a national federation. The organization of the producer base can also be promoted to push for cooperative development or facilitate contract farming arrangements.

The cases show that an individual instrument may be not enough to improve sector performance. In many cases it is the combination of instruments that facilitate this, and the combination is context specific. The first conclusion of the study is that the highest sector performance seems to be where market dynamics prevail, but within the (strict) boundaries set by the government or coordinating body. Cases such as cocoa in Ivory Coast or coffee in Costa Rica show that it is possible to set conditions according to which market actors can continue doing their business and market dynamics prevail (e.g. buying, selling, price discovery, competition, low barriers to market entry). The conditions create a level playing field, mitigate market failures and contribute to sector performance. Some of the cases also included coordinated marketing efforts by either the coordination body (e.g. cocoa Ghana and coffee Colombia) or through state-sanctioned monopolies (cotton Burkina Faso). It appears that more centralized marketing brings additional financial risks to the system. In other words, it is important that sector governance does not become too heavily market distorting and allows a sector to respond to (international) market dynamics.

The second conclusion is that a coordinated sector governance approach can achieve sector-wide impacts on value capture by farmers, price stabilization and raising overall product quality. The case studies provide some successful examples of pricing instruments that have promoted value capture by farmers and brought some stability in prices. The cases also show that a coordinated approach on product quality can result in higher prices. The Ivory Coast cocoa case, and a comparison between the West-African and Southern Africa cotton sectors show that a coordinated approach on quality is likely to be more successful than leaving everything to market forces. Sector governance models seem to have been less effective in ensuring sector-wide service delivery.

The case studies also help to draw some preliminary guidelines for how sector governance could look in the 21st century. Today's globalized world – with differentiated market channels and challenges of poverty, food security, climate change and depletion of natural resources – requires a different approach to sector governance than that implemented in the pre-liberalized era of the previous century. The two decades of supply chain initiatives have also offered a number of insights into what works and what does not. Although every sector will have its own specificities, some possible guidelines emerge. They include:

- the creation of a shared vision on sector performance;
- policy setting to mitigate commodity price volatility and promote value capture at producer level (as long it follows international market price developments and uses a political decision-making);
- the development of robust quality control mechanisms to build reputation on the world market;
- the ability to collect revenues to survive market booms and busts without needing recapitalization and to invest in the root causes of unsustainability at farm, landscape and sector level.

This research will continue to obtain a better understanding of specific sector governance instruments and to support the development of a methodology to facilitate the diagnosis of sectors from a governance and performance perspective.

Introduction

For years, public, private and non-governmental agents have worked to better understand smallholder value chains. They have sought to identify where companies that source from smallholders can have the biggest impact on poverty reduction and sustainable production of agricultural commodities.

It is clear that linking smallholders with well-functioning local or global markets plays a critical part in long-term strategies to reduce rural poverty and environmental harm. In recent decades much emphasis has been given to 'inclusive' value chain approaches. Yet to reach scale and sustainability, inclusive chains need to be part of more inclusive and stable sectors—the backbone of more inclusive markets. The sector rules and governance create the context in which more inclusive value chains can operate and succeed (or fail). Relatively little attention has been paid to how to proactively create sector structures and mechanisms that support more sustainable livelihoods for farmers sector-wide.

To bridge that gap in understanding the role of sector governance, IIED and Aidenvironment, in partnership with the Sustainable Food Lab, have conducted a scan of existing sector governance models to better understand how these sectoral models work and how they can improve sector performance. In support of this, they developed an analytical framework and analysed 13 case studies in different commodity-country contexts. This paper presents the analytical framework and describes the outcomes of the case studies. It aims to inform agents that work on the development of agricultural sectors and are interested to think about solutions which go beyond the value chain approaches.

The report starts by describing the rationale for sector transformation and governance approaches. Chapter 2 explains the concept of sector governance in more detail and presents the case studies. Chapter 3 describes examples of specific governance instruments, and chapter 4 presents four cases that combine different sector governance instruments. The report ends with some key insights. A description of the cases are included in Appendix I. It should be noted that most information for these case studies was collected during in autumn 2016 and therefore does not include the most recent developments in the respective sectors.

In practice, the sector governance structures and mechanisms found in different crops and countries come through very context specific histories. This paper is not suggesting that it is possible to life an entire sector governance design from one country to a next – that would be ignore all the historical and cultural contexts in which these sector structures arose. But the proposition of this research is that it is possible to provide a guiding framework and a “tool kit” of structures and mechanisms derived from the range of actual cases that can support the innovation of “practitioners” who are actively working to improve sector performance in the specific contents.

1. Transforming sectors requires an approach that moves beyond the value chain

Agriculture and agricultural supply chains are still central for addressing rural poverty. Worldwide more than 850 million people live on less than \$1 per day. These poor households are concentrated in rural areas, and most of them depend on agriculture for a substantial part of their income. According to the World Bank, agriculture is a “source of livelihoods for roughly 86% of the world’s rural people and provides jobs for 1.3 billion smallholders and landless workers.”¹

Since the 1990s, the liberalization of agri-commodity sectors shifted the locus of intervention from a central role of the state in market management to a primary role of the private sector through value chain development. Until the ‘90s, management of agricultural commodity sectors and markets was seen as essential to encourage output and generate revenue. In the pre-liberalization phase, the public sector invested heavily in rural extension and research. Many markets were governed by marketing boards and sectors were often organized through state-owned monopolies. In the coffee sector, for example, commodity prices were managed through buffer stock management, which was governed at the international level. In the ‘90s many sectors were liberalized with the goal of allowing markets to freely function.

The shift away from government intervention in markets and sector organization was a reaction against some of the persistent weaknesses that were associated with heavy regulation and coordination. Those weaknesses included high sector taxation, market and trade distortions, rent seeking and patronage, mismanagement, and failure to adapt to market demands for quality and traceability.

With the liberalisation of commodity sectors and markets the development of sectors shifted to individual value chain participants. Large food and commodity traders, processors and brands – sometimes supported by development donors—have focused on the value chain as the locus for interventions in support of legal and standards compliance, sustainability, productivity, and quality. These initiatives have sometimes achieved remarkable success in terms of creating more transparent trading relationships and providing benefits to both farmers and commercial partners. Benefits to farmers of value chain approaches include improved market access and access to support and services improving productivity, sustainability, and income. To companies, benefits include a chance to secure a stable source of supply, increase brand value and protect their reputation.

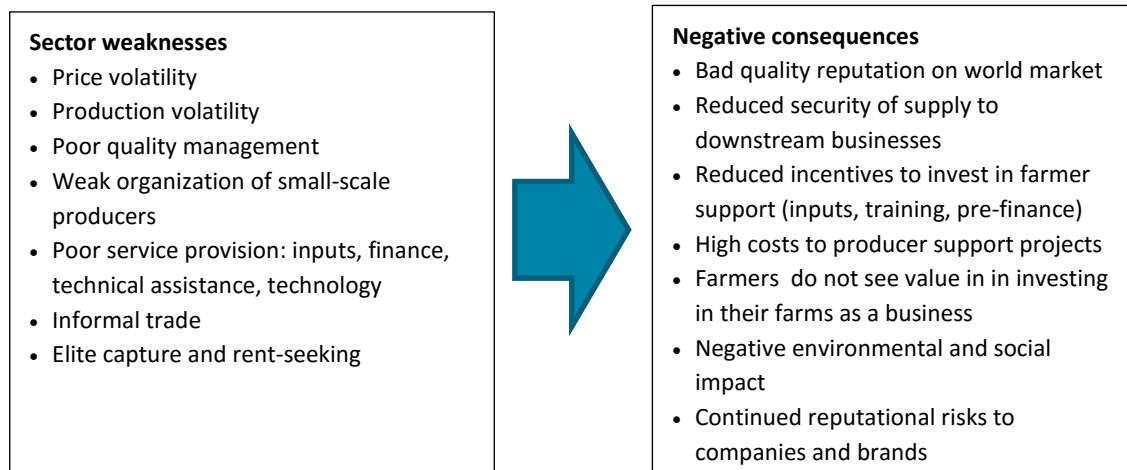
However, the successes of individual supply chain projects generally may not improve the overall performance or resilience of a sector. Individual supply chain initiatives tend to result in ‘islands of success’ limited to that portion of the production base connected to individual chains. These projects generally do not bring the systemic changes that are required to tackle issues that can make or break sector performance, such as price volatility, natural resource depletion or long-term security of supply. There is little attention to reversing the shrinking share that producers have of the end value of the commodities that they produce. In addition, the high cost of interventions of supply chain projects can become limiting when donor funding is withdrawn or when pilot projects are scaled up. A temporary ‘pilot project’ lifespan can limit the longevity of interventions. The result is a tendency to pick the low-hanging fruit: the part of the production base that is already more accessible, better capitalized, and better organized.

Individual supply chain projects can themselves be undermined by poor sector performance and resilience. For example, the vanilla sectors in Madagascar and Uganda are characterized by high price volatility, limited quality management, and poor organization of smallholders. During periods of high

¹ World Bank (2008), *World Development Report, Agriculture for Development*.

prices, aggressive buying by traders incentivises theft from farmer fields and causes poor harvest practices, which undermines product quality and company programs. Other indicators of poor sector performance include significant variations in production volumes, a structural decline in productivity (e.g. soil depletion as a consequence of underinvestment in production) and poorly functioning service provisions (see Figure 1).

Figure 1: National commodity sectors can have structural weaknesses that undermine the performance of producers and value chain actors



Strong sector performance can facilitate improvement of the performance of individual producers.

Scaling up good performance from farm level (e.g. yield, quality, sustainability) or landscape level (e.g. watershed management, forest protection) requires an enabling environment that offers the right incentives. Many of these incentives depend on what happens at sector level: comprising the stakeholders, policies, rules and strategies at national or regional level congregated around one or more commodities. A high performing sector is:

- **competitive:** has a good reputation and performance in world market (price and quality)
- **resilient:** reduces the risk and absorption of shocks related to price volatility and climate variability
- **profitable:** allows producers, workers and supply chain actors to capture a fair share of end value enabling re-investments at sector and farm level
- **innovative and adaptive:** is flexible to respond to market trends, add value and develop differentiated products based upon origin and quality attributes
- **sustainable:** protects the environment, respects of labour rights and builds human and environmental capital
- **inclusive:** provides opportunities to the most vulnerable to participate in the market with access to services and to have voice in sector governance
- **resistant to rent seeking and elite capture**
- **transparent:** operates within legal frameworks with transparent or traceable supply chains

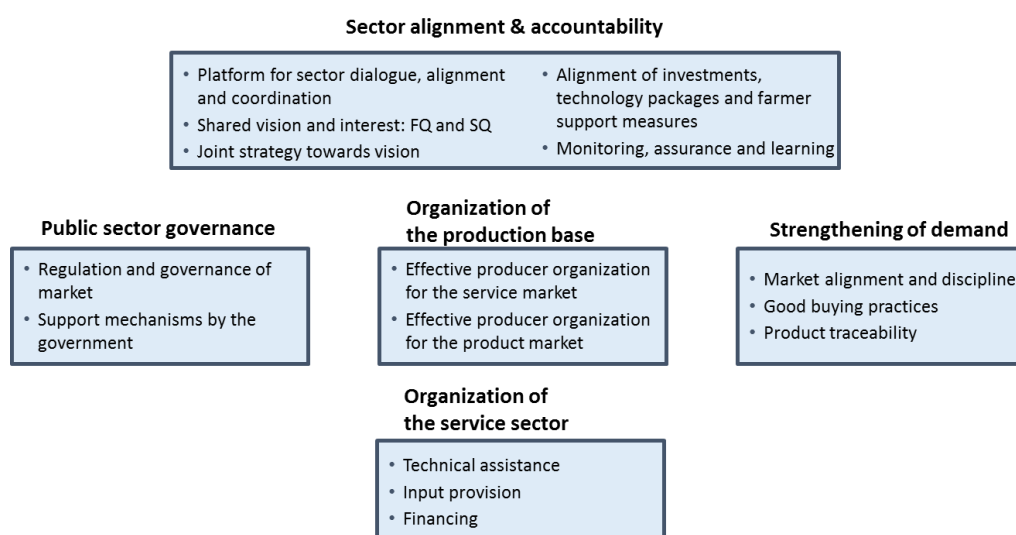
Raising the performance of a sector as a whole, or sector transformation, requires a holistic approach which goes beyond individual value chains.

In 2015, Aidenvironment, IIED and NewForesight published a study² which called for a more comprehensive and coordinated approach towards the transformation of commodity sectors. It emphasises stakeholder alignment and the need for complementary investments and actions by producers, value chain actors, the public sector, and the service sector. It recognizes that sector transformation requires performance improvement at both sector and producer

² Molenaar, J.W., Gorter, J., Heilbron, L., Simons, L., Vorley, B., Blackmore, E., Dallinger, J. (2015). *Sustainable Sector Transformation: How to drive sustainability performance in smallholder-dominated agricultural sectors?* White Paper 1. Commissioned by IFC.

levels. It developed a model for effective sector transformation which included five building blocks: 1) alignment and accountability; 2) market demand; 3) public sector governance; 4) service sector organization; and 5) production base organization (see Figure 2). The Aidenvironment, IIED and NewForesight study is an important basis for the work presented here.

Figure 2: The sector transformation model provides a comprehensive framework along which strategies could be designed to promote sector-wide change



- **Sector alignment and accountability:** The foundation of sector transformation rests on the need for key stakeholders to develop a shared vision on the desired performance levels of producers and the sector, and the improvement paths, strategies and actions to realize this vision. These stakeholders also define the accountability process that monitors progress towards sector transformation to learn, adapt, and disseminate the lessons learned.
- **Market demand:** This refers to how the market organizes its procurement practices in such a way that it incentivizes continuous improvement within its supply base in line with the sector vision.
- **Public sector governance:** refers to the regulatory environment promoting continuous improvement and removing worst practices, especially where the market or service sector fails to realize such improvements.
- **Organization of the service sector:** This refers to a professional service sector supporting producer improvement through the delivery of, for example, technical assistance, inputs, and finance. The challenge is to build incentives into the delivery models to promote continuous improvement.
- **Organization of the production base:** Finally, producers need to be organized around service delivery, market access and having a voice at sector level. Organizational dynamics can also include incentives for continuous improvement of producers (e.g. through peer pressure).

In this study, we emphasize the above-mentioned sector alignment and accountability, and public sector governance building blocks.

In this study, we focus on sector governance and its four core functions as a coordinated approach to transforming sectors. The first one is the capability of a sector to set a vision for its development, align the key stakeholders behind it and organize accountability around investments and commitments. The second function is to generate revenues at sector level (rather than looking to donors or lead firms) in order to re-invest in the sector. The third function is to organize research and sector-wide service provision to ensure short-term and long-term development. The fourth function is the management and promotion of markets with mechanisms that determine the basic rules on trade, prices, quality,

traceability and sustainability. In other words, sector governance comprises the institutions, policies, rules and strategies congregated around one or more commodities. It implies a more horizontal organization of the sector with coordinating institutions that are placed within or at arm's length of the government.

Ultimately, good sector governance leads to benefits for producers, supply chain actors, government and environment. Sector governance can improve the performance of a sector (e.g. competitiveness, resilience, inclusivity) and thereby drive performance of producers (e.g. profitability, quality). Good sector governance provides a better foundation from which companies can have more successful value chain initiatives, but can also drive sustainability outcomes directly for both producers and buyers. A study by David Knopp & James Foster³ showed that in 2009, tea produced in Kenya under the governance of the Kenyan Tea Development Agency (KTDA) returned 75% of the export price to the farm gate, compared to 25-40% in competing countries, while maintaining superior quality. The Costa Rican coffee institute ICAFE manages to ensure nation-wide high quality, stabilize farm prices, enforce transparency in supply chains, and invest in research and extension programs to combat pest and diseases, or to promote climate neutral farming.

This report presents the outcomes of a study on different sector governance instruments and how they influenced sector performance. It does so by analysing 13 different case studies, using an analytical framework which links instruments to sector performance and producer performance. Despite liberalization, a number of sector governance models have endured and adapted to fit new political and economic contexts. New sector governance models have also emerged. These models can work alongside and reinforce (rather than displace) value chain initiatives. Wider application of those models can potentially assist in the wider transition of agriculture to more sustainable structures that work in the 21st century. This research analyses the drivers, successes, weaknesses and key success factors of the instruments that drive sector performance. It aims to inform policy makers, development agencies, and multi-stakeholder commodity initiatives on their potential strategies in promoting sector-wide improvement through a sector transformation or sector governance approach.

³ Knopp, D. & Foster, J. (undated). *The economics of sustainability*, Wood Family Trust and Gatsby.

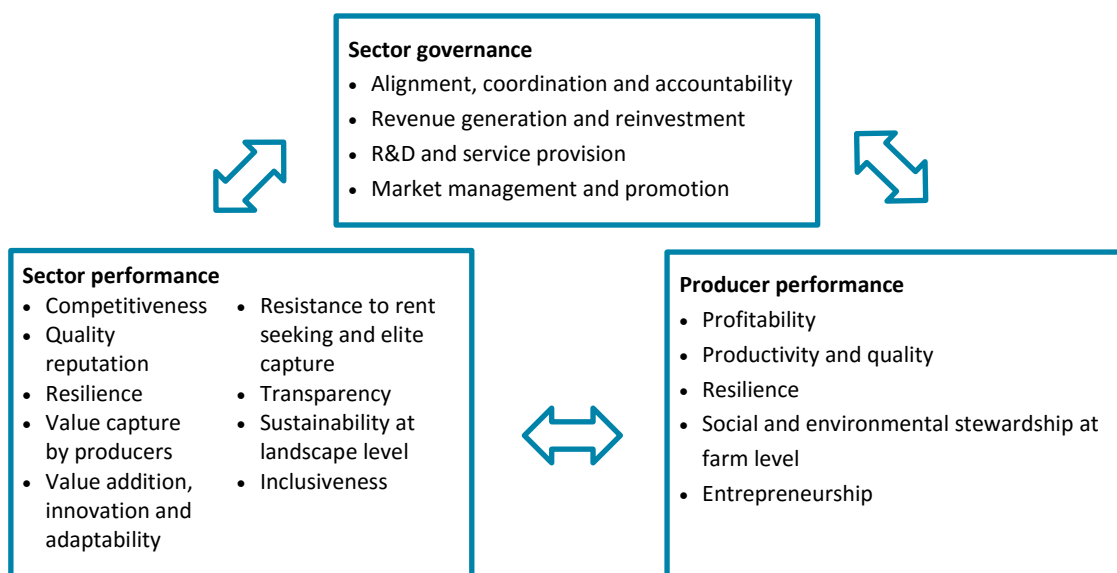
2. Analysing sector governance

This section shares the proposed analytical framework of sector governance, from which the drivers, successes, weaknesses and key success factors of sector governance instruments can be assessed.

2.1 How sector governance can improve sector and producer performance

Sector governance or a sector governance model refers to a set of instruments which drive sector performance and producer performance (see Figure 3). It refers particularly to instruments including rules and institutions which enable sector alignment, coordination and accountability (i.e., to collect revenues and reinvest them in research and service provision or to manage and promote markets). This section explains in more detail these concepts.

Figure 3: Sector governance to improve sector performance and producer performance.



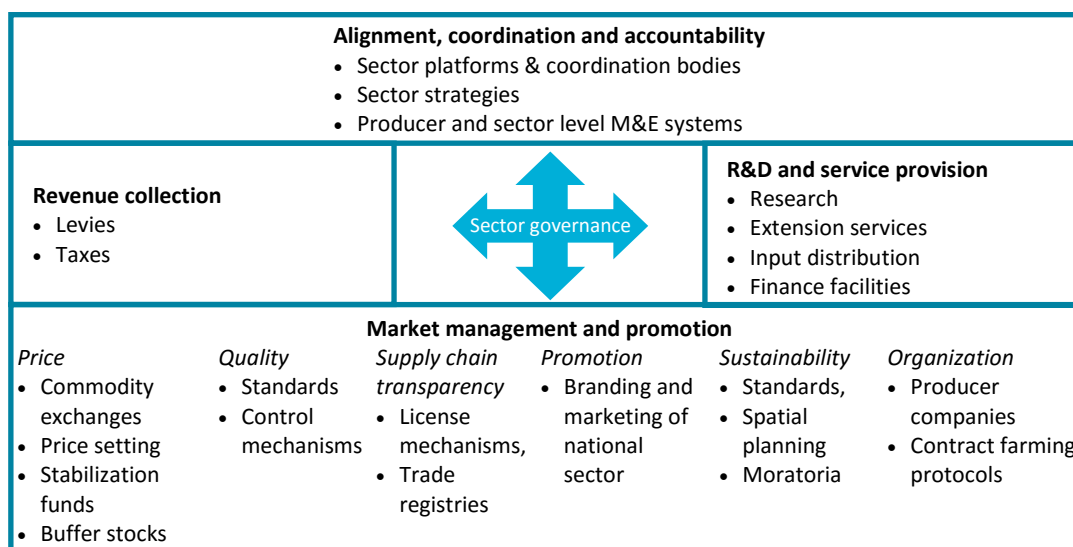
The central hypothesis following the case analysis is that four central functions of sector governance have the ability to drive sector and producer performance. These four functions are enabled in practice through a wide variety of instruments and mechanisms situated in diverse contexts. The four core functions of sector governance are to:

1. Alignment, coordination and accountability: ensure alignment and coordination between key stakeholders and organize accountability of investments and activities, monitor progress and promote learning, (e.g. sector platforms, coordination bodies, sector strategies and producer and sector level monitoring and evaluation (M&E) systems)
2. Revenue generation: generate revenues at sector level (e.g. levies and taxes) to be re-invested in the sector
3. R&D and service provision: sector investments in R&D and sector-wide service provision (e.g. research, extension services, (subsidized) input distribution, finance facilities) to ensure short-term and long-term development.
4. Market management and promotion: which can include manage product quality, (e.g. quality standards and control mechanisms), create supply chain transparency (e.g. license systems and trade registries), promote the product in markets (e.g. branding and marketing of national sector,

geographical indication) set and stabilize prices and organize price discovery, (e.g. commodity exchanges, price setting policies, price stabilization funds, buffer stocks and fiscal instruments), and organize the production base around markets, service provision and sector alignment: regulation regarding farmer organization, (state-sanctioned) producer companies, contract farming protocols, industry associations

Our research demonstrates that a sector that has a capable forum for multi-stakeholder alignment and coordination, is better able to consistently gather revenues and re-invest back into services to farmers and longer term research and development, and to manage key aspects of the market such as quality and volatility. The sector is more likely to be competitive and resilient and therefore deliver greater benefits to producers. Of course there are many instruments and approaches which can be used to build specific capabilities which ultimately determine competitiveness and benefits to farmers (see Figure 4).

Figure 4: Types of sector governance instrument



Improved capabilities at sector level should result in improved sector performance. We identify 10 categories of indicators of sector performance, as follows:

- Competitiveness
- Resilience
- Profitability
- Innovation and adaptability
- Resistance to rent seeking and elite capture
- Transparency
- Sustainability
- Inclusiveness

These indicators can be sector specific as priorities differ between sectors. In many cases, one instrument might be a tool to support sector governance but by itself it is not enough to improve sector performance on the above indicators. It is often a combination of instruments, in combination with value chain and service delivery structures, that impact sector performance.

Improved sector performance should drive investments in, and performance of, producers. Increased sector performance should not only generate funds for investment in the sector, but also improve the climate for investment by supply chain actors, including producers themselves. Despite the attention given to commercial investment, the bulk of investment in agricultural production is still made by small-scale farmers themselves. These investments and other incentives should reward good performance,

remove worst practices, and contribute to improved producer performance. Indicators of producer performance include:

- *Profitability*: long run sustainability requires a net revenue that contributes to a living income and to pay living wages, allowing for reinvestments in production
- *Productivity and quality*: optimal productivity in terms of financial sustainability and land use efficiency, as well as the ability to deliver quality that corresponds to market demand
- *Social & environmental stewardship*: respect of social and environmental norms, employment generation, natural resource efficiency and climate friendly production practices
- *Entrepreneurship and resilience*: capacity to take and manage risks, and invest and respond to market opportunities

Two important factors to consider in promoting producer performance are the farming system and farm size. In many cases, producer performance will not depend on only one single product but also on other products they produce. This makes the link between the performance of a specific commodity and producer performance less direct. Therefore, it is important to evaluate producer performance from a farming system perspective, i.e. taking into account various forms of income generation activities and subsistence production farming households may undertake. This also calls for sector improvement strategies that have potential spill-over effects to other products farmers produce; for example, promoting improved rotation schemes and making finance and input available for other crops. Another important consideration is farm size. Smallholder farms can be so small, that even if profitability and productivity were to triple the farm would still not be a viable basis for livelihood development and re-investment. If applicable, this aspect should be considered when formulating a vision of desired farm performance. Sector improvement strategies may also promote more viable farm sizes (e.g. by facilitating land reforms, opening up the rental market, or promoting land lease constructions). This research does not address specific instruments on this topic.

2.2 Introduction to the case studies

Using the above concepts as an analytical framework, this research analysed 13 cases of sector governance. The cases concerned various agricultural commodity export sectors, including: cocoa, coffee, tea, cotton, palm oil, pineapple and sugarcane in selected origins, in which one or more instruments noted above have been used. We analysed instrument design and how they influenced sector and producer performance. The analysis was based upon publicly available information.

The cases have been selected based on their potential for wider lesson-learning about how to improve sector performance in sectors characterized by fragmentation of the production base, price volatility, quality issues and weak institutional environments. Due to time limitations, we did not include unsuccessful cases, of which there are many. Consequently, the findings in this research are biased towards the positive impacts that sector governance can have.

Table 1 presents the cases and instruments they include. The following chapter will discuss a selection of instruments and cases in more detail. More detailed information on each case can be found in Appendix I.

Table 1: Overview of the sector governance instruments analysed in the selected cases

| | Platforms & coordination bodies | Revenue collection | Price setting | Price stabilization mechanisms | Commodity exchange | Quality management | Trade registries | Contract farming protocol | R&D & service provision | Agro-ecological zoning |
|--|---------------------------------|--------------------|---------------|--------------------------------|--------------------|--------------------|------------------|---------------------------|-------------------------|------------------------|
| Cocoa in Ivory Coast (CCC) | | X | X | X | X | X | X | | X | |
| Cocoa in Ghana (COCOBOD) | | X | X | X | | X | | | X | |
| Cocoa in Indonesia (Cocoa Sustainability Platform) | X | | | | | | | | X | |
| Cotton in Burkina Faso | X | X | X | X | | X | | | X | |
| Cotton in Zambia | | | | | | | | X | | |
| Coffee Ethiopia (ECX) | | | | | X | X | | | | |
| Coffee in Colombia (FNC) | | X | | X | | X | | | X | |
| Coffee in Costa Rica (ICAFE) | X | X | X | X | | X | X | | X | |
| Coffee in Vietnam (VCCB) | X | | | | | | | | | |
| Tea in Kenya (KTDA) | | X | | | | X | | | X | |
| Sugarcane in Brazil (Agro-ecological zoning) | | | | | | | | | | X |
| Palm oil in Honduras (PASH) | X | | | | | | | | | |
| Pineapple in Costa Rica (National Platform) | X | | | | | | | | | |

3. Understanding specific sector governance instruments

This section presents analysis of a selection of sector governance instruments implemented in selected case study countries/sectors. Firstly, sector platforms and coordination bodies are discussed as they form the basis to develop a more coordinated approach to transform sectors. Secondly, price setting and stabilization mechanisms are looked at in more detail as price dynamics have such an essential influence on sector performance. Finally, a number of key insights are provided from the other instruments that have been included in the cases.

3.1 Sector platforms and coordination bodies

The cases include several examples of sector platforms and coordination bodies. The rationale behind these institutions is to focus the whole sector around a common vision and strategy and establish a clear division of responsibilities. They can also set rules or make investments that increase overall sector performance and create a level playing field for producers. Sector platforms are generally voluntary and focused on alignment, learning, or the coordination of development efforts. Sector coordination bodies are state-sanctioned with a formal mandate to coordinate sectors and possibly manage markets. The sector platforms and coordination bodies in this research were either managed by the government or had strong government buy-in. Note that there are many multi-stakeholder platforms that aim for some kind of governance mechanism in contexts where governments are unable to provide this structure. Government involvement in such platforms is generally weak.

The cases included in this analysis are:

Sector platforms:

- Coffee in Vietnam: the Vietnam Coffee Coordination Board (VCCB) is a public-private partnership established in 2013 whose mandate includes advising the Minister of Agriculture and Rural Development (MARD) on matters of strategy, policy, planning, and programming implementation.
- Cocoa in Indonesia: The Cocoa Sustainability Partnership (CSP) was established in 2006 as public-private sector communication, coordination and collaboration platform to develop the Indonesian cocoa sector with a focus on farmer empowerment.
- Pineapple in Costa Rica: The National Platform for Responsible Production and Trade of Pineapple in Costa Rica (Pineapple Platform) was established in 2010. It is a space for inter-institutional and inter-sectoral dialogue, which articulates and monitors the actions and tasks required in the short, medium and long term by the various stakeholders and others affected by pineapple activity, to improve the environmental and social performance of this crop.
- Palm oil in Honduras: Sustainable Palm Oil in Honduras (PASH) is a consortium of palm oil companies, cooperatives, government representatives and international NGOs established in 2013 with the objective to promote better management and RSPO certification and to strengthen relationships throughout the supply chain.

Coordination bodies:

- Coffee in Costa Rica: ICAFE is a public, non-governmental institution that was established in 1933 to promote national coffee growing activity. ICAFE is both the regulator and supervisor of the country's coffee sector.
- Cotton in Burkina Faso: The Inter-branch Cotton Association of Burkina Faso (AICB) was established in 2016 by the government. It is a non-profit organization regrouping the national industry association and national producers' association. The AICB is responsible for the coordination of the cotton sector which is defined in the intra-branch agreement (AIP).

The cases also included several other institutions that were not part of the in-depth analysis of sector platforms and coordination bodies, including the coordination platforms and sector platforms in the cocoa sectors of Ghana and Ivory Coast (in Ghana the COCOBOD and Ghana Cocoa Platform and in Ivory Coast the Café-Cocoa Council (CCC) and the Public-Private Partnership Platform (PPPP), the Kenyan Tea Board, Zambian Cotton Board and Zambia Cotton Ginners Association. However, the text below may also refer to these institutions.

The drivers for sector platforms include the need for more alignment and coordination, a crisis, and/or often a foreign donor willing to invest in such platform. A strong driver behind the Cocoa Sustainability Partnership in Indonesia was a World Bank-funded cocoa program which recognized the critical importance of sector alignment. The Vietnam Coffee Coordination Board was created to improve coordination among, and representation of, all coffee stakeholders in Vietnam. It has been established as an advisory body under the Ministry of Agriculture and Rural Development (MARD), but at the initiative of the Institute of Policy and Strategy for Agriculture and Rural Development (IPSARD) and with support of the Sustainable Trade Initiative (IDH).⁴ The drivers behind the Pineapple Platform in Costa Rica were a combination of growing negative reputation, due to environmental and labour and welfare issues that urgently needed to be addressed, and a donor (UNDP) willing to invest in setting-up a platform. The palm oil platform in Honduras evolved from a consortium of companies and NGOs willing to learn from each other's sustainability projects funded by Solidaridad's Farmer Support Program.

3.1.1 Governance and membership

Sector platforms tend to be more inclusive than coordination bodies, but equal representation remains a challenge in both models. Sector platforms have an open membership structure in which all types of stakeholder can generally participate. They can include producers, supply chain actors, civil society, trades unions, research, input companies, financial institutions and governments. Despite the open structure, obtaining equal representation of different stakeholder groups can be a challenge. For example, to the Vietnam Coffee Coordination Board it is a challenge to get smaller scale domestic enterprises on board. And even when on board, they may be less engaged or less vocal than other stakeholders, partly because of cultural differences with foreign companies being more vocal.⁵

The two sector coordination bodies in this study, ICAFE in Costa Rica and the Inter-branch Cotton Association of Burkina Faso (AICB), have more closed membership restricted to producers and domestic supply chain actors and possibly government representatives. The balance of power between stakeholder categories is usually determined by the number of seats on the Board. Within ICAFE, the producers have the majority of the Board seats.⁶ This has helped to ensure that ICAFE has a clear focus on improving the benefits delivered to farmers. In the case of cotton in Burkina Faso, producer and industry representatives have equal voting power in the AICB. Despite this, the perception is that the cotton companies have the power and dictate decisions on collective management issues.⁷ Voting power does not necessarily reflect real decision making power. The creation of the AICB facilitated the increase of representation and bargaining power of producers in the sector, but it takes considerable time and investments before they can be considered equal negotiating partners with their industry counterparts.

⁴ GSP (2016). *National Coffee Platform: Public/Private alignment for a sustainable coffee sector*.

⁵ GSP (2016). *National Coffee Platform: Public/Private alignment for a sustainable coffee sector*.

⁶ <http://www.cafedecostarica.com>

⁷ Kaminski, J. (2011). Cotton Dependence in Burkina Faso: Constraints and Opportunities for Balanced Growth, in *Yes Africa Can: Success Stories from a Dynamic Continent*, World Bank 2011. & Key Informant Interview September 2016.

The role of the government in platforms and coordination bodies can be one of participating, mandating and/or convening. The cases showed different governance models in which the government can play different roles:

- Sector platforms convened by the government (VCCB, Pineapple Platform) – the management can be outsourced an external partner
- Sector platforms managed as independent association or by an NGO, with government representatives as member of the advisory board or participant (CSP, PASH)
- Coordination bodies convened by the government (not in the scope of this particular analysis) but examples include the Café-Cocoa Council (CCC) in Ivory Coast, Ghana COCOBOD, Zambia Cotton Board and the Tea Board of Kenya)
- Coordination bodies, state sanctioned but placed at arm's length from the government (ICAFE, AICB)

Platforms and coordination bodies managed at arm's length from the government can probably better resist the challenges linked to changes in the political leadership of a country. It can make such institutions better placed to react quickly to change or make necessary adaptations in their own design and working, and less bureaucratic than in government-led institutions. However, cocoa case in Ivory Coast case shows that a government led institution can introduce reforms relatively fast. In any case, successful sector platforms or coordination bodies require significant political capital.

3.1.2 Functions of sector platforms and coordination bodies

The platforms and coordination bodies included in the cases had varying functions. Table 2 gives an overview of these functions.

Table 2: the functions of the included cases sector platforms and coordination bodies

| | Sector platforms | | | | Coordination bodies | |
|--|------------------|-----|--------------------|------|---------------------|-------|
| | VCCB | CSP | Pineapple Platform | PASH | AICB | ICAFE |
| <i>Sector alignment, coordination and accountability</i> | | | | | | |
| Awareness raising and knowledge exchange | X | X | X | X | X | X |
| Development of sector-wide vision and strategy | X | X | X | | X | X |
| Alignment of investments/ coordination of development projects | | | | | | |
| Advocacy / informing policy making | X | X | X | X | X | X |
| Monitoring performance and impact | | X | X | | | |
| <i>Revenue collection, R&D and service provision</i> | | | | | | |
| Revenue collection | | | | | X | X |
| Investments in research | | | | | | X |
| Tool development | X | X | X | X | | X |
| Investments in service provision | | X | | | X | X |
| <i>Market management and promotion</i> | | | | | | |
| Price setting | | | | | X | X |
| Price stabilization | | | | | X | X |
| License management / trade registries | | | | | | X |
| Quality management | | | | | | X |
| Market promotion | | | | | | X |

Functions of sector platforms

Sector platforms can promote voluntary action through alignment of vision and projects, strategy development, learning, and sector-relevant tool development. Multi-stakeholder platforms are well suited to promote sector dialogue and create shared awareness on priority topics and potential solutions to improve sector performance. For example, the pineapple platform in Costa Rica, the Vietnam Coffee Coordination Board (VCCB) and the Cocoa Sustainability Partnership (CSP) in Indonesia have developed a vision for the sector and corresponding strategies (see Box 1). The platforms are also well placed to develop tools that support positive impact on the ground in support of this vision. For example, the VCCB developed a National Sustainability Curriculum as a basis for public and private extension programs. The palm oil consortium in Honduras resulted in guidelines on environmental management practices for palm oil, and tools to develop inclusive supply chains. Platforms like the VCCB and CSP also invest in monitoring producer performance as an important tool to monitor progress on the sector strategy.

Box 1: Sector alignment requires engagement and commitment of key stakeholders. A shared sense of urgency and a participatory process of sector diagnostic and strategy development are instrumental in this.

The challenge of multi-stakeholder platforms is to move beyond general discussions. Any process of alignment can be hampered by conflicting views and mistrust between stakeholders. Various cases have experienced this. For example, during the initial years, the commitment to the dialogue and ownership of the Vietnam Coffee Coordination Board (VCCB) among stakeholders varied. Alignment between stakeholders was hampered by distrust and different perceptions of the sense of urgency and priorities. One of the main reasons was that the activities of the VCCB were quite general. Over time this has changed. The participatory development of a sector strategy, Vision 2020, was instrumental in bringing the discussion to a more strategic level, helping to develop a shared understanding of the sector dynamics, and aligning the stakeholders behind specific priorities. Such strategy development processes have also taken place in the Cocoa Sustainability Partnership (CSP) in Indonesia and the Pineapple Platform in Costa Rica. CSP was able to develop a clear vision and strategic priorities which now form a basis for program development of the CSP and its members. In the Pineapple Platform, the exercise resulted in an action plan which will be implemented in the coming years.

Some other insights from the cases are:

- When developing a vision, it is important to align it with that of the end customers (e.g. alignment between CSP and the international industry platform CocoaAction).
- Strong leadership and facilitation skills are critical to making progress.
- Short-term tangible outputs can promote engagement and trust between actors. In the palm oil consortium of Honduras (PASH) a key success factor was that the consortium members were engaged in field projects which resulted in concrete results (proof of concept) and enabled learning from each other. In CSP the establishment of local sub-platforms allowed for more hands-on information exchange and collaboration between members, improving the value of participation and alignment on the ground.

While sector platforms generally cannot introduce instruments that manage markets, they can inform governments on this matter. For example, the National Sustainability Curriculum developed by the VCCB is approved by the Ministry as the official extension document for all trainings of farmers within the World Bank's Vietnam Sustainable Agriculture Transformation (VnSAT) Project. Being considered as representative of the Vietnamese coffee sector, many departments within the Vietnamese government also welcome the VCCB's contributions and policy advice.⁸ The guidelines on environmental

⁸ GSP (2016). *National Coffee Platform: Public/Private alignment for a sustainable coffee sector*.

management practices developed by the palm oil consortium (PASH) have been endorsed by the Honduran government and have become a condition to obtain a legal permit for new plantations. The influence of the consortium on public policy is even larger. Partly inspired by the dialogue in which it participated in the consortium, the government has dropped its expansion ambition in oil palm cultivation and replaced it with one of sustainable intensification. It is also considering making RSPO certification compulsory for all plantations.⁹ The Pineapple Platform in Costa Rica also raised various issues for discussion that could affect legislation in the entire agricultural sector such as the obligation to hold a license for the application of agrochemicals, the establishment of a system of public and periodic monitoring of land use in production landscapes, or inter-institutional coordination for inspection of plantations.¹⁰ While the Indonesian government has always considered the Cocoa Sustainability Partnership as a platform to inform itself on potential policy making, collaboration has intensified with the launch of a joint program in 2016 called the Collaborative Program Cocoa Economic Cluster Partnership (CEPAT).¹¹

Sector platforms generally do not have the mandate or capabilities to raise revenues at a sector level, making them highly dependent on donor funding or members' own investments. Donor funds are critical in the early phase of the establishment of sector platforms, but self-financing is a key challenge for durability. Of the cases, only the CSP introduced membership fees making it less dependent on donor funding. The capitalisation of these platforms generally does not go beyond their own functioning, and some development of tools and demonstration (pilot) projects. Sector platforms seem to have less potential to raise the required sector-wide investments than the more institutional forms of revenue collection such as taxation and levies.

Functions of sector coordination bodies

Sector coordination bodies with a clear mandate can manage sectors. Sector coordination bodies such as ICAFE and AICB were established as part of agricultural policy reforms with the aim to improve the governance of the sector. Whether situated within government (e.g. CCC and COCOBOD), or at an arm's length from the government (e.g. ICAFE and AICB), the mandate of such bodies goes well beyond those of voluntary platforms. For example, the inter-branch association (AICB) was established by the government in Burkina Faso to coordinate the cotton sector. In particular, it sets the input transfer prices and seed-cotton purchasing price for farmers and manages a stabilization fund. ICAFE registers and enforces coffee contracts and enforces high quality standards throughout the sector in Costa Rica. It also defines the pricing structure between farmgate and exporters and manages a stabilization fund. When properly designed and implemented, these instruments have far-reaching consequences for the performance of the whole sector.

The management of markets allows revenue collection for sector-wide investments in research, extension, input distribution and social programs. Price setting mechanisms (see section 3.2 below) offer important opportunities to finance the functioning of such bodies as well as the investments they make in the sector. ICAFE's pricing policies enables the deduction of a certain fee at export which is reinvested in its own functioning but also in dedicated research, development and transfer of knowledge to the industry.¹² Similar dynamics are found in the cocoa sector in Ivory Coast and Ghana, where export levies generate a lot of resources that are reinvested in research, extension and social programs. These bodies can play a pivotal role in targeted research and extension programs (e.g.

⁹ Aidenvironment (2016). *Evaluation of Solidaridad's Farmer Support Program*.

¹⁰ National Platform of Responsible Production and Trade of Pineapple in Costa Rica (Undated). *Systematization of Experiences and Dissemination of the Dialogue Process Conducted under the Framework of the National Platform of Responsible Production and Trade of Pineapple in Costa Rica*. Systematization Document.

¹¹ <http://www.csp.or.id/news/yteHD-general-assembly-meeting-april-2016.html>

¹² http://www.cafedecostarica.com/about-us/AboutUs_Research.html

combatting plant diseases, renovation programs). Sector-wide access to services is a critical to the inclusive development of smallholder agriculture, rather than access being limited islands of technical support paid for by lead firms or donors. However, the cases also show that ensuring high quality services for all producers may require additional resources above those the revenue collection mechanisms can generate. In these cases, the coordination bodies can function as counterpart for other investors. For example, ICAFE manages a coffee plantation renovation program by supporting producers in replanting, but it requires a credit line from the government to make the investments.¹³ The AICB is responsible for an Input Fund for the Burkina cotton sector that is capitalized by the state and managed by Ecobank. The fund works by serving as a guarantee mechanism that enables cotton companies to receive input credit at lower costs and on more flexible, longer terms. This results in lowering the costs of the initial purchase of fertilizers by the companies, enabling them in principle to then sell inputs to the farmers at reduced prices with less distortion from subsidies.¹⁴

3.2 Price setting and price stabilization instruments

Price stability is particularly important in agriculture with its long crop cycles and fixed assets. Risk influences confidence of farmers and others to invest in productivity, quality and sustainability. Liberalisation has increased the exposure of developing country farmers and supply chain intermediaries to price volatility.¹⁵ Several of the cases introduced pricing instruments that promoted value capture by farmers or more stable prices within or between seasons. This section will discuss these instruments in more detail.

3.2.1 Increasing value capture by farmers through price setting mechanisms

The coffee sector in Costa Rica (ICAFE), cocoa in Ivory Coast (CCC), cocoa in Ghana (COCOBOD) and cotton in Burkina Faso have introduced policies that set farmgate prices to ensure farmers receive a certain proportion of the export value. Different variations of these instruments exist and some incorporate price setting for other supply chain actors. This section discusses these in more detail.

Prices can be set daily by allowing contracts not to be lower than a daily reference price. ICAFE's policy is that farmers receive at least 80% of the export price. In support of this, ICAFE implements a system where they set a reference price based upon the New York future prices. Contracts between farmers and coffee washing stations are not allowed to be lower than this reference price at the day of the coffee delivery. It has also defined the distribution of margins for washing stations and exporters, collects a levy from the export price to cover ICAFE's operational costs and investments in research activities and special programs, and finances a price stabilization fund. The distribution of the margins is presented by Table 3. The prices are set by the ICAFE Board and contracts between farmers and washing stations are closely monitored by the Liquidation Commission (Junta de Liquidación). This commission, with two members from the ICAFE board (one farmer representative and one representative from the washing stations) and one representative from the Economics and Trade Ministry, has the role of tracking all the coffee 'cherries' deposited by the

Table 3: Distribution of the margins in the Costa Rica coffee sector

| Item | % in export price |
|--------------------|-------------------|
| Farmer | 80% |
| Washing station | 14.9% |
| Exporter | 3.3% |
| ICAFE | 1.2% |
| Stabilization Fund | 0.5% |

¹³ http://www.cafedecostarica.com/about-us/AboutUs_Research.html

¹⁴ IMF (2014). *Burkina Faso*, IMF Country Report No. 14/230

¹⁵ Dana, J., Gilbert, G.L. (2008). *Managing Agricultural Price Risk in Developing Countries*, Università Degli Studi del Trento, Discussion Paper No. 19

registered farmers at the washing stations, the contracts signed and executed by the washing stations, and the working costs of the washing stations according to the standards of reporting and accounting.¹⁶

Prices can be set pre-season, using forward sales, historical prices and market projections. Price signals before the start of a season are important signals for farmers to take the risk of investing in production, and therefore in promoting productivity. The CCC introduced (in 2012) a pre-season fixed farm gate price that aims to ensure farmers receive at least 60% of the export price. This price is fixed twice per crop year: one for the main agricultural season and another one for the secondary agricultural season. In the Ivory Coast, all cocoa needs to be exported via an export auction system managed by CCC. Under this system, 70-80% of the upcoming season's crop is pre-sold on the auction, with the balance being sold in spot sales during the season. The pre-season farm gate price is based upon the average of forward contract prices and an estimation of the remaining 30% based on an average of London cocoa future prices (Liffe). After averaging these two figures to arrive at the national CIF price, it subtracts the guaranteed costs differential to arrive at the minimum farmgate price.¹⁸ See Table 4 for an overview of the costs included.

In Ghana, all cocoa is exported by the Cocoa Marketing Company (CMC), a subsidiary of COCOBOD. Upstream collection of cocoa from farmers for transport to COCOBOD warehouses is privatized to licensed buying companies (LBC) that have to abide by various rules set by COCOBOD. Cocoa farmgate prices are fixed annually by the Producer Price Review Committee (PPRC). The PPRC is chaired by the Minister for Finance and Economic Planning (MOFEP) and membership includes representatives of farmers, hauliers, local buying stations, the Ministry of Finance and Economic Planning and COCOBOD.¹⁹ Producer prices are set in advance of the harvest season based on forward sales (60-70% of estimated total sales) and price forecasts for the upcoming year.²⁰ From the projected gross FOB value, withholdings are made amongst other things for programs regarding disease and pest control, scholarships, child labour, and farmer pension schemes. Based on these costs, a net FOB value per tonne is calculated. The net FOB value is distributed across different actors in the supply chain, COCOBOD (including quality management), a stabilization fund and other programs (e.g. infrastructure development, rehabilitation scheme).

In the cotton sector of Burkina Faso prices are also fixed before the season. The sector is divided into three regional concessions areas, in which state-run or private cotton companies have a monopoly and are responsible for the procurement of inputs, technical assistance to producers, the purchase, collection and ginning of seed cotton, and commercialization of the cotton fibre and by-products.²¹ At the beginning of the season, the inter branch association (AICB), consisting of the cotton companies and producers, set cotton seed prices. The AICB announces a "floor price", which is 95 percent of the "pivot price", a reference based on the average international price of the fibre in the last three years. This is

Table 4: Distribution of the margins in the Ivory Coast cocoa sector¹⁷

| Item | % in export price |
|------------------------------|-------------------|
| Farmer-gate price | 60% |
| Sourcing & transport to port | 6% |
| Bean bags | 1% |
| Cleaning & drying | 1% |
| Storage & finance | 1% |
| Export expenses | 2% |
| Exporter margin | 1% |
| Freight & insurance | 4% |
| Taxes | 22% |

¹⁶ Dragusanu, R. & Nunn, N. (2014). *The Impacts of Fair Trade Certification: Evidence From Coffee Producers in Costa Rica*.

¹⁷ Data received from an cocoa expert in 2016.

¹⁸ Communication of the Coffee-Cocoa Board - see for a detailed description of the procedure: http://www.conseilcafecacao.ci/index.php?option=com_k2&view=item&id=77:coffee-cocoa-board

¹⁹ Tel Quartey, E. (2013). *The determination of producer price in Ghana's cocoa sector and the provision of service to cocoa farmer*, UNCTAD Multi-year expert meeting on commodities and development 2013.

²⁰ Aidenvironment, IIED, NewForesight (2015). *Case study report; Cocoa in Ghana*, commissioned by IFC.

²¹ Peltzer and Röttiger (2013). *Cotton Sector Organisation Models and their Impact on Farmer's Productivity and Income*, D.I.E. Discussion Paper 4/2013.

subject to various adjustments based on the recovery rate of the fibre, export value and farmers' debt to the cotton companies. Farmers are paid the adjusted floor price at the delivery of the cotton. At the end of the season, the "ex-post" price or rebate of cotton is calculated using the average sale price during the season. If the "ex-post" price is between 95 percent and 101 percent of the pivot price, producers receive a refund. If the "ex-post" price is lower than the floor price, ginners receive a compensating payment from the stabilization fund. If the "ex-post" price exceeds 101 percent of the "pivot" price, the exceeding portion goes partly to the "stabilization" fund, partly to the ginners, and partly to the producers.²²

Value capture by farmers can also be promoted by vertical integration, purchase guarantee systems, high quality standards and service provision. The case studies also revealed other mechanisms to improve value capture by farmers.

- Vertical integration: Farmer ownership of tea processing and marketing increases their returns related to these value adding activities.
- Purchase guarantee system: the FNC in Colombia implements a purchase guarantee system which allows farmers to sell as much of their output as they choose at an established minimum price based on international prices.
- Quality management systems: the COCOBOD, CCC, KTDA, ICAFE, and cotton Burkina Faso cases all have rigorous quality management systems resulting in a premium on the world market and a higher farmgate prices.
- Service provision: Investments in extension services, input distribution and finance can improve farm performance and profitability.

3.2.2 Price stabilization mechanisms

In addition to price setting, the cocoa sectors in Ivory Coast and Ghana, the cotton sector in Burkina and the coffee sector in Costa Rica also have stabilization funds that allow for some price stabilization. The cases also include examples of contract terms that provide farmers with some protection against price fluctuations. This section presents these examples.

Price stabilization funds can stabilize prices within and between seasons. Like price setting, this can reduce farmer's risks of investing in production and productivity. The price stabilization fund of the CCC allows the pre-season farmgate prices to be maintained, also when prices during the season decline. If prices of spot sales decline below the pre-season price, exporters are compensated by a stabilization fund. If spot prices are higher, exporters are obliged to transmit the difference to the fund. In Ghana, the COCOBOD can decide to install a levy on the export price to capitalize the stabilization fund or to use the stabilization fund to support farmgate prices. In Burkina Faso, the stabilization fund compensates ginners at the end of season when the ex-post price has been lower than the fixed pre-season price they have paid to the farmers. When the ex-post price exceeds 101 percent of the "pivot" price, the exceeding portion goes partly to the stabilization fund.²³ In Costa Rica, the stabilization fund is capitalized by a 0.5% levy of the export price. This fund compensates farmers when the final price is below the costs of production by more than 2.5%. This is based upon a minimum price set by law.²⁴

Prices can also be stabilized by alternative contract and payment modes. In Costa Rica, farmers are paid based on a weighted average of the prices prevailing in the coffee market throughout the year. Washing stations make advance payment to the farmer upon delivery (usually one to two thirds). These are followed by trimestral payments that are defined by ICAFE according to each stations' sales. At the

²² IMF (2014). *Burkina Faso*, IMF Country Report No. 14/230 & AICB (2014), *Presentation of the cotton sector in Burkina Faso*.

²³ IMF (2014). *Burkina Faso*, IMF Country Report No. 14/230 & AICB (2014), *Presentation of the cotton sector in Burkina Faso*.

²⁴ <http://www.icafe.cr/productores-de-cafe-continuan-pagando-deuda-de-fonecafe/>

end of the season, the station pays the farmer a definitive amount resulting from the total sales minus each mill's expenses and profits plus possible contributions of the Stabilization Fund. This amount and its calculation are defined exclusively by ICAFE.²⁵ In Colombia, FNC offers contract forms to farmers that can protect them from price volatility or enable them to speculate on higher prices:

- Price Protection Contract (CPP): whereby farmers can sell their coffee at a price offered on that date (and receive immediate payment), or they can deposit their coffee at the cooperative and see if market conditions improve; and
- Pay Now for Future Delivery Contract (CCCEF): through which farmers can sell up to 50% of their harvest in anticipation of up to 6 months at a price that is determined at the moment of subscribing the contract.²⁶ In this case, 90% of the total purchase is paid in advance.²⁷

3.2.3 Key insights

The price setting and stabilization mechanisms discussed in the previous sections provide some insights that can be relevant when considering how best to reduce price volatility and increase value capture by producer through market management.

Price setting and stabilization mechanisms help in price discovery and can result in more stable and higher prices. In contrast to the other cases, the price setting policies in Ivory Coast have only been introduced recently. Since its introduction in 2012/13, the CCC has steadily increased prices in response to high international prices. The increases in price have been gratefully received by farmers, who are more profitable than they have been for decades and, through the greater transparency that reforms have brought to the sector, are less vulnerable to unscrupulous practices by their buyers. The benefits these policies bring to farmers are also recognized by other stakeholders, including supply chain actors. But there is also criticism. The higher nominal prices conceal the fact that the farmgate price in US\$ actually decreased from 64% of the average international price in 2012/13, to below 50% in 2014/15. This is because of the weak Euro, to which the CFA Franc is pegged, coupled with strong international cocoa prices in US Dollar terms.²⁸ In addition, recent price declines caused some exporters to default on their future contracts, resulting in an oversupply of cocoa. In such conditions, it appears to be hard for the CCC to enforce the fixed prices.²⁹

In Burkina Faso, the system indeed helps to stabilize prices. Their system has many elements which are also implemented by other centrally led cotton sectors in West Africa. This is in contrast to most cotton sectors in Eastern and Southern Africa, where, with the exception of Mozambique, pricing depends more strongly on competition. A comparative study between West African and Eastern and Southern African sectors shows that farmers in West Africa receive higher prices when world market prices decline and lower prices when prices world market prices increase.³⁰

Price setting mechanisms can also contribute to revenue collection for reinvestment in the sector. The pricing structure in Costa Rica, Ivory Coast and Ghana raise taxes and levies which can be used for the functioning of coordination bodies and for investments in research, extension and other programs. Different approaches are possible. In Costa Rica, ICAFE applies a relatively small fee (1.2%) which is fully invested the coffee sector. In the Ivory Coast, the government has installed a 22% export tax which in

²⁵ Dragusanu, R. & Nunn, N. (2014). *The Impacts of Fair Trade Certification: Evidence From Coffee Producers in Costa Rica*

²⁶ FNC (2012). *Sustainability that matters*, 2011.

²⁷ http://colombiancoffeehub.com/origin/purchase-guarantee-for-coffee-growers_929/

²⁸ Ecobank (2015). *Middle Africa Briefing Note – Soft Commodities - Cocoa*, September 2015.

²⁹ Baudelaire, M. and Almeida, I Ivorian Cocoa Piles Up at Ports as Shippers Halt Purchases, Bloomberg, December 28, 2016.

³⁰ Peltzer, R. and Röttiger, D. (2013). *Cotton Sector Organisation Models and their Impact on Farmer's Productivity and Income*, German Development Institute, Discussion Paper 4/2013.

addition to re-investments in the sector also supports other budgetary needs in the country. In other words, sector governance is still a means to impose a net tax on the sector

Price setting mechanisms can also push for a transformation of supply chain relationships. In the Ivory Coast, producers and value chain actors appreciate its effect on producers in terms of transparency, value distribution and price stability. However, the middle segment of the supply chain (cooperatives, traders and exporters) also complain that margins have become too thin. The overall perception is that trade in conventional cocoa beans has become bad business. Some exporters started to divest from conventional cocoa trade. Instead, they have become supply chain managers for their customers' sustainability programmes. Rather than purely buying and selling cocoa beans, they now add value by training farmers and producer groups and organizing certification, traceability and monitoring. They are (partly) paid for this by their customers. This development also resulted in more stable trading relationships between farmers, cooperatives and exporters.³¹ In Ghana, the fixed prices promote licensed buying companies to compete for supply through service delivery to farmers (e.g. speed of payment, credit, inputs).³²

Price setting and stabilization schemes require prices to be set and contributions to be designed on a non-political basis. Price setting is highly sensitive as different stakeholders may have conflicting interests. This requires a good governance model and clear decision-making procedures based upon price-setting formulae. In Ghana, prices are set by an independent committee. In Costa Rica they are set by the ICAFE Board based upon the New York Stock Exchange, while the stabilization fund has a separate governance model. In Burkina Faso prices are set in the AICB, which regroups the industry and farmers. Concerns exist regarding the unequal decision-making power between producers and the cotton companies as well as the influence from the government. Given that cotton fibre exports are the second largest source of foreign currency earnings, the Burkinabè government may have an incentive to push prices upwards to avoid an exodus by farmers into more profitable cash crops. In a negative price environment, they may prefer to offset the cost of higher farmgate prices elsewhere in the chain, rather than risk a collapse in output.³³

The stability of price mechanisms may be jeopardized by long-lasting declining market prices and coordinated and/or monopolized marketing. Under long-term declining world market prices, stabilization funds will be unable to support prices unless they are re-capitalized. This may put the continuity of the system at risk. Some systems are also confronted with structural deficits. For example, the purchase guarantee system of the FNC puts too much strain on the National Coffee Fund, raising concerns about the sustainability of the whole model.³⁴ The cotton sector in Burkina Faso is also in structural deficit and still depends on support from the State and foreign donors.³⁵ This is partly linked to deteriorating market circumstances but also rent-seeking behaviour, misallocation of resources, inefficient investments and corruption.³⁶ In Ghana, the monopoly of COCOBOD in export exposes the system to additional commercial risks. For example, as a consequence of the disappointing harvest in the 2014/15 season, COCOBOD had oversold its crop by promising to deliver more to buyers than it had

³¹ Molenaar, J.W., Blackmore, E. Smith, S. van Bragt, W., Petit dit de la Roche, C.R.M., Heuvels, S. Vorley, B. and Fearn, A. (in publication). *Fairness in trade matters for sustainability. An impact evaluation of Fairtrade's supply chain interventions*. Aidenvironment and IIED.

³² Laven, A. and Boomsma, M. (2012) *Incentives for sustainable cocoa production in Ghana; Moving from maximizing outputs to optimizing performance*, Royal Tropical Institute.

³³ Ecobank (2015). *Burkina Faso: Changes loom for 2015/16 cotton season*, Middle Africa Briefing Note | Soft Commodities | Cotton, 12 June 2015

³⁴ Echavaria, J. J., Esguerra, P., McAllister, D., Robayo, C.F. (2015). *Executive Summary*, The Commission on Coffee Competitiveness in Colombia, March 2015.

³⁵ IMF (2014). Burkina Faso, IMF Country Report No. 14/230. & Ecobank (2015). Burkina Faso: Changes loom for 2015/16 cotton season, Middle Africa Briefing Note | Soft Commodities | Cotton, 12 June 2015

³⁶ Kaminsky, J. and Serra, R. (2011). *Endogenous Economic Reforms and Local Realities: Cotton Policy-Making in Burkina Faso*, Africa power and politics, Working Paper 17

been able to produce. This negatively affected their international reputation.³⁷ Whereas in Ivory Coast and Costa Rica export is left to a competing private sector, export in Ghana and Burkina Faso is the exclusive role of the government or state-sanctioned monopolies. These cases may suggest that the financial continuity of price support mechanisms is more likely to be guaranteed in a sector where market dynamics prevail, hence the private sector bears part of the market risks. The KTDA seems to be financially more healthy, but they are also less financially exposed, because there is not the same level of price setting and stabilization.

3.3 Insights on other sector governance instruments

The cases included a wide range of instruments that went beyond sector platforms, coordination bodies, price setting and stabilization mechanisms. This section will discuss some of them.

3.3.1 Commodity exchanges

Commodity exchanges can support price discovery and transmission and support price setting and stabilization instruments. The Ethiopian Commodity Exchange (ECX) is a trading floor which brings buyers and sellers together, virtually or physically to facilitate sales and purchases. Market data feeds are transmitted daily to radio, print media, TV, SMS and interactive voice recognition using mobile telephones to rural areas. It has more than 60 warehouses in the country.³⁸ ECX has aided price discovery and transmission, but had no significant impact on price stabilization.³⁹ Commodity exchanges are, however, important in providing a reference price which is a condition to set prices at farmgate and supply chain (such as in the ICAFE, CCC, COCOBOD models). Future markets also allow prices to be locked in for a season, which favours setting seasonal fixed prices (such as with CCC, COCOBOD and cotton Burkina Faso).

Something to consider is that commodity exchanges should accommodate differentiated trade and full traceability. The ECX system had not allowed for full segregation according to quality or origin. This has been problematic for coffee, where specialty coffees receive a price premium, and require traceability to guarantee their origins. To address the weaknesses around traceability, it has launched i(2015) a new i traceability system.⁴⁰ In addition, coffee cooperatives in Ethiopia do have the ability to circumvent ECX and export the coffee themselves, and thereby trace coffee back to a single farm.⁴¹

3.3.2 Supply chain transparency and traceability instruments

Supply chain transparency and traceability instruments can support price policies and quality management. ICAFE and CCC implement a comprehensive trade registry. ICAFE manages a registry of farmers containing information on their location and their coffee deliveries to washing stations as well as all working capital loans provided to farmers. Furthermore, all transactions between farmers, washing stations and exporters are registered and monitored by ICAFE.⁴² The CCC introduced a traceability system where each operator needs to administer its purchase and sales. It aims to manage

³⁷ <https://www.ghanabusinessnews.com/2015/06/22/the-sad-story-of-ghanas-cocoa-industry-and-the-way-forward/>

³⁸ Andersson, C., Bezabih, M., and Mannberg, A. (2016). *The Ethiopian Commodity Exchange and Spatial Price Dispersion*, Environment for Development, Discussion Paper Series, January 2016.

³⁹ Hernandez, Manuel A.; Rashid, Shahidur; Lemma, Solomon and Kuma, Tadesse. 2015. *Institutions and market integration: The case of coffee in the Ethiopian commodity exchange*. IFPRI Discussion Paper 1464. Washington, D.C.: International Food Policy Research Institute (IFPRI).

⁴⁰ <http://www.theworldfolio.com/company/ethiopia-commodity-exchange-ecx-/1373/>

⁴¹ <http://whitetalecoffee.com/blogs/news/55161539-growers-tale-ethiopian-coffee-exchange-ecx-aricha>

⁴² Dragusanu, R. & Nunn, N. (2014). *The Impacts of Fair Trade Certification: Evidence From Coffee Producers in Costa Rica*.

the physical flow of the internal marketing to ensure compliance with the admitted prices and quality.⁴³ The system is linked to the distribution and collection of bags in which the cocoa is transported between farmers and exporters.

The high degree of organization of the producer base in cases such as KTDA, COCOBOD and FNC also facilitate transparency and even traceability if requested. Such organization is lacking in the cotton sector in Zambia. Although the vast majority of farmers are contracted by a ginner, side-selling as well as side-buying is widespread. The introduction of an industry-wide Code of Conduct on contract farming, the establishment of a farmer database and common buying points should improve this. This will also allow for the monitoring and documentation of the volumes collected by individual farmers.

An alternative way of creating transparency is by enforcing no-go areas for production such as the agro-ecological zoning in the Brazilian sugarcane sector. When effectively implemented, buyers are assured that their products do not come from unsustainable areas, reducing the need to trace products back for mitigating that risk.

3.3.3 Quality management systems

Several of the cases included quality management systems that were implemented at sector level (CCC, COCOBOD, ICAFE, ECX, cotton Burkina Faso) or by the organisations that cover a large proportion of the production base (KTDA, FNC).

Most cases use a combination of quality standards and control mechanisms. In the 2000s, Ivory Coast was known for its poor quality cocoa, for which it received a price penalty on the market. In 2012, CCC introduced a rigorous quality control system where the quality of cocoa is controlled at factory gate. Lowest quality cocoa are not permitted to be sold. Due to the public quality management system, overall quality has increased drastically and the Ivory Coast now receives a premium on the world market. Although cases exist where the rules are circumvented, the regulation turns out to be much more effective than all the voluntary action that has been taken in the past by industry and NGOs.⁴⁴ In Colombia, coffee quality is monitored by Almacafé, a subsidiary of FNC. Almacafé implements quality controls of every lot of coffee that is exported from Colombia and checks are carried out to corroborate the quality from when the beans leave the farm through to the export point and fulfil the guarantee of origin regulations for roasted coffee that is distributed by brands around the world.⁴⁵ In Ghana, post-harvest quality control is organized by COCOBOD's subsidiary Quality Control Division (QCD) and starts with quality control measures which farmers must observe to facilitate the acceptance of their produce at the buying centres. Quality is also controlled before exporting.⁴⁶ In Ethiopia, the ECX is responsible for grading and certifying quality once the coffee is delivered to the buying stations.

Quality can be promoted by creating the right market incentives. In the above CCC example, lower quality is not permitted to be sold. The KTDA offers better prices for better quality and rejects green leaf that does not meet quality standards. The price received by Kenyan smallholder teas at the weekly Mombasa Auction remains consistently higher than the average of all teas sold at the auction by about 12%.⁴⁷

⁴³ Communication of the Coffee-Cocoa Board - see for a detailed description of the procedure:
http://www.conseilcafecacao.ci/index.php?option=com_k2&view=item&id=77:coffee-cocoa-board

⁴⁴ Aidenvironment, NewForesight and IIED (2015). *Case study report; Cocoa in Ivory Coast*, commissioned by IFC

⁴⁵ www.federaciondefeferos.org/caficultores/en/que_hacemos/comercializacion_del_cafe_colombiano/instrumentos/seguimiento_de_calidad/

⁴⁶ https://cocobod.gh/Objectives_Functions_Board.php

⁴⁷ KTDA (undated). *Company Profile, Products and Services*.

Investments in research and extension can also support quality. In addition to a system of standards and regulations, FNC invests in research by the National Coffee Research Centre (Cenicafé) to develop the varieties and techniques that support quality production. More than 1,600 extension agents offer technical assistance to farmers all over the country on production and processing practices to maximise quality. KTDA also promotes quality by offering farmers training on good agricultural practices and access to inputs.

Regulation of the choice of varieties can raise quality sector-wide. In the coffee sectors of Colombia and Costa Rica, the law prescribes the cultivation of only Arabica varieties. This has helped to build the reputation of both countries. But it also makes these countries less flexible to respond to changes in market demand. This can also pose problems. With consumers interested in a number of different flavour profiles and origins, the simple Arabica/Robusta distinction is no longer as important.⁴⁸

Active branding can also promote perceived quality on the world market. FNC invests in protected designations of origins and actively markets its designated trademark Juan Valdez. ICAFE actively promotes its national brand in export markets. To promote quality ICAFE also organizes a Cup of Excellence contest.

3.3.4 Organization of the production base

National producer organizations offer opportunities to ensure sector-wide access to services and markets, and producer's voice in sector alignment and governance processes. The FNC and KTDA are state-sanctioned producer owned organizations that include the majority of smallholders in the sector. The FNC is a membership based organization, while the KTDA is a limited company with farmers as shareholders. The scale of these organizations allows the provision of services and market access to hundreds of thousands of farmers. It also allows farmers to profit from value addition activities such as processing and marketing. In Burkina Faso, the government has organized all cotton farmers in a multi-tiered system of village association, regional cooperatives and one national federation. This enables farmer voice in sector governance processes, as well as to use of the structure in the distribution of inputs and the collection of cotton seed for all cotton farmers in the country. In all these three cases, there is a high level of organization, but in all three cases this has been facilitated by the establishment of pre-liberalized institutions.

Cooperative building and contract farming arrangements can bring some structure in unorganized sectors. The cases also include instruments to organize an unorganized production base. In Ivory Coast, the CCC is obliging farmers to become members of a cooperative. However, building strong cooperatives requires a lot of support and investments in terms of access to services and markets is still much lower than in the above mentioned models. In Zambia, the industry tries to improve the organization of producers around contract farming. To counteract side-selling and side-buying and the subsequent disincentive of ginners to invest in producers, a Code of Conduct was introduced in 2014 by the Ginners Association. All members of the Ginners Association have signed the Code of Conduct, including those with a previous reputation of side buying. Penalties for breach of the Code of Conduct will be (a) dismissal from the Ginners Association, and b) the risk of revoking licenses (the Cotton Board has the authority to revoke licenses, presumably at the recommendation of the Ginners Association). Verification is via district committees. Stakeholders are generally positive about the Code of Conduct, though there remain concerns around enforcement, particularly in regards to the removal of licenses to operate.

⁴⁸ Echavvaria, J. J., Esguerra, P., McAllister, D., Robayo, C.F. (2015). *Executive Summary*, The Commission on Coffee Competitiveness in Colombia, March 2015.

3.3.5 Social and environmental capital management

Sustainability can be promoted through a variety of instruments including service provision, community investments, standards and spatial planning. In addition to the enforcement of social and environmental laws and regulation, the cases include other instruments to promote sustainability:

- Sustainable production practices are incorporated in extension services (FNC, ICAFE, KTDA, CCC, COCOBOD)
- Implementation of sustainability programs (e.g. ICAFE is implementing partner of the Coffee Nationally Appropriate Mitigation Actions (NAMA))
- Public private investments in community development (CCC)
- Active promotion of voluntary sustainability standards (KTDA, FNC)
- Development of a national sustainability norm (CCC)
- Development of a national sustainability strategy (Cotton Burkina Faso)

The Brazilian sugarcane case focused on a spatial planning tool. The Agro-Ecological Zoning (AEZ) Sugarcane plan is a regulatory framework, consisting of a land use planning instrument related to the sustainable expansion of the sugarcane sector in Brazil. The AEZ is a technical-scientific instrument built from the knowledge of environmental capabilities and vulnerabilities of a particular region. It considers soil characteristics and climate risks related to the requirements of the crop (rainfall, temperature, occurrence of frosts and short summer droughts). Of all Brazil's land, 7,5% (64.7 million hectares) were deemed suitable land for sugarcane cultivation. This land was divided into classes of suitability, in which low productivity pasture and agriculture land as well as degraded lands are given priority.⁴⁹ The ZAE Cana is a Presidential Decree and not a full law. It can therefore only operate as a voluntary guideline for stakeholders who want to expand sugarcane production. It is however used as a reference in policies related to public and private funding, the installation of new ethanol plants and environmental license procedures. Some experts have the opinion that the AEZ should become an enforceable law to empower public authorities to punish illegal expansions out of ZAE Cana, instead of just the technical guideline it is now.⁵⁰ Others claim this is not necessary as the philosophy of ZAE Cana has already been consolidated and it became de-facto a norm.⁵¹

4. Cases that combine instruments to drive sector performance

The instruments presented in chapter 2 are tools to support sector governance, but by itself an individual instrument may be not enough to improve sector performance. In many cases it is the combination of instruments that facilitate this. This chapter presents some examples showing different combinations of sector alignment, revenue generation and reinvestment, and market management.

4.1 KTDA – A producer company enabling farmers to benefit from value addition and investments in quality and sustainability management

Smallholder producers in Kenya get a larger share of the value of tea when compared to producers in other African countries, improving their market power and livelihoods. The producer share of made tea prices was three times higher than other East- African countries in 2009 (at 75%), and smallholder

⁴⁹ Theme page: Agroecological Zoning. Website embrapa (<https://www.embrapa.br/en/tema-zoneamento-agroecologico/nota-tecnica>).

⁵⁰ Kaup, F. (2015). *The sugarcane complex in Brazil; The role of innovation in a dynamic sector on its path towards sustainability*. Cham, ZG: Springer.

⁵¹ Almeida, M. (2012). *Analysing the Brazilian Sugarcane Agroecological Zoning; Is This Government Policy Capable of Avoiding Adverse Effects from Land-Use Change?*.

profits at least 10 times higher. This has been attributed to farmer collective ownership of processing and the quality of plucking and of made tea as a result of training and access to inputs (offered by KTDA).⁵²

The KTDA was created in 2000 after the Kenya government sought to liberalise the tea sector through the prescribed structural adjustments programmes. As part of liberalisation, the government decreased its control over the parastatal Kenya Tea Development Authority and it was transformed to the Kenya Tea Development Agency, which is not answerable to the government.

Ownership and management of the KTDA is 100% local by the small-scale tea farmers. The individual farmers have a shareholding in their respective factory company, commensurate to the volume of their green leaf deliveries.⁵³ Farmers are not obliged to join the KTDA, but barriers to entry are low; a farmer has to sell to one of the KTDA factories, and become a shareholder through deductions made to the tea sales. Farmers are paid a dividend when the factories make a profit.

Part of the **added value created is retained for reinvestment**. KTDA charges a levy at the point of processing. These funds are used to provide farmers with **extension services, inputs and finance**. There is a particular emphasis on quality management, which positively contributes to the value of tea sold. Quality plucking is further promoted by a **quality sensitive pricing model** for made tea. Increasingly, sustainability has also become a key part of KTDA's model, though this has been driven by Unilever and a number of donors. The KTDA model offers an infrastructure that facilitates wide-scale certification (e.g. organisation of producers around factories for group certification, auditing etc. and the delivery of technical assistance). In 2013, Rainforest Alliance has certified 54 factories in sustainable agriculture practices while the Fairtrade Foundation has certified 13 factories for Fairtrade. Sustainable practices have enabled farmers to increase yields by 36% on average and receive premiums from buyers of certified tea.⁵⁴

A strength of the KTDA model is its scale. Its 66 factories regroup 550,000 smallholders, representing the vast majority of all smallholders in Kenya. Such a high degree of organization offers many opportunities in terms of service delivery, quality management and promoting sustainability. This is in sharp contrast to its neighbouring countries, where the production base is much more unorganized and farmers lack access to similar services, and do not benefit from any value addition activities.

Furthermore, KTDA appears to be self-sufficient as it does not place a strain on public finances and does not stockpile or overproduce. While the KTDA model obviously brings a lot of value to the farmers, there has also been concerns about ineffective or compromised representation in KTDA leadership, lack of transparency and possible corruption, as well as dissatisfaction with the KTDA service provision.

4.2 FNC – A sector funded system of purchase guarantee, research, extension and market promotion

The **National Federation** of Coffee Growers of Colombia (FNC) has a long history. It was founded by growers in 1927 to raise the sector's economic and social performance. FNC is farmer governed and leadership is chosen democratically. A central element of the FNC is its mechanism for revenue collection via the **National Coffee Fund (FoNC)**, financed by a legislated tax collected on all coffee

⁵² Knopp, D. & Foster, J. (undated). *The economics of sustainability*, Wood Family Trust and Gatsby.

⁵³ KTDA (undated). *Company Profile, Products and Services*.

⁵⁴ http://www.ifc.org/wps/wcm/connect/f097d4004ff4df23a8c0ff23ff966f85/FT-Award-Shortlist_KTDA.pdf?MOD=AJPERES

exports.⁵⁵ The fund is used to support a purchase guarantee mechanism, investments in research, extension, quality control, marketing and investments in social and infrastructure programs in coffee-growing communities. Most of the 560,000 coffee farmers are members of FNC, but are free to use other marketing channels.

The **purchase guarantee mechanism** gives farmers the safeguard to sell its coffee always against a minimum price (based on current international prices and exchange rates, and deductions for transport). It ensures a fairer distribution of power between buyers and sellers by providing a point of leverage in price negotiations (whether producers sell to the FNC or not). The price is communicated daily by FNC, and acts as a reference point for the entire market. The purchase guarantee mechanism ensures prices received by farmers do not drop below a certain minimum in relation to the international world market prices. Other potential value capture and price stabilization mechanisms FNC offers to its members are coffee delivery contracts that allow farmers to manage price risks.

FNC also promotes value capture by farmers by asking them to dry coffee at home, rather than selling wet cherries to wet mills.⁵⁶ Colombia's **legal restriction to only producing Arabica varieties** and ICAFE's **quality control mechanisms** ensure its coffee receives a premium on the world market. This is further promoted by the **marketing** of its signature brand Juan Valdez.

The National Coffee Fund also allows investment in **research and extension services**. The research performed by FNC's research centre, Cenicafé, has led to a reduction in the use of pesticides and agro-chemicals in the coffee cultivation process.⁵⁷ The FNC system of research, extension and financing enabled the sector to recover from disease pressures more quickly than other coffee producing countries.⁵⁸ On the other hand, there still seems to be a potential for improved extension services – both in terms of quality and coverage.⁵⁹ For example, there is significant scope to improve the productivity of Colombian coffee via relatively simple improvements in agronomic practices – Colombia's yields have remained nearly flat while other countries' yields have improved.

Whereas the FNC model brings a lot of benefits in terms of sector and producer performance, significant questions remain about FNC's suitability for the future. The purchase guarantee mechanism is a significant drain on resources available for direct reinvestment. Only 5% of the fund is spent on direct and targeted sector investments of extension services, research, market promotion and quality control, hence the fund's redevelopment. Current contributions to the fund would need to double to cover the fund's current deficit. There are also concerns that the system is oversized, inflexible and not transparent; it does not offer a sufficiently favourable environment for private initiative and innovation, for the development of differentiated coffees or to increase domestic consumption; it does not react fast enough to the changing dynamics of the international market.⁶⁰

⁵⁵ FNC (2012). *Sustainability that matters*, 2011.

⁵⁶ Technoserve (2014). Colombia. *A business case for sustainable coffee production*, For the Sustainable Coffee Program, powered by IDH.

⁵⁷ <http://www.scaa.org/chronicle/2011/10/17/the-fnc%C2%B4s-national-coffee-research-center-cenicafe-was-awarded-with-the-blue-planet-prize-2010-2011/>.

⁵⁸ FNC (2013), Colombia, Better Prepared against the Coffee Leaf Rust than its Neighbors in Central America, editorial, May 2013

⁵⁹ Echavvaria, J. J., Esguerra, P., McAllister, D., Robayo, C.F. (2015). *Executive Summary*, The Commission on Coffee Competitiveness in Colombia, March 2015.

⁶⁰ Technoserve (2014). Colombia. *A business case for sustainable coffee production*, For the Sustainable Coffee Program, powered by IDH.

4.3 ICAFE – Price politics, quality management, supply chain transparency and investments managed at arm’s length from government

The ICAFE was established in 1933 as regulator and supervisor of the coffee sector in Costa Rica. It is a state-sanctioned, non-governmental organization with significant producer representation. It implements a comprehensive set of instruments that promote sector and producer performance. An important component is its price policies. Farmers receive (at least) a **minimum farmgate price** based upon the New York exchange prices and are paid an annual weighted average of this price. This has resulted in more stable farmgate prices and guarantees farmers receive 80% of the export price. Margins are also set for washing stations and exporters. The price structure includes a fee for a **stabilization fund** which compensates farmers when prices drop below cost of production by more than 2.5%. The price policies also allow the collection of a levy (1.2%) which is used by ICAFE for its running costs as well as investments in research, quality management, and market promotion.⁶¹

ICAFE implements rigorous **national quality standards and control mechanisms**. It has also limited choice of varieties to 100% Arabica. This high quality, in combination with an active marketing by ICAFE of the Costa Rica brand, means its coffee receives one of the highest premiums on the world market.

The price and quality policies are supported by a **license system and trade registry** which includes all farmers, value chain actors and trade transactions. ICAFE closely monitors the transactions. The transparency of this system also facilitates credit provision by commercial banks and washing stations.⁶²

The collected levy enables investment in **research and input programs** targeting diseases and the renovation of plantations.⁶³ It also functions as a central coordination point for donor funded projects, such as the Coffee Nationally Appropriate Mitigation Actions (NAMA).⁶⁴ Its role in organizing technical assistance is limited. This is done by the government, supply chain actors and other donors.

4.4 CCC - Government led export auction, price mechanisms, quality control, service provision and supply chain transparency mechanisms

The reforms the CCC introduced since 2012 show that sector governance does not have to depend on old pre-liberalisation institutions. The reforms led to improved quality, more stable and higher (nominal) farmgate prices, more transparency and more value addition within the country. This was achieved by introducing a combination of instruments including an export auction, price politics, stabilization fund, quality management, trade registry and a differentiated tax regime.

Through the compulsory **export auction**, approximately 70% of the next season is sold before the seasons starts. This facilitates the setting of a **pre-season farmgate price** that ensures farmers receive at least 60% of the export price (CIF).⁶⁵ A **price stabilization fund** allows the absorption of risks related to the remaining 30% sold on the spot market. The price setting mechanism has led to higher nominal prices to farmers for several years. Value capture by farmers is further promoted by a rigorous CCC-led **quality control system** which has ensured Ivorian cocoa receives a price premium on the world market,

⁶¹ <http://www.cafedecostarica.com>, viewed September 2016.

⁶² Miguel Florensa, P. Monitoring the markets in the Rwanda coffee sector; Lessons from Costa Rica and Colombia, International Growth Center, Policy Brief 38214, November 2015.

⁶³ GAIN (2015), *Costa Rica; Coffee Annual; Coffee production, consumption, and trade*.

⁶⁴ GIZ (2015) *NAMA Café Costa Rica; A Tool for Low Carbon Development*.

⁶⁵ CCC (2012). *Réforme de la filière café-cacao de Côte d'Ivoire*.

instead of a penalty (which was the case before this system was implemented). The benefits of the price setting system emerged under favourable market circumstances. However, recent declining world market prices resulted in defaults of future contract by local exporters. The declining purchases by exporters increased instances of farmers being offered prices below the fixed price and farmers to accept these as they have concerns in finding buyers.⁶⁶

CCC puts a lot of emphasis in formalizing the sector. Exporters and processors are licensed against strict criteria and it pushes farmers to become members of a cooperative. CCC also introduced a **trade registry** in which each operator needs to administer its purchase and sales. It has also organized the distribution of cocoa bags centrally. These measures support the enforcement of price and quality policies.

The sector is an important source for tax revenues. It raises a 22% **export tax**. This is partly reinvested in the sector, including research, extension, market management and investments in social infrastructure. Thanks to tax breaks for cocoa grinders, Ivory Coast became the world's largest grinder.⁶⁷

While CCC has taken firm control over the sector it also invested in stakeholder alignment. CCC has set up a **Private-Public Partnership (PPP) platform** as consultation framework with the private sector on issues related to the sustainability of the cocoa sector and as a platform for public-private investments.

There are also challenges. Investments by CCC are insufficient to increase farmers' yields across the sector, rejuvenate aging plantations and improve sustainability performance. This requires complementary investments from the industry and donors. In recognition of this, CCC signed protocols for collaboration and co-investment with several actors including CocoaAction, IDH, GIZ, World Bank, UNDP, UTZ, and various companies.⁶⁸ There are also concerns regarding bureaucracy (e.g. of the trade registry), transparency (e.g. of awarding contracts in the export auction), the differing levels of access for local and international exporters to the auction system, the relevance of some of the CCC investments, the lack of farmer representation at sector level, and differences of vision between the government and industry.

⁶⁶ Baudelaire, M. and Almeida, I Ivorian Cocoa Piles Up at Ports as Shippers Halt Purchases, Bloomberg, December 28, 2016.

⁶⁷ Ecobank (2015), *Middle Africa*, Briefing Note – Soft Commodities - Cocoa, September 2015.

⁶⁸ CCC (2015). *Rapport d'activités de la PPPP : Période Mai 2014 – Mars 2015*.

5. Conclusions

Based upon the analysis of the cases in the previous sectors it is possible to draw some initial lessons on how sector governance is best achieved.

High sector performance is where market dynamics prevail, but within the (strict) boundaries set by the government or coordinating body. A combination of sector governance instruments can drive sector and producer performance. The instruments are idiosyncratic in design; some function in a liberalized market, others in state-sanctioned monopolies, some exist for decades, while others have been recently introduced. Cases such as CCC and ICAFE show that it is possible to set conditions according to which market actors can continue doing their business and market dynamics prevail (e.g. buying, selling, price discovery, competition, low barriers to market entry). The conditions create a level playing field, mitigate market failures and contribute to sector performance. Some of the cases also included coordinated marketing efforts by either the coordination body (e.g. COCOBOD and FNC) or through state-sanctioned monopolies (cotton Burkina Faso). It appears that more centralized marketing brings additional financial risks to the system. In other words, it is important that sector governance does not become too heavily market distorting and allows a sector to respond to (international) market dynamics.

A coordinated sector governance approach can achieve sector-wide impacts on value capture by farmers, price stabilization and raising overall product quality. The case studies provide some successful examples of pricing instruments that have promoted value capture by farmers and brought some stability in prices. The cases also show that a coordinated approach on product quality can result in higher prices. The Ivory Coast cocoa case, and a comparison between the West-African and Southern Africa cotton sectors show that a coordinated approach on quality is likely to be more successful than leaving everything to market forces.

Sector governance models seem to have been less effective in ensuring sector-wide service delivery. The case studies show that sector governance instruments can make important contributions to investments in research and service delivery. However, in most cases these investments are insufficient to reach out to all producers with high quality services. In particular, the transformation to higher yielding and more sustainable production systems, as well as the rejuvenation of tree crop plantations, require more investments. It seems that sector platforms and coordination bodies have an important role to play in creating the alignment and tools necessary for other actors to co-invest in service provision.

Whether managed by the government or at arm's length from the government, sector governance requires a certain level of political capital. Sector governance can, but does not have to be managed by the government. Some of the cases show that a strong government role facilitates the introduction of radical reforms (e.g. the CCC in Ivory Coast). Other models, such as ICAFE in Costa Rica and KTDA in Kenya suggest that part of their strength is based upon a management model at arm's length from the government. Nonetheless these models still need a clear mandate from the government as well as continuous respect of this mandate (i.e. no political interference). In a weak institutional environment, sector governance appears to be better placed at an arm's length from the government. This provides more opportunities for inclusive and transparent processes. But even then, some government mandate and buy-in will be necessary.

The case studies also help to draw some first guidelines for what sector governance could like in the 21st century. Today's globalized world with differentiated market channels and challenges of poverty, food security, climate change and depletion of natural resources requires a different approach to sector governance than that implemented in the pre-liberalized era of the previous century. The two decades

of supply chain initiatives also brought a lot of insights into what works and what does not. Although every sector will have its own specificities, some possible guidelines emerge. Sector governance:

- is based upon a shared vision and monitors progress to prove and improve the business case of investments at sector and producer level;
- does not come between farmers and their customers in the supply chain (does not intervene in marketing);
- is able to respond to changes in the market/consumer demand and allows for market differentiation;
- can survive market booms and busts without needing recapitalization;
- is not afraid to intervene in pricing structures to ensure value capture at producer level and revenue collection, as long it follows international market price developments and uses apolitical decision-making;
- ensures a robust quality control mechanism to build reputation on the world market;
- acknowledges that high quality service delivery for all (technical assistance, inputs and finance) requires multiple providers with some alignment between them;
- does not achieve farmer and supply chain benefits at cost to the environment or people;
- focuses investments on root causes of unsustainability at farm, landscape and sector levels.

The next step in this research will be to obtain a better understanding of specific sector governance instruments. This research was a first attempt to obtain a better understanding of what sector governance could look like. It provided many insights but also raised many questions. More detail is needed on how particular instruments work, when they work and with what sequence of interventions, how they are governed and how they interact with other instruments. There also questions on the replicability of instruments in different contexts. Several of the instruments included in the case studies exist because they have been inherited from pre-liberalized institutes. This may give the impression that they are difficult to replicate. Sector-wide organizations like FNC and KTDA may indeed be difficult to replicate in already established sectors. However, the cases may inspire us to think differently and more ambitiously about organizing smallholder dominated sectors around service provision, markets and voice in sector governance. Institutes such as ICAFE and COCOBOD have existed for many decades and their position can be credited partly to pre-liberalization institutions. However, the example of CCC shows that structural reforms can also be introduced in the post-liberalized era, and take effect relatively quickly. This raises questions on how instruments have been introduced, what steps and decision-making processes have been followed and what capabilities were needed. In the next phase, the research will continue to obtain answers on these questions and report on this.

Another next step is to develop a framework to measure sector performance. If sector performance is key, it is important to define it, to benchmark sectors, and thereby monitor the impact of improved sector governance. In order to facilitate this, the research team will develop a sector governance diagnostic methodology with indicators to measure sector performance. It can be used by sector governance initiatives to benchmark sector performance and help identify areas of strategies This methodology will be tested in collaboration with partners that implement sector transformation and governance programs. The final methodology will be made publicly available.

Finally, the research team will be entering into learning partnerships with a limited number of emerging sector platforms, both to inform and learn from the application of sector governance instruments in specific circumstances, often in an environment of relatively weak institutions and low levels of farmer organisation.

Appendix I - Case studies

I. Cocoa in Ivory Coast: Sweeping reforms have transformed the sector

Background

In 2011, the government of Ivory Coast launched a reform program to tackle the main problems of flagging production, mediocre quality and growing numbers of farmers quitting the crop. Particular attention was given to the underlying cause of the structural problems in the segment: low prices for farmers. The reforms have been implemented by government led Conseil du Café-Cacao (CCC).

Key actor

The Commission for the Regulation, Stabilization and Development of the Coffee-Cocoa Sector, abbreviated to the Coffee-Cocoa Council (CCC), lays down the rules for the marketing of coffee and cocoa in Ivory Coast. The technical supervision of the CCC is assured by the Ministry of Agriculture and the financial supervision by the Ministry of the Economy and Finance. The CCC is governed by a Board of Directors composed by representatives of the government and representatives of the cocoa and coffee industry and finance and insurance sector.⁶⁹

Sector governance instruments

| | |
|---|---|
| Alignment, coordination and accountability & association | Revenue collection |
| <ul style="list-style-type: none">• Coordination body• Sector platform | <ul style="list-style-type: none">• Export tax |
| R&D & service provision | Market management & promotion |
| <ul style="list-style-type: none">• Research• Extension services | <ul style="list-style-type: none">• Export auction• Price mechanism• Stabilization Fund• Quality management• Trade registry |

Key figures⁷⁰

- 800,000 smallholders
- Average farm size 3,5 ha
- Cocoa represents roughly 10% of the GDP and 40% of national exports.
- Ivory Coast represents approx. 40% of global production

Sector performance

Value capture by farmers - The CCC sets a pre-season farm gate price that aims to ensure farmers receive at least 60% of the export price (CIF).⁷¹ It also fixes margins for all intermediaries between farmgate and export. Prices are based upon average futures contract prices for 70% of the crop sold before the season starts and estimated value of the remaining 30%. All export goes through a CCC led auction system. The system has protected farmers against unscrupulous practices from buyers and resulted in more stable and higher nominal farmgate prices in the years following its introduction (but lower compared to the cocoa price in US\$ terms). The benefits of the price setting system worked well under favourable market circumstances. However, recent declining world market prices increased the cases of (particularly domestic) exporters defaulting on their export contracts as they did not hedge against low prices. Meanwhile some large exporters cannot absorb more beans due to restrictions imposed by the CCC on the amount each company is allowed to purchase. This contributed to increasing instances of farmers being offered lower prices than the fixed price, and farmers accepting these as they have issues in finding clients.⁷² There are also questions whether the CCC could not have foreseen the declining market conditions and whether price setting was not partly driven by political motivations.

⁶⁹ <http://www.conseilcafecacao.ci>

⁷⁰ Aidenvironment, NewForesight and IIED (2015), Case study report; Cocoa in Ivory Coast, commissioned by IFC

⁷¹ CCC (2012), Réforme de la filière café-cacao de Côte d'Ivoire.

⁷² Baudelaire, M. and Almeida, I Ivorian Cocoa Piles Up at Ports as Shippers Halt Purchases, Bloomberg, December 28, 2016.

Price stability - Prices between farmgate and export are stable throughout the season (there are two seasons per year). As 70% of the crop is already been sold before the season starts, there is only a price risk for the remaining 30% sold on spot sales. Any variation between the 30% spot sales and the reference price are transmitted to or compensated by a Stabilization Fund. CCC has a buffer fund to cope with any sustained losses.

Competitiveness - CCC implements a rigorous quality control system where quality of cocoa is controlled at factory gate. The lowest quality is not permitted to be sold. Since its introduction, Ivory Coast receives a price premium on the world market. A major future risk are aging plantations.

Revenue generation and reinvestment - The government raises 22% taxes of the export price. These funds are partly reinvested in the sector, including research, extension, market management and investments in social infrastructure. The investments are however not enough to reach all farmers. Decision-making on the investments is with CCC and some stakeholders doubt exist on the effectiveness of some investments.

Price distribution

- taxes (22%)
- freight and insurance (4%)
- export expenses (2%)
- storage and finance (1%)
- general expenses (1%)
- bean bags (1%)
- cleaning and dying (1%)
- exporter margin (1%)
- sourcing and transport to port (6%)
- farmer (60%)

Transparency - The government introduced a traceability system where each operator needs to administer its purchases and sales. Its supports enforcement of price and quality policies. Some value chain actors complain about the bureaucracy of the system.

Innovation, value addition, adaptability - Thanks to tax breaks for grinded cocoa, Ivory Coast became the world's largest grinder.⁷³

Alignment and coordination - The CCC has set-up a Private-Public Partnership (PPP) platform as consultation framework with the private sector on issues related to the sustainability of the cocoa sector and as platform for public-private investments. The CCC functions as main counterpart for many industry and donor initiatives. It signed protocols for collaboration and co-investment with several actors including CocoaAction, IDH, GIZ, World Bank, UNDP, UTZ and various companies.⁷⁴

Inclusiveness - CCC promotes / obliges smallholders to become member of a cooperative. The quality of the cooperatives is generally weak and largely depends on the support they receive from buyers and NGOs. Farmer representation in national platforms and policy making is weak. Another challenge is to provide equal access opportunities of national export companies and exporting cooperatives to the system who struggle to meet the financial requirements.⁷⁵ One way the CCC tries to support local exporters is by awarding them 200,000 MT of international cocoa contracts. However, foreign traders and off-takers fear that these companies do not have the logistical capacity to meet their contracts.⁷⁶

Key takeaways

- The CCC reforms are government led and most have been introduced without consensus from the industry. Alignment with the industry and other stakeholders became more important over time.
- The CCC reforms have drastically improved overall quality and price safeguards to farmers in a relative short time. Higher prices have boosted farmers' incomes and driven improved farm management,

⁷³ Ecobank (2015), Middle Africa Briefing Note – Soft Commodities - Cocoa, September 2015.

⁷⁴ CCC (2015), Rapport d'activités de la PPPP : Période Mai 2014 – Mars 2015.

⁷⁵ Aidenvironment, NewForesight and IIED (2015), Case study report; Cocoa in Ivory Coast, commissioned by IFC.

⁷⁶ Ecobank (2015), Middle Africa Briefing Note – Soft Commodities - Cocoa, September 2015.

while tighter quality controls have incentivized farmers to ferment and dry beans properly. The increase in cocoa prices resulted in an expansion of production area, but did not result in further intensification (e.g. by fertilizer use or rejuvenation). However, the price system is challenged under rapid declining market circumstances.

- Fixed prices can improve trust levels between farmers, cooperatives, traders and exporters and free up energy to work on quality management and capacity building. However, as the fixed price policy reduced the margins of the middle segment significantly, supply chain investment have become highly dependent on global chocolate industry and donors.⁷⁷ Government investments are insufficient to reach out to all farmers with quality extension and social investments.

⁷⁷ Molenaar, J.W., Blackmore, E. Smith, S., van Bragt, W., Petit dit de la Roche, C.R.M., Heuvels, S., Vorley, B. and Fearn, A. (in publication). *Fairness in trade matters for sustainability. An impact evaluation of Fairtrade's supply chain interventions*. Aidenvironment and IIED.

II. Cocoa in Ghana: Government controlled marketing and re-investments

Background

In recognition of the contribution of cocoa to the development of Ghana, the government in 1947 established the Ghana Cocoa Board (COCOBOD) as the main government agency responsible for the development of the industry. The COCOBOD has resisted liberalization, although its goals have changed through the years, reflecting both necessity and donor pressures. Over time it experienced many reforms amongst others a liberalization of the internal market for cocoa beans, and instruments to raise producer prices and reduce export tax.⁷⁸

Key actor

COCOBOD is a parastatal organization in which there is no representation of different stakeholders in its leadership. It has several divisions and sub-divisions responsible for extension, research, seed production, quality control and marketing. The Cocoa Marketing Company Limited (CMC) is a wholly-owned subsidiary of COCOBOD and has the sole responsibility for the sale and export of Ghana cocoa beans. Upstream collection of cocoa from farmers for transport to COCOBOD warehouses is privatized to Licensed Buying Companies (LBC), licensed by COCOBOD. Farmers can choose to which LBC they sell, and can negotiate for services. COCOBOD is the major shareholder in Ghana's largest licensed buying company (LBC), the Produce Buying Company. It also owns the largest Licensed Buying Company A Producer Price Review Committee (PPRC) is responsible for setting farmgate prices. The PPRC is chaired by the Minister for Finance and Economic Planning (MOFEP) and membership includes representatives of farmers, hauliers, local buying stations Ministry of Finance and Economic Planning and COCOBOD.⁷⁹

Sector governance instruments

| | |
|--|--|
| Alignment, coordination and accountability & association | Revenue collection |
| <ul style="list-style-type: none"> • Coordination body • Sector platform | <ul style="list-style-type: none"> • Export levy |
| R&D & service provision | Market management & promotion |
| <ul style="list-style-type: none"> • Research • Extension services | <ul style="list-style-type: none"> • Monopolized marketing • Price setting • Stabilization Fund • Quality management |

Key figures

- 800,000 smallholders farmers, with average plot size of 1.6-1.8 ha
- Most important export crop, which accounted for 8.2 % of the country's GDP and 30 % of total export earnings in 2010.⁸⁰
- Ghana represents approx. 20% of global production

Sector performance

Value capture by farmers – Cocoa farmgate prices are fixed annually by the PPRC in advance of the harvest season based on forward sales (60-70% of estimated total sales) and price forecasts for the upcoming year.⁸¹ In recent years, the government also has reduced export duties in years of lower market prices in order to be able to support producer prices.⁸²

Price stabilization – The COCOBOD can decide to install a levy on the export price to capitalize the stabilization fund or to use the stabilization fund to support farmgate prices.

⁷⁸ Tel Quartey, E. (2013), The determination of producer price in Ghana's cocoa sector and the provision of service to cocoa farmer, UNCTAD Multi-year expert meeting on commodities and development 2013

⁷⁹ Tel Quartey, E. (2013), The determination of producer price in Ghana's cocoa sector and the provision of service to cocoa farmer, UNCTAD Multi-year expert meeting on commodities and development 2013

⁸⁰ <https://www.ghanabusinessnews.com/2015/06/22/the-sad-story-of-ghanas-cocoa-industry-and-the-way-forward/>

⁸¹ Aidenvironment, IIED, NewForesight (2015), Case study report; Cocoa in Ghana

⁸² <http://www.mofep.gov.gh/?q=content/review-producer-price-cocoa-20142015-cocoa-season>

Competitiveness – Ghana is known for a reliable supply of good quality cocoa, for which it is rewarded with a premium price on the world market.⁸³ COCOBOD has several instruments to improve and ensure the quality of the cocoa. At farm level, quality is promoted in its technical assistance and the pests and disease control programs (e.g. massive spraying). Relevant post-harvesting activities are undertaken by the Quality Control Division (QCD). The Post-harvest activities of COCOBOD start with quality control measures of QCD which farmers must observe to facilitate the acceptance of their produce at the buying centres by the LBCs engaged in internal marketing of cocoa at the time.⁸⁴

Revenue generation and reinvestment – The price setting scheme install levies for various services, including extension, research, subsidized fertilizers, mass spraying, scholarships, seeds/ hybrid seedlings distribution, rehabilitation and replanting programs, mistletoe removal, investment in road infrastructure, child labour program, farmers’ housing program, and pension fund scheme.⁸⁵ Despite COCOBOD’s efforts, the access to services (including extension and inputs) is perceived to be inadequate in terms of coverage and quality and productivity levels remain low.⁸⁶

Resistance to rent-seeking and elite capture - Several studies mention that COCOBOD has for many years been corruption-free and free of political interference. This is partly related to high organizational standards, strong leadership, merit-based appointments and reliable salaries, but also the governments’ commitment to quality and its .⁸⁷ However, in recent years there has been a surge of accusations on bad management and corruption by the COCOBOD leadership.⁸⁸

Inclusiveness - Approximately 25% of the farmers are organized in cooperatives. Because farmgate prices are fixed, LBC’s cannot compete on prices. Instead they tend to compete for supply through service delivery (e.g. speed of payment, credit, inputs). Farmers have limited voice in COCOBOD. There is no representation of different stakeholders in its leadership. The relation between COCOBOD and farmers can be best described as paternalistic. Because farmers do not supply cocoa beans directly to COCOBOD, the latter relies solely on reciprocity, that is, by designing a number of beneficial policies in the hope that farmers will respond by supplying quality cocoa beans.⁸⁹

Sector alignment - The Ghana Cocoa Platform is an avenue created by the COCOBOD with support of UNDP. The platform, through plenary sessions provides opportunities for a wider inclusion of sector stakeholders to discuss a mirage of issues that will have a positive impact on the Ghanaian cocoa sector.

Key takeaways

- The centrally managed quality control makes Ghana cocoa receive a quality premium on the world market.
- The price setting policy provides farmers with stable prices throughout the season and to collect revenues which are re-invested in production and social related programs. Despite these investments, productivity is low.
- For a centralized institution as COCOBOD it is crucial to keep accountability standards high.

⁸³ Aidenvironment, IIED, NewForesight (2015), Case study report; Cocoa in Ghana

⁸⁴ https://cocobod.gh/Objectives_Functions_Board.php

⁸⁵ Tel Quartey, E. (2013), The determination of producer price in Ghana’s cocoa sector and the provision of service to cocoa farmer, UNCTAD Multi-year expert meeting on commodities and development 2013

⁸⁶ Quarmin et al. (2012), & <https://www.ghanabusinessnews.com/2015/06/22/the-sad-story-of-ghanas-cocoa-industry-and-the-way-forward/>

⁸⁷ McCloughlin, C. (2016). The politics of what works in service delivery, in Hickey, S. Sen, K., Bukenya, B. (eds), The Politics of Inclusive Development: Interrogating the Evidence, Oxford University

⁸⁸ www.graphic.com.gh/news/general-news/icu-cocobod-workers-clash-over-dr-opuni.html & <http://dailyguideafrica.com/cocobods-opuni-sacked/>

⁸⁹ Quarmin, W., Haagsma, R., Sakyi-Dawson, O., Asante, F., van Huis, A., Obeng-Ofori, D. (2012) Incentives for cocoa bean production in Ghana: Does quality matter?, in NJAS – Wageningen Journal of Life Science 60-63 (2012) 7-14.

III. Cocoa in Indonesia: Building a sector-wide strategy, and promoting coordination at local level

Background

The Cocoa Sustainability Partnership (CSP) was established in 2006 with the goal of establishing a public private coordination forum for cocoa development with a focus on farmer empowerment in Indonesia. A strong driver was a World Bank's funded cocoa program which recognized the critical importance of sector alignment in the country. The initial members of the partnership included the Ministry of Agriculture, representatives of cocoa companies and producers, IFC and Mars Incorporated. Since its establishment, many other NGOs, companies and other organizations came on board.⁹⁰

Key actor

The CSP is a public-private sector forum for communication, coordination and collaboration between public and private stakeholders. Forum members consist of representatives from the companies (traders, processors, grinders), government, farmer organizations, NGOs, research institutions, media, experts, financial institutions, and input suppliers. While initially managed by SwissContact, it is nowadays managed as an independent entity. It has many features as many other public-private platforms: regular meetings and workshops where information is exchanged. Task forces identify best practices and develop strategies around priority topics. CSP is very active in communication through its own magazine, website, social media.⁹¹ CSP has set up different Regional Cocoa Fora at provincial or district level as a means of communication for the stakeholders involved in the development of the cocoa sector at the regional level.

Sector governance instruments

Alignment, coordination and accountability & association

- Sector platform
- Sector strategy
- M&E system

Revenue collection

R&D & service provision

- Tool development

Market management & promotion

Key figures

- Cocoa is Indonesia's fourth crop in area planted after oil palm, coconut and rubber.
- The vast majority (>95%) of cocoa in Indonesia are cultivated by more than 1,5 million smallholder farmers with an average of 1 ha.⁹²
- Indonesia represents approx.. 10% of global cocoa production.

Sector performance

Sector alignment and accountability – In 2013 CSP developed a 2020 Roadmap, based upon a wide-ranging consultation of nearly all CSP members and the most prominent stakeholders in the sector. The exercise of formulating the roadmap in a participatory way has helped to articulate a clear vision (doubling productivity and maintain an average age of farmers in below 40 years) and identify key strategies (on agro-inputs, planting material, knowledge, modes of delivery and organizations, finance and role of the government).⁹³ The roadmap aligns with the priorities of CocoaAction, an international industry initiative, which increases its relevance for international buyers. The roadmap has become a key reference for programming for the CSP and its members. In 2016, CSP has formed five Task Forces aimed to encourage active participation from members by working together to find solutions on common key issues related to the roadmap. One Task Force develops KPIs to measure the achievement

⁹⁰ <http://www.csp.or.id/about.html>

⁹¹ <http://www.csp.or.id/about.html>

⁹² Directorate General of Estate Crops (2014). Tree crop estate statistics 2013-2015, Cocoa

⁹³ NewForesight (2013) The 2020 Roadmap to Sustainable Indonesian Cocoa, Commissioned by the Cocoa Sustainability Partnership.

of the target and acts as a data and information center for this data. CSP also developed a national curriculum on good agricultural practices and certification guidelines with the objective to promote more consistent messages to farmers throughout the country.

The provincial or district fora enable stakeholders to coordinate on-the-ground activities on a regular basis. It facilitates coordination of extension work between public, private or non-profit agents. This avoids farmers receive twice the same training and allows to identify complementary activities by different stakeholders for the same farmers (e.g. public extension support on grafting focusses on those villages where a an exporter or NGO already provides training on good agricultural practices).⁹⁴

The Ministry of Agriculture has been an active member of the CSP since its inception and has a seat in the Advisory Board. The CSP provides a platform to provide input to public policy (both national and local). Early 2016, collaboration between the government and CSP has become formal with the launch of a joined program called Collaborative Program Cocoa Economic Cluster Partnership (CEPAT), which a strong emphasis to promote multi-stakeholder collaboration at local level, input distribution and learning on best practices.⁹⁵

Competitiveness – For some years, Indonesia’s production is decreasing by a declining productivity (aging trees, increased diseases and climate change) and farmers divesting in cocoa production. CSP primary goal is to increase the sector’s competitiveness by improving productivity and farmer’s profitability.

Revenue collection and reinvestment - The CSP is operating in a context where there are already many investments from the private sector, Indonesian government and international donors. These investments would (partly) also be made without the CSP. The CSP plays however an important role in aligning these investments. It has introduced a membership fee which reduced the need for donor funds to finance its own functioning. The establishment of a credible governance model and a progressive transfer of responsibilities from SwissContact to the platform as well as reduction of core-funding has facilitated member’s buy-in.

Sustainability – the national training curriculum on good agricultural practices and certification developed by CSP puts strong emphasis on sustainable production practices.

Key takeaways

- Creating a sector-wide vision and strategy with buy-in of key stakeholders (including international buyers) is an important instrument to align investments by these stakeholders.
- The establishment of local sub-platforms allow for more hands-on information exchange and collaboration between members, improving alignment on-the-ground and the value of participation.
- CSP has managed to reduce donor dependency by installing a membership fee. For investments in service provision it still relies heavily on donor funding.
- The influence of the platform over the market is limited, making it a less suitable institution to improve for example the quality of cocoa sector-wide.

⁹⁴ Aidenvironment (2016), Evaluation of UTZ in the Indonesian cocoa sector.

⁹⁵ <http://www.csp.or.id/news/yteHD-general-assembly-meeting-april-2016.html>

IV. Coffee in Costa Rica: Comprehensive sector governance at arm's length from the government driving a highly competitive sector

Background

The ICAFE was established in 1933 as regulator and supervisor of the coffee sector. It implements a comprehensive set of instruments that promote sector and producer performance. In 1977, ICAFE created its research center, CICAPE, a 12-hectare experimental station. In response to the crisis following the collapse of the International Coffee Agreement in 1989, the an ICAFE managed Coffee Stabilization Fund (FONECAFE) was created in 1992.

Key actor

ICAFE is a state-sanctioned non-governmental organization. It represents and supervises the whole sector. The ICAFE board is composed of seven members: four are representatives of the producers, one of the washing stations, one of the exporters, one of the roasters and one representative of the national regulatory powers.⁹⁶ It has also established a Liquidation Commission (Junta de Liquidación) which sets prices and monitors contracts between farmers and washing stations. This commission has two members from the ICAFE board (one farmer representative and one from the washing stations) and one representative from the Economics and Trade Ministry.

Sector governance instruments

| | |
|---|--|
| Alignment, coordination and accountability & association | Revenue collection |
| <ul style="list-style-type: none">• Coordination body | <ul style="list-style-type: none">• Export levy |
| R&D & service provision | Market management & promotion |
| <ul style="list-style-type: none">• Research• Extension services | <ul style="list-style-type: none">• Price setting• Stabilization Fund• Quality management• Trade registry• Promotion of Costa Rica brand |

Key figures⁹⁷

- 78,000 growers of which 92% cultivates less than 5 ha. They produce 44% of national output. 6% are medium-sized (5ha-20ha) who produce 21%, and 2% is large-scale producing 35% of national output.
- 90% of the coffee is exported and represents 11% of the country's export earnings
- Costa Rica is the 13th-largest producer globally

Sector performance

Value capture by farmers – Farmers receive (at least) 80% of a daily reference price based upon the New York exchange prices. ICAFE controls all contracts between farmers and washing stations are not below this. Value capture by farmers is further promoted by high yields and high quality (it also has one of the highest yield in the world). ICAFE also defines the margins of washing stations and exporters. For example, washing stations receive 14.9% which includes a 9% gross margin and 5.9% for expenses.

Distribution of the margins in the Costa Rica coffee sector

| Destination | % in export price |
|--------------------|-------------------|
| Farmer | 80% |
| Washing station | 14.9% |
| Exporter | 3.3% |
| ICAFE | 1.2% |
| Stabilization Fund | 0.5% |

⁹⁶ <http://www.cafedecostarica.com>

⁹⁷ <http://www.globalexchange.org/fairtrade/coffee/cooperatives#4>

Price stabilization – Farmers are paid an annual weighted average of the reference price resulting in more stable farmgate prices. If prices drop below cost of production by more than 2.5% they can be compensated by a Stabilization Fund.

Competitiveness – ICAFE implements rigorous national quality standards and control mechanisms. It has also regulated choice of varieties to 100% Arabica. ICAFE is very active in promoting its coffee. On an international level, Café de Costa Rica is presented as a country brand and positioned on specific markets by participation in fairs, advertisement and publications. ICAFE also promotes the enjoyment of coffee among the Costa Rican population (Costa Rica is one of the producer countries with the highest coffee consumption per capita). The high quality in combination with an active marketing by ICAFE of the Costa Rica brand, makes its coffee to receive one of the highest premiums on the world market. Around quality management resulted that 80% of the coffee is sold as specialty coffee.⁹⁸

Revenue generation and reinvestment

- The price policies also allow to collect a levy (1.2%) which is used by ICAFE for its running costs as well as investments in research, quality management and market promotion.

An important investment is the in research and input programs targeting the combat against diseases and the renovation of plantation.⁹⁹ Its role in organizing technical assistance is limited. This is done by the government, supply chain actors and other donors. For example, INFOCOOP is a government led agency which is very important in supporting the vivid cooperative sector with technical assistance and targeted funding. They support producer organizations in a step-by-step approach to evolve from an association to a more strictly regulated cooperative.¹⁰⁰ An additional levy of 0,5% is used by ICAFE to capitalize the Stabilization Fund.¹⁰¹ The Fund is in debt to the government, but continues to reimburse its debt.¹⁰²

Resistance to rent seeking and elite capture – ICAFE's management at arm's length from the government and its effective governance structure has increased trust levels between the stakeholders. Despite

Trade procedure

ICAFE's installed a trade procedure which follows the following process and is called the System of Final Liquidation¹:

- The coffee farmer sells the coffee to the washing station (can be the cooperative or company)
 - farmers receive a receipt which is by law valued as contract;
 - Station makes an advance payment upon delivery (usually one to two third);
 - Station report bi-weekly on all purchases and advance payments to ICAFE
- Station writes contracts with exporters
 - Contracts specify date, quantity, price and delivery date
 - All contracts are registered by ICAFE
 - ICAFE can refuse contracts if prices are below reference price (based upon NY commodity exchange)
- Stations make trimestral payments to the Producer. These payments are defined by ICAFE according to each Mill's sales.
- At the end of the season, the station pay the Producers a final Liquidation, a definitive amount resulting from the total sales minus each mill's expenses and profits plus possible contribution of the Stabilization Fund. This amount and its calculation are defined exclusively by ICAFE.
- The final liquidation prices for each mill must be published in Costa Rica's main newspapers in November, and the mill is obliged to pay the producer the balance of the payment within 8 days.

⁹⁸ ResponsAbility (2013), Research Insight Fair Trade Coffee from Costa Rica: A Smallholder Success Story

⁹⁹ GAIN (2015), Costa Rica; Coffee Annual; Coffee production, consumption, and trade

¹⁰⁰ ResponsAbility (2013), Research Insight Fair Trade Coffee from Costa Rica: A Smallholder Success Story

¹⁰¹ <http://www.cafedecostarica.com>, viewed September 2016

¹⁰² <http://www.icafe.cr/productores-de-cafe-continuan-pagando-deuda-de-fonecafe/>

these strongholds, it is also being criticized of being slow in responding to changing sector needs (e.g. needs related crop diversification and the emergence of farmer owned / operated micro-mills).

Transparency – The price and quality policies are supported by a license system and trade registry which includes all farmers, washing stations and exporters. ICAFE closely monitors the transactions (see box). The transparency of this system facilitates the implementation of the pricing policy as well as credit provision by commercial banks and washing stations.¹⁰³ Both commercial banks and washing stations provide credit to farmers guaranteed by harvest sales. When the loan is provided by a commercial bank, the farmer needs to report the debt to the washing station so that the washing station can directly pay the financing institution at the moment of the harvest payments. The mill obtains the funds for the producer advance payments from loans made by state banks, at a fixed exchange rate. In this way, the mill is exposed only to the fluctuation in the international price of coffee, while the bank has the exchange rate risk.¹⁰⁴ A critical success factor of this system is the high administrative capabilities that are needed to manage its sophisticated information structure.¹⁰⁵

Sustainability – Costa Rica is known for its strong environmental and social policies. The coffee sector has to comply with environmental laws, for instance concerning water pollution through the mills, and the usage of chemicals is effectively regulated. Despite the favorable policy environment there are still issues around the protection of worker's rights of migrant labour.¹⁰⁶ ICAFE functions as central coordination point for external projects, such as the Coffee Nationally Appropriate Mitigation Actions (NAMA) as a channel for climate finance.¹⁰⁷ Climate adaptation is a key challenge for the sector.

Inclusiveness - ICAFE vision and strategy has a strong emphasis on inclusiveness. The majority of the board are representatives of producers.

Key takeaways

- The combination of price setting, stabilization, supply chain transparency and rigorous quality management result in high yields, high quality and premium prices on the world market. Its mix of instruments provide a very interesting case for sector governance in liberalized economies.
- ICAFE's management at arm's length from the government makes it less vulnerable to the effects of political regime changes. In combination with the absence of donor dependency, because of its revenue collection model, makes it a very sustainable model.
- Some of the identified critical success factors of this model are (a result of) an enormous political capital and a strong commitment by the board in promoting and protecting the interests of farmers. Trust levels between stakeholders are high and a result of lengthy historical relationship between participants and the governance boards of the ICAFE, which have a democratic and representative structure.¹⁰⁸

¹⁰³ Miguel Florensa, P. Monitoring the markets in the Rwanda coffee sector; Lessons from Costa Rica and Colombia, International Growth Center, Policy Brief 38214, November 2015

¹⁰⁴ Dragusanu, R. & Nunn, N. (2014), The Impacts of Fair Trade Certification: Evidence From Coffee Producers in Costa Rica

¹⁰⁵ Miguel Florensa, P. Monitoring the markets in the Rwanda coffee sector; Lessons from Costa Rica and Colombia, International Growth Center, Policy Brief 38214, November 2015

¹⁰⁶ ResponsAbility (2013), Research Insight Fair Trade Coffee from Costa Rica: A Smallholder Success Story

¹⁰⁷ GIZ (2015) NAMA Café Costa Rica; A Tool for Low Carbon Development

¹⁰⁸ Miguel Florensa, P. Monitoring the markets in the Rwanda coffee sector; Lessons from Costa Rica and Colombia, International Growth Center, Policy Brief 38214, November 2015

V. Coffee in Colombia: Smallholder-led federation that has been vital for farmers' livelihoods, but at significant financial cost

Background

The FNC was established in 1927 to raise the sector's economic and social performance and to represent smallholders – who had been poorly represented to date.¹⁰⁹ It was created as a trade association, private entity and non-profit organization.¹¹⁰

This case is of interest to sector governance because of its combination of instruments that allow for quality control, market management, revenue generation and reinvestment. Its smallholder-centered creation and management is also of interest because of its high level of inclusivity, and its positive impacts on farmer livelihoods.

Key actor

FNC is farmer governed and 'profoundly democratic'.¹¹¹ Farmers are elected by other farmers to make decisions about management of FNC.

Sector governance instruments

| | |
|--|--|
| Alignment, coordination and accountability & association | Revenue collection |
| <ul style="list-style-type: none"> Accountable to its members through its democratic structure | <ul style="list-style-type: none"> National Coffee Fund (FoNC) |
| R&D & service provision | Market management & promotion |
| <ul style="list-style-type: none"> Research Extension services Financial services National replanting scheme | <ul style="list-style-type: none"> Guaranteed purchase Price Protection Contract Pay Now for Future Delivery Contract Promotional campaigns to promote Colombian coffee and has developed the Juan Valdez brand. |

Key figures

- Coffee production reached 14.6 million 60 kilo bags between June 2015 and May 2016.¹¹²
- Colombia has 560,000 coffee farms, of which approximately 100,000 farmers are inactive.
- 95% of farms have less than 5 hectares of coffee (more than 50% have less than 1 ha).¹¹³
- FNC has 563,000 members.¹¹⁴
- Coffee makes up 17% of Colombia's agricultural output¹¹⁵ and remains the largest employer and source of livelihoods in rural areas.¹¹⁶
- Industry was valued at US\$2.7 billion in 2014, including exports.¹¹⁷

Sector performance

Value capture by farmers – FNC's purchase guarantee is a critical component of its model. Growers have the option to sell as much of their output as they choose at an established minimum price ('fair and transparent, based on international prices'), and may do so at any time at one of the 540 purchase

¹⁰⁹ Federación Nacional de Cafeteros de Colombia (2000). El café en el desarrollo de Antioquía: visión histórica y acción gremial. Federación Nacional de Cafeteros de Colombia. ISBN 958-33-1279-7.

¹¹⁰ Ibid.

¹¹¹ https://www.federaciondecafeteros.org/particulares/en/quienes_somos

¹¹² http://www.federaciondecafeteros.org/particulares/en/sala_de_prensa/detalle/year-to-date_colombian_coffee_production_increases_8/

¹¹³ Technoserve (2014). Colombia. A business case for sustainable coffee production, For the Sustainable Coffee Program, powered by IDH.

¹¹⁴ http://www.federaciondecafeteros.org/particulares/en/quienes_somos/fnc_en_cifras/

¹¹⁵ <http://www.meas-extension.org/meas-offers/program-evaluation/national-coffee-growers-federation-fnc-colombia>

¹¹⁶ Technoserve (2014). Colombia. A business case for sustainable coffee production, For the Sustainable Coffee Program, powered by IDH.

¹¹⁷ http://www.cafedecolombia.com/cci-fnc-en/index.php/comments/colombian_coffee_production_and_exports_continue_growing/

points located around the country (via the network of 36 coffee cooperatives).¹¹⁸ The price is communicated daily by the Federation, and acts as a reference point for the entire market. It is public and is based on criteria of transparency and the current conditions of the international coffee market (New York Stock Exchange, contract C), the quality premium granted to Colombian coffee and the exchange rate (minus transport costs).¹¹⁹

The purchase guarantee ensures a fairer distribution of power between buyers and sellers by providing a point of leverage in price negotiations (whether producers sell to the FNC or not) and of value. The FNC argues that their purchase guarantee means farmers can receive the highest price and transfer the largest percentage of the international price to producers. Supply chain efficiencies have also helped ensure farmers receive about 80% of the export price, which compares well to other producers in Latin America. In addition, Farmers undertake processing at home leading to more value add.¹²⁰

Price stability – The FNC offers farmers two contract forms that can protect them from price volatility (or speculate on higher prices):

- Price Protection Contract (CPP): whereby farmers can sell their coffee at a price offered on that date (and receive immediate payment), or they can deposit their coffee at the cooperative and see if market conditions improve, and
- Pay Now for Future Delivery Contract (CCCEF): through which farmers can sell up to 50% of their harvest in anticipation of up to 6 months at a price that is determined at the moment of subscribing the contract.¹²¹ In this case, 90% of the total purchase is paid in advance.¹²²

Competitiveness – While Colombia is the world's second largest Arabica producer, accounting for 15 percent of global Arabica exports, its market share compared to its competitors has eroded over time. This has in part been attributed to its reluctance and inability to respond to changing market demands e.g. the growth in demand for Robusta and different coffees that are not necessarily considered to be 'high quality'. In the early 1990s Colombian coffee exports represented close to 18% of the international market, but fell to less than 10% in 2013.¹²³ The Colombia coffee sector faces a number of challenges which the FNC has been slow to respond to, including eroding farmers' margins, a failure to increase productivity when compared to competitors', and increasing opportunity costs.¹²⁴

Revenue generation and reinvestment – A central element of the FNC is its mechanism for revenue generation via the National Coffee Fund (FoNC), financed by a legislated tax (managed by the FNC itself) imposed on all coffee exports. The fund is used to guarantee purchase at a minimum price and invest in social and infrastructure programs in coffee-growing communities, as well as to deliver extension and credit. In 2011, the Colombian coffee growers contributed the equivalent of 6 USD cents per pound of green coffee exported to the FoNC. The Fund also receives income for the sale of coffee resulting after value add and from the royalties from the use of brands associated with the Juan Valdez® signature trademark.¹²⁵

The fund is significantly in debt. In addition it is delivering a number of public goods that should arguably be the responsibility of government (healthcare, infrastructure etc). The government has had to

¹¹⁸ <http://knowledge.wharton.upenn.edu/article/coffee-in-colombia-waking-up-to-an-opportunity/>

¹¹⁹

http://www.federaciondefeteros.org/particulares/en/que_hacemos/comercializacion_del_cafe_colombiano/instrumentos/garantia_de_compra/

¹²⁰ Technoserve (2014). Colombia. A business case for sustainable coffee production, For the Sustainable Coffee Program, powered by IDH.

¹²¹ http://www.federaciondefeteros.org/static/files/Informe_de_Sostenibilidad_2011_Ingles.pdf

¹²² http://colombiancoffeehub.com/origin/purchase-guarantee-for-coffee-growers_929/

¹²³ <http://coffeelands.crs.org/wp-content/uploads/2015/03/Colombian-Coffee-Commission-Executive-Summary-March-2015.pdf>

¹²⁴ Technoserve (2014). Colombia. A business case for sustainable coffee production, For the Sustainable Coffee Program, powered by IDH.

¹²⁵ http://www.federaciondefeteros.org/static/files/Informe_de_Sostenibilidad_2011_Ingles.pdf

subsidise coffee farmers in recent years despite the existence of the FoNC. 88% of the fund is spent on the purchase guarantee, significantly reducing direct investments in building farm and sector productivity, extension, inputs, advertising/promotion etc., which are limited to 5% of the total fund. A new version of the fund is being created to protect farmers and allow them 'to produce profitably at lower international prices' (planned for 2017). It will not create a minimum price. The aim is for it to be self-financing over time, though it will require some external funding in the beginning.¹²⁶ No additional information is publicly available at this time.

Evidence suggests there is, despite FNC's investments, potential for improved extension services – both in terms of quality and coverage. Colombia's yields have remained nearly flat while other countries, such as Brazil, have increased yields steadily.¹²⁷ Evidence suggests that almost half of the country's coffee producers do not receive any assistance from the FNC Programs.¹²⁸

FNC has implemented national replanting of coffee trees (via cash or in kind incentives to farmers) to maximise productivity and address leaf rust. In 2014, more than 50% of total coffee areas had been renovated (the target is to renovate 98% of total coffee areas by 2020), and production is expected to rise again to pre-renovation levels.

Inclusiveness – Inclusiveness is a core aspect of FNC. The FNC is led by a CEO who is chosen by the National Congress of Coffee Growers. FNC is made up of 15 Departmental Coffee Grower Committees and 366 Municipal Coffee Grower Committees, whose members are chosen by coffee growers themselves. Federation management, led by the CEO, is in charge of designing the programmes requested by coffee growers. Producers can be federated (which means they obtain an ID card, and can then vote or be elected). Those who are not federated can still obtain other benefits from FNC.¹²⁹ There are very high levels of voting turnout of farmers – in 2014, 67.3% of farmers voted (in person) in the elections for FNC.¹³⁰ But criticisms that 'democracy is limited, at least in the composition of the Directive Committee and the National Committee. Every four years the department delegations choose one of their members to represent them, but this delegate must be accepted by the FNC manager'.¹³¹

Sustainability – The impact on environmental sustainability by FNC is less clear, though FNC facilitates certification and its research (via a dedicated research centre¹³²) has reduced the use of pesticides and agrochemicals. It has had a generally positive impact on coffee-growing communities in comparison to other countries (in terms of income, public services, literacy and political sustainability). The democratic structure of the Federation and its smallholder-farmer centered ethos is likely to have been significant in limiting opportunities and instances of rent-seeking and corruption, of which there are no reports in relation to the FNC.

Key take-aways

- Colombia's political economy has undoubtedly been a key factor in determining the viability and success of FNC. It has made the creation of a producer-led organisation possible, achieved government buy-in, has promoted transparency in governance, and reduced opportunities for corruption. A strong 'internal' driving force has arguably been a key success factor for FNC to be

¹²⁶ <http://www.bloomberg.com/news/articles/2016-05-16/colombia-coffee-group-says-price-stabilization-fund-almost-ready>

¹²⁷ Technoserve (2014). *Colombia. A business case for sustainable coffee production*, For the Sustainable Coffee Program, powered by IDH.

¹²⁸ <http://www.meas-extension.org/meas-offers/program-evaluation/national-coffee-growers-federation-fnc-colombia>

¹²⁹ http://www.federaciondecafeteros.org/static/files/Informe_de_Sostenibilidad_2011_Ingles.pdf

¹³⁰ http://www.cafedecolombia.com/bb-fnc-en/index.php/comments/coffee_growers_elections_a_symbol_of_cafe_de_colombia_soundness_legitimacy/

¹³¹ <http://coffeelands.crs.org/wp-content/uploads/2015/03/Colombian-Coffee-Commission-Executive-Summary-March-2015.pdf>

¹³² <http://www.scaa.org/chronicle/2011/10/17/the-fnc%C2%B4s-national-coffee-research-center-cenicafe-was-awarded-with-the-blue-planet-prize-2010-2011/>

established and to maintain its relevance over time. The producer-centered approach has been central to the design and implementation of the model and endeavours to ensure it retains its relevance for farmers. The democratic structure allows for high levels of accountability to smallholder farmers and limits opportunities for rent-seeking.

- The purchase guarantee is a significant drain on resources available for direct reinvestment and is becoming a drain on public resources – hence the fund’s redevelopment and recapitalisation. Current contributions to the fund would need to double to cover the fund’s current deficit. A change in the design of the fund may allow for greater direct investments to be made in the sector (e.g. in greater quality and coverage of extension).
- Significant questions remain about FNC’s suitability for the future, with concerns that it is ‘oversized, inflexible and not transparent; it does not offer a favorable environment for private initiative and innovation, for the development of differentiated coffees or to increase domestic consumption; it does not react fast enough to the changing dynamics of the international market.’¹³³

¹³³ Technoserve (2014). Colombia. *A business case for sustainable coffee production*, For the Sustainable Coffee Program, powered by IDH.

VI. Coffee in Ethiopia: bringing together buyers and sellers to try and solve the sector's problems

Background

The driver for the establishment of the Ethiopian Commodity Exchange (ECX) was Eleni Gebre-Madhin, former economist at the World Bank. She had experienced firsthand the high transaction costs and market failures involved in trading in Ethiopia and the consequences of those costs for the country – including the infamous Ethiopian famine in 1983-85, which was attributed not to a shortage of grain in the country, but rather an inability to get grain to the places where it was most needed. Both farmers and traders were ultimately getting a bad deal. Farmers' share of the final price in most markets was no more than 30%. There was significant underinvestment in the sector and in processing, transport costs were high, market information lacking, inadequate enforcement of contracts and standards, poor storage facilities and weak bargaining power of producers.

The case study was selected as an example of the use of a specific market management instrument to attempt to solve many of the sector's issues (e.g. pricing, matching supply and demand, rewarding quality etc). Whilst this case focuses on coffee (as a predominantly export commodity), the Exchange has been more successful with the trading of grains and other staples.

Key actor

ECX is a private company owned by a partnership of the market actors, members of the exchange, and the Ethiopian government (public-private partnership), led by a CEO.

Sector governance instruments

Alignment, coordination and accountability & association

Revenue collection

R&D & service provision

- Warehouse receipt financing

Market management & promotion

- Commodity exchange

Key figures (coffee)

- All of Ethiopia's coffee is traded on the Exchange (legally required).
- In 2012, coffee accounted for about a quarter of Ethiopia's export value.¹³⁴ Exports valued at \$0.74 billion in 2013. Half of Ethiopia's coffee is consumed locally.
- Production continues to grow, but export earnings have declined from the peak of \$0.84 billion in 2012 to \$0.74 in 2013.¹³⁵ Production for MY15/16 is expected to hold relatively steady at 6.508 million bags (390,500 metric tons), but less than record production levels registered the preceding year.¹³⁶
- Over 4 million smallholder-farming households are estimated to grow coffee.¹³⁷ At least 95% of Ethiopia's coffee is grown by smallholders.

¹³⁴ <http://www.rff.org/files/document/file/EfD-DP-16-02.pdf>

¹³⁵ <http://ebrary.ifpri.org/cdm/ref/collection/p15738coll2/id/129604>

¹³⁶ http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Coffee%20Annual_Addis%20Ababa_Ethiopia_5-26-2015.pdf

¹³⁷ <http://www.rff.org/files/document/file/EfD-DP-16-02.pdf>

Sector performance

Value capture by farmers – Evidence of the positive impact of the Exchange on farmers' retention of share of end value is limited. Where it does exist it appears to be patchy e.g. some farmers reporting higher prices.¹³⁸

Price stability – Research did not find any significant change in the extent of volatility spillovers from international to domestic markets.¹³⁹ Other evidence suggests that the implementation of local warehouses as part of the Exchange has reduced price volatility: local markets connected to the ECX via local warehouses experience less price dispersion, however it is unclear whether this reduction in price volatility trickles down to local coffee producers.¹⁴⁰

Competitiveness – Ethiopia is renowned for its high quality (origin-based) coffee. The ECX is responsible for grading and certifying quality once the coffee is delivered in the buying stations, but it has faced difficulties in allowing sufficient segregation on the basis of quality.

Revenue generation and reinvestment – No revenue generation mechanism is built explicitly into the model (e.g. levy or a tax) or reinvestment in the sector in the form of service provision, apart from access to credit. ECX has worked to facilitate access to credit via warehouse receipt finance, with support from the World Bank's International Finance Corporation. When a well-functioning warehouse receipt system is in place, farmers have a choice in deciding whether to sell immediately after harvest (when prices are often lowest) or to store in a licensed warehouse and to apply for a short-term credit (thus enabling farmers to sell at a later date, when prices may be higher).¹⁴¹ Warehouse receipt financing can reduce financiers' risk and costs of delivery by linking traditional financial tools with the commodity exchange services.¹⁴²

Transparency – Market data feeds are transmitted daily to radio, print media, TV, SMS and interactive voice recognition using mobile telephones to rural areas: 'ECX provides accurate, reliable, and timely data on a continuous basis to all market players.' Opening price, highest price, lowest price, last traded or current price, and volume of trade have been transmitted continuously using electronic networking to public display boards in Addis and other major market centres for every commodity grade traded.

While the ECX system allowed for prompt payment and streamlines supply chain issues, it had not previously allowed for full traceability (a previous attempt to implement a system to allow traceability in coffee – the Direct Specialty Trade Program – failed). This has been problematic for coffee, where specialty coffees receive a price premium, and require traceability to guarantee their origins. However, coffee cooperatives in Ethiopia do have the ability to circumvent ECX and export the coffee themselves, and thereby trace coffee back to a single farm.¹⁴³

To address the weaknesses around traceability, ECX, launched in 2015 its IBM-enabled national traceability system, known as eATTS (in collaboration with USAID). This was piloted in coffee in 2015. The implementation of the system will encompass a wide array of new initiatives, including electronic tracking of bags, innovations in washing and processing, and streamlined storage and transportation processes.¹⁴⁴ Success remains to be seen.

¹³⁸ http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Guidebook_on_African_Commodity_and_Derivatives_Exchanges.pdf

¹³⁹ <http://ebrary.ifpri.org/cdm/ref/collection/p15738coll2/id/129604>

¹⁴⁰ <http://www.rff.org/files/document/file/EfD-DP-16-02.pdf>

¹⁴¹ <http://www.ifc.org/wps/wcm/connect/55301b804ebc5f379f86bf45b400a808/Innovative+Agricultural+SME+Finance+Models.pdf?MOD=AJPERES>

¹⁴² <http://www.nortonrosefulbright.com/files/how-commodity-exchanges-can-help-africas-fragmented-farmers-120828.pdf>

¹⁴³ <http://whitetailcoffee.com/blogs/news/55161539-growers-tale-ethiopian-coffee-exchange-ecx-aricha>

¹⁴⁴ <http://www.theworldfolio.com/company/ethiopia-commodity-exchange-ecx-/1373/>

Alignment and coordination – Gebre-Madhin sought and achieved government buy-in to her vision for the Exchange from the outset. Ethiopia had a series of consultations, starting from early 2005, to align the key stakeholders, including ensuring commitment from the highest level of political leadership. Results from the initial consultation were presented in a 2005 policy working paper, jointly published by the Ethiopian Development Research Institute and IFPRI.¹⁴⁵ It took two further years to develop the policy framework.¹⁴⁶ In 2007, the Ethiopian Parliament passed a landmark proclamation allowing the ECX to be established under the supervision of the Ministry of Agriculture and Rural Development.

The Exchange's institutional set up (as a private company) gives it separation from government, which may limit opportunities for rent seeking and elite capture.

Inclusiveness – The Exchange is a membership-based system. Members buy a membership seat – they trade either on their own behalf or on behalf of others. The Exchange has been able to include some smallholders directly in trade – but the cost of membership to trade is high and entry requirements (e.g. financial statements, literacy, membership exams etc.) are likely to be prohibitive for most smallholders. Only standard lot sizes of 5 tons can be deposited – many smallholders produce smaller quantities. Financial access for some players is therefore an issue. In addition, prospective members have to take a membership certification exam in order to obtain a seat. Some critics have argued that farmers have not and do not benefit from the new marketing system.¹⁴⁷ The majority of members on the exchange are not producers but are engaged in buying and selling commodities produced by farmers, and private investors.

Key take-aways

- The Ethiopian Government outlawed any other means to sell the commodities that are covered by the exchange directly on the export market (other than cooperatives who can sell directly for export) – this has undoubtedly been essential in determining its success in terms of volumes of commodities traded.
- Government has played a key role in establishing and endorsing the Exchange, but the day-to-day running and finances are insulated from government – no profits are paid at all from the Exchange and certainly none to government. This lessens opportunities for rent-seeking.
- Traceability, quality management and differentiation have been key challenges in making the Exchange viable for coffee trade: The Exchange has its own established standards to allow for some differentiation but these are quite general: e.g. limited moisture content, limited impurities, no insects. Differentiation has been limited for coffee, but evidence that there are processes being put in place to improve capacity for differentiation. There have also been several instances of reported warehouse mismanagement, including a divergence between stated and actual quality, and replacement of higher-grade goods with lower grades.¹⁴⁸
- Though commodity exchanges can solve many issues associated with price discovery, matching supply and demand and incentivising quality, doubts have been cast over their suitability for developing countries, since their success relies so heavily on a number of enabling conditions and institutions which are not in place, for example: a strong financial sector, and a commitment to transparency.¹⁴⁹

¹⁴⁵ <http://ebrary.ifpri.org/cdm/ref/collection/p15738coll2/id/129604>

¹⁴⁶ <http://ebrary.ifpri.org/cdm/ref/collection/p15738coll2/id/129604>

¹⁴⁷ http://www.competeafrica.org/Files/Commodity_Exchanges_Best_Practices.pdf

¹⁴⁸ <http://www.rff.org/files/document/file/EfD-DP-16-02.pdf>

¹⁴⁹ <https://www.bloomberg.com/news/articles/2015-04-02/africa-s-commodity-exchanges-fail-to-bring-hoped-for-benefits>

VII. Coffee in Vietnam: A sector platform with the ambition to become a coordination body

Background

The coffee sector in Vietnam comprises different stakeholders with limited coordination at the national level in relation to coffee policies and programs. To improve coordination in the sector, the Vietnam Coffee Coordination Board (VCCB) was set-up in 2013 by the Ministry of Agriculture and Rural Development (MARD) at the initiative of the Institute of Policy and Strategy for Agriculture and Rural Development (IPSARD) and with support of the Sustainable Trade Initiative (IDH). Whereas the Vietnam Coffee Coordination Board is nowadays essentially a platform, the ambition is to make it an effective coordinating body for the coffee sector.¹⁵⁰

Key actor

The VCCB is a public-private partnership whose mandate includes advising the MARD on matters of strategy, policy, planning, and programming implementation. The Coffee Board's members include representatives from MARD's Planning Department, International Cooperation Department, Department of Processing and Trade in Agriculture, Forestry, Fisheries and Salt, VICOFA (an industry association), officials from two main coffee growing provinces, domestic and foreign enterprises, and producers.

Sector governance instruments

Alignment, coordination and accountability & association

- Sector platform
- Sector strategy
- M&E system

R&D & service provision

- Tool development

Revenue collection

Market management & promotion

Key figures

- Approx. 510,000 smallholders with average farm size of 1,1 ha produce the majority of the coffee.¹⁵¹
- 94% destined for export, making it the second largest export crop.
- Vietnam is the second largest producer and exporter of coffee.¹⁵²

Sector performance

Sector alignment and accountability – During the initial years, the commitment to the dialogue and ownership of the VCCB among stakeholders varied. Alignment between stakeholders was hampered by distrust and different perceptions of the sense of urgency and priorities. One of the main reasons was that the activities of the VCCB were quite general or focused on very specific topics.¹⁵³ Over time this has changed. The participatory development of a sector strategy, Vision 2020, was instrumental in this. It brought the discussion to a more strategic level, helped to develop a shared understanding of the sector dynamics and to align the stakeholders behind specific priorities. The strategy fits within the framework of the Vision2020 program of the Global Coffee Platform (GCP), which emerged out of the 4C Association and IDH's Sustainable Coffee Program.

Another activity the VCCB undertook was the development of a National Sustainability Curriculum (NSC) (which is also one of the strategic pillars of the GCP). The NSC should solve the issue that Vietnamese

¹⁵⁰ GSP (2016), National Coffee Platform: Public/Private alignment for a sustainable coffee sector.

¹⁵¹ NewForesight, Aidenvironment, IIED (2015), Sector Transformation, Case Study Report, Coffee Vietnam, commissioned by IFC

¹⁵² Ipsos (2013), Vietnam Coffee Industry <http://www.ipsosconsulting.com/pdf/Ipsos-Research-Note-Vietnam-Coffee.pdf>

¹⁵³ GSP (2016), National Coffee Platform: Public/Private alignment for a sustainable coffee sector.

coffee farmers have been the target of multiple often conflicting training programs, by both the public and private sector.¹⁵⁴ The NSC developed by the VCCB is approved by the Ministry as the official extension document for all trainings of farmers within the World Bank's Vietnam Sustainable Agriculture Transformation (VnSAT) Project.

While its official mandate is to advise MARD, the VCCB, considered as representative of the Vietnamese coffee sector, is increasingly asked by other departments within the Vietnamese government for contributions and policy advice.¹⁵⁵

Whereas the Vietnam Coffee Coordination Board is nowadays essentially a platform, the ambition is to make it an effective coordinating body for the coffee sector. Some of the tasks it could take up include:¹⁵⁶

- Development and oversight of sector policy
- Coffee Development Fund
- Sector Monitoring and Reporting

Full development of an institution of this nature will take time however. It also requires increased capabilities in the organization. In recognition of this, the World Bank established in 2016 the Vietnam Sustainable Agriculture Transformation Project (vnSAT). One of the components of the project is to support the VCCB to transition to an effective coordinating body for the coffee sector.

Sustainability – The Vietnam coffee sector is characterized by high yields but also by overuse of water and chemical inputs. Therefore the VCCB has taken a very active role in promoting sustainable production practices which is reflected in the content of the NSC.

Inclusiveness - It is a challenge to get smaller scale domestic enterprises on board. And even when such actors are on board, they may be less engaged or less vocal than other stakeholders, partly because of cultural differences with foreign companies being more vocal.¹⁵⁷

Key takeaways

- A national platform able to create a shared sector-wide vision and strategy is an important instrument to create trust and buy-in from these stakeholders (including international customers).
- In an alignment process it is important to have a strong, neutral and knowledgeable facilitator, able to speak the language of both the public and private sector.
- A key success factor is the strong government buy-in – having a public sector champion-, strong donor support and the linkages to national and international industry.¹⁵⁸
- The VCCB intends to develop itself from a sector platforms into a coordination body. This step-wise approach will however require time and investments in the necessary capabilities.

¹⁵⁴ <http://www.idhsustainabletrade.com/home/national-sustainability-curriculum-approved-for-use-in-the-world-bank-s-300-million-usd-vietnam-sustainable-agriculture-transformation-vnsat-project>

¹⁵⁵ GSP (2016), National Coffee Platform: Public/Private alignment for a sustainable coffee sector.

¹⁵⁶ World Bank (2015), World Bank support for Vietnam's coffee sector

¹⁵⁷ GSP (2016), National Coffee Platform: Public/Private alignment for a sustainable coffee sector.

¹⁵⁸ GSP (2016), National Coffee Platform: Public/Private alignment for a sustainable coffee sector.

VIII. Cotton in Burkina Faso: A semi-liberalized sector ensures farmers receive services and market access and are partly protected against price fluctuations

Background

In 1979, Compagnie Francaise pour le Développement des Fibres Textiles (CFDT) partnered with the Burkinabé authorities to coordinate production and export, eventually culminating in the emergence of SOFITEX, the state-owned ginning company. In 2004, SOFITEX sold some of its ginning capacity and regional production rights to two companies. The partial selling occurred mainly as a result of liberalization reforms encouraged by the World Bank. The buyers would receive exclusive rights to production zones.¹⁵⁹ Recent structural reforms include the creation of an inter-branch association (2004 – 2006) and the establishment of a stabilization fund (2007) and an input fund (2012) to protect producers from international price fluctuations and the high cost of inputs.

Key actors

Three organizations are key in coordination of the sector¹⁶⁰:

- Three companies regrouped in an industry association (APROCOB); Each company is responsible for the procurement of inputs, technical assistance to producers, the purchase, collection and ginning of seed cotton, and commercialisation of the cotton fiber and by-products.
- National Union of Cotton Producers in Burkina (UNPCB): regrouping all cotton producers. Its role include the distribution of inputs, short and mid-term credit management, the collection of cotton and social activities.
- Inter-branch association (AICB); regrouping APROCOB and UNPCB and responsible for the coordination of the cotton sector, including price setting of farm inputs and cotton seed and the management of a stabilization fund.

Sector governance instruments

| | |
|--|--|
| Alignment, coordination and accountability & association | Revenue collection |
| <ul style="list-style-type: none"> • Coordination body | <ul style="list-style-type: none"> • Export levy |
| R&D & service provision | Market management & promotion |
| <ul style="list-style-type: none"> • Research • Input fund • Extension services | <ul style="list-style-type: none"> • Monopolized marketing • Price setting • Stabilization Fund • Quality management |

Key figures

- 100% smallholders, 350,000 growers with an average 1.8 ha of cotton
- Cotton contributes about 10% to the GDP
- 100% is destined for export making it the second largest source of foreign exchange earnings

Sector performance

Value capture by farmers – The AICB announces a minimum farmgate price at the beginning of the season based upon on the average international price of the fiber in the last three years and various adjustments based on the recovery rate of the fiber, export value and farmers' debt to the cotton companies. At the end of the season, farmers may receive an additional compensation if realized prices by the ginner were higher.

Price stabilization – A stabilization fund compensates ginner at the end of season when the realized prices have been lower than the fixed pre-season price. When the ex-post price exceeds 101 percent

¹⁵⁹ IMF (2014), Burkina Faso, IMF country report No14/230; www.imf.org/external/pubs/ft/scr/2014/cr14230.pdf

¹⁶⁰ AICB (2014), Presentation of the cotton sector in Burkina Faso https://www.icac.org/getattachment/mtgs/Plenary/73rd-Plenary/Details/Documents/Country-Statements/Burkina_Faso_E.pdf

of the pre-season price, the exceeding portion goes partly to the “stabilization” fund.¹⁶¹ Prices are indeed more stable than in the more liberalized cotton sector of Eastern and Southern Africa.¹⁶²

Competitiveness - Burkina Faso is Sub-Saharan Africa’s leading cotton producer. Compared to Southern Africa, average yields are higher. This is primarily linked to the effective input use by farmers. An earlier choice to produce GM cotton is reversed as the cotton fibre trades at a discount to other West African origins.¹⁶³ The sector is however considered to be vulnerable and the repetitive cotton crises still threatens the survival of the cotton sector.

Revenue generation and reinvestment – The strong governance model facilitates tax collection on all cotton exported. The combination of the Input Fund and price fixing mechanisms allows to distribute inputs on credit and reimburse credit. The Input Fund serves as a guarantee mechanism that enables ginners to receive input credit at lower costs and on more flexible, longer terms. In addition, ginners can gain information with which to purchase fertilizers when the international prices are lower. This can result in lowering the costs of the initial purchase of fertilizers by the companies, enabling them in principle then to sell inputs to the farmers at reduced prices with less distortion from subsidies.¹⁶⁴ However, the cotton system appears to be in structural deficit.

Resistance to rent seeking and elite capture – The sector is criticized for rent-seeking behaviour, misallocation of resources, inefficient investments and corruption.¹⁶⁵

Sustainability – Cotton production is entirely rain-fed and climate vulnerability is considered to be high.¹⁶⁶ The AICB and the cotton companies develop programs to improve soil and water conservation. However, until recently this did not seem to be in the core of their strategies. Recently, and partly under pressure by donors, sustainability considerations receive a more prominent position in its strategies.¹⁶⁷

Inclusiveness – All 350,000 smallholders receive inputs on credit, technical assistance and have guaranteed market access. Through the national union they are all represented in the AICB. Although voting power is equally divided between producers and industry, the perception is that the cotton companies have the power and dictate decisions on collective management issues.¹⁶⁸

Key take-aways

- The high degree of producer organization in combination with an Input Fund and monopolistic marketing model ensures all farmers receive inputs on credit, technical assistance and have guaranteed market access. Together with the price policies this results in more price stability and higher yields than in liberalized sectors. However, the system is financially vulnerable under weak market circumstances.
- Pricing mechanisms require a-political decision-making to avoid rent-seeking and elite capture.
- The creation of the AICB increased representation and bargaining power of producers, but it takes considerable time and investments before they can be considered equal negotiating partners.

¹⁶¹ IMF (2014). *Burkina Faso*, IMF Country Report No. 14/230 & AICB (2014), *Presentation of the cotton sector in Burkina Faso*.

¹⁶² Peltzer, R. and Röttiger, D. (2013). Cotton Sector Organisation Models and their Impact on Farmer’s Productivity and Income, German Development Institute, Discussion Paper 4/2013

¹⁶³ Ecobank (2015), Burkina Faso: Changes loom for 2015/16 cotton season, Middle Africa Briefing Note | Soft Commodities | Cotton, 12 June 2015

¹⁶⁴ IMF (2014). *Burkina Faso*, IMF Country Report No. 14/230.

¹⁶⁵ Kaminsky, J. and Serra, R. (2011), Endogenous Economic Reforms and Local Realities: Cotton Policy-Making in Burkina Faso, Africa power and politics, Working Paper 17

¹⁶⁶ AICB (2014), *Presentation of the cotton sector in Burkina Faso*.

¹⁶⁷ Key informant interview, September 2016

¹⁶⁸ Kaminsky, Jonathan. “Cotton Dependence in Burkina Faso: Constraints and Opportunities for Balanced Growth”, Chapter 6 of “Yes Africa Can: Success Stories from a Dynamic Continent”, World Bank 2011. & Key Informant Interview September 2016.

IX. Cotton in Zambia: private sector governance to enforce contract farming

Background

The vast majority of the cotton crop in Zambia is contracted to ginning companies who pre-finance inputs. 99.5 per cent of farmers are estimated to be operating as outgrowers under contract to the ginners, with very few self-financed independent cotton farmers. Ginning companies use agents in the field – usually lead farmers or dedicated staff – who work on commission to recover loans and contracted volume of cotton.¹⁶⁹ The dominant contracting model, and the provision of inputs (and sometimes technical services) therein, means there are high levels of dependence between cotton farmers and ginners.¹⁷⁰

The market has become less concentrated and more competitive, and evidence suggests that this has been associated with increase contract defaulting in the form of side-selling – undermining the long-term financing, structure and performance of the sector. The cotton sector in Zambia was perceived to have reached crisis point recently, with two of the country's largest ginners (Cargill and NWK) reporting default levels on credit for inputs/contracts at 15% and 30% respectively.¹⁷¹

This case study focuses on sector governance in Zambia in support of contract farming that works for ginners and farmers, as an example of sector coordination regulated largely by the private sector.

Key actor

The Government of Zambia has largely left the regulation of cash crop sectors to the private sector and has (mainly) focused instead on a policy environment to support industry self-regulation, to keep order in the sector and protect the contract system through a number of different institutions.

The Zambia Cotton Ginners Association, is a membership-based association of ginners, with a common interest in how to protect their pre-investment in the cotton sector. Its purpose is to self-regulate production, extension, and the marketing of cotton in Zambia.¹⁷²

Sector governance instruments

Alignment, coordination and accountability & association

- Aligning of private sector players via Zambia's Cotton Ginners Association
- Monitoring via a farmer database

R&D & service provision

- Extension services

Revenue collection

Market management & promotion

- Contacting code-of-conduct
- Common Buying Points

Key figures¹⁷³

- 115,000 MT of seed cotton produced in 2014/15, 110,000 MT in 2015/16.
- Domestic and export -- 14,500 MT of lint cotton goes to national spinning industry, remaining 25,000 is exported (to South Africa, China etc).
- 'Raw' cotton (presumably lint) is Zambia's 5th largest export (constituting 2.5 per cent of exports).
- Smallholder crop – 200,000 smallholders grow cotton.

¹⁶⁹ Based on interviews carried out by IIED and IAPRI in Zambia in January 2015 with a number of private, government and farmer representatives from the cotton sector.

¹⁷⁰ Based on interviews carried out by IIED and IAPRI in Zambia in January 2015 with a number of private, government and farmer representatives from the cotton sector.

¹⁷¹ Based on interviews carried out by IIED and IAPRI in January 2015 with key cotton stakeholders in Chipata and Lusaka.

¹⁷² New ginners apply to join the Association – existing members decide whether to accept the new members – and members pay a levy (unclear how the levy is used). The criteria for joining include a consideration of whether the company applying is reputable, employs good staff, and whether it has its own ginning capacity or engages in toll ginning. Based on an interview with the Ginners Association by IIED and IAPRI in January 2015.

¹⁷³ http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Supply%20and%20demand%20of%20cotton%20in%20Zambia_Pretoria_Zambia_12-4-2014.pdf

Sector performance

Alignment, coordination and accountability – A Code of Conduct was introduced in 2014 by the Ginners Association. All members of the Ginners Association have signed the Code of Conduct, including those with a previous reputation of side buying. Penalties for breach of the CoC will be (a) dismissal from the Ginners Association, and b) the risk of revoking licences (the Cotton Board has the authority to revoke licences, presumably at the recommendation of the Ginners Association). Verification is via district committees. Stakeholders are generally positive about the Code of Conduct, though there remains concerns around enforcement, particularly in regards to the removal of licenses to operate.

A farmer database is in development to allow for monitoring of adherence to the Code of Conduct (by ginners and farmers). The purpose of the database is to allow ginners to work with farmers who have a good track record. The database is supposed to show if farmers are contracted to more than one ginning company, or have not repaid their loan in full, or engaged in side-selling. Data will be collected by field staff of the Cotton Board, who will keep an eye on procurement. But Malawi has found establishing a database and registration system to be very expensive. And the Cotton Board may lack personnel (based on previous issues of establishing it as intended).

Price stability – Cotton farmers are strongly exposed to price shocks and to currency fluctuations. The Zambian model has not addressed this. Cotton purchase prices are announced pre-harvest rather than pre-planting, so farmers bear price risk. And price volatility has exacerbated side-selling. Avoiding side-selling and buying will not lead to improvements in farmers' vulnerability to price shocks.

Transparency – Since liberalization there has been no price-setting or price guidance of any kind from the Zambian government. As of 2007, Dunavant (now NWK) was reported to be a price leader, announcing a minimum pre-planting price to farmers which may be adjusted upwards at the start of the buying season. Cargill typically has followed Dunavant's pricing, while smaller ginners frequently pay higher prices than Dunavant. Competition authorities have challenged price setting as collusion (a common practice pre-2014); in mid-2014 the Consumer and Competitive Protection Commission (CCPC) announced measures that would allow individual farmers to negotiate the prices of cotton with individual ginneries.

Prices are not made any more transparent by the model – some ginners may offer an indication of prices at the beginning of the planting season but this is generally not specified in contracts.

Revenue generation and reinvestment – Intended to maximise input provision to farmers (on credit) by insuring ginners' investments in input provision and that they can recoup their costs. Side-selling has seen a reduction in input provision and extension as ginners seek to cut costs in order to recover debts. Effectiveness remains to be seen. It is unclear how fines obtained from penalization associated with side-selling will be used.

Key take-aways

- In the absence of government intervention and effective enforcement, the private sector has opted to fill the gap through self-regulation, via an Association and Code of Conduct (as well as common buying points and a farmer database) to enforce and regulate contract farming.
- Under the contract farming model, delivery of inputs and technical services to farmers by ginning companies depends on the ability of those companies to recoup their investments. Sector governance then becomes focused on contract enforcement. There is a low level of farmer engagement in sector alignment. Farmers may see the instruments of enforcement as working against their interests and/or their agency.
- A levy is collected on the sector, but it is unclear how it is used. Farmers have raised concerns that levies collected at the district level are not being used to upgrade infrastructure or invest in anything that benefits cotton production.

X. Pineapple in Costa Rica: Successful stakeholder alignment to find a way forward for an industry at crisis point

Background

The Pineapple sector in Costa Rica reached crisis point, after significant growth. The sector faced growing environmental and labour/welfare issues that urgently needed addressing, including non-compliance with labour and health regulations within the industry.¹⁷⁴

The National Platform for Responsible Production and Trade of Pineapple, a multi-stakeholder platform, was launched in 2011 to establish 'a process of dialogue and development of inter-institutional and inter-sector proposals aimed at improving productive performance, relationship with communities, workers and the environment throughout the agricultural chain of pineapple production, ranging from cultivation to the end consumer.'¹⁷⁵

Key actor

Led jointly by two government departments: the International Affairs Directorate of the Ministry of Agriculture and Livestock; and the Directorate of Environmental Quality Management of the Ministry of Environment and Energy.

UNDP serves as project implementation agency. Members of the platform include the private sector (Walmart and Tesco); NGOs (international and national); consumer groups; trade unions; academia (universities and research centres) and small-scale producers. It is supported by donors: ICCO and IDH.

Sector governance instruments

Alignment, coordination and accountability & association

- Sector platform
- Steering committee
- Monitoring committee

Revenue collection

R&D & service provision

- May offer some service delivery as part of the action plan (e.g. agricultural research and technology transfer)

Market management & promotion

- Action plans seeks to 'incentivise adoption of good agricultural practices'

Key figures

- Exports have increased from 7.6% of agricultural GDP in Costa Rica in 1998 to 27.83% in 2005 and 30% in 2010.
- Costa Rica produces 60% of the world's pineapple (as of 2015).
- Industry is valued at US\$800 million a year.
- Constituting 7% of total exports, pineapples are Costa Rica's second largest foreign currency earner.

Sector performance

Alignment, coordination and accountability – The Platform's value proposition is to bring together key stakeholders to promote dialogue, collaboration and shared action to solve the social and environmental issues in the sector, culminating in the production of an action plan (for the time period 2013-2017). The Platform has been structured according to 'Working Groups' – each consisting of representatives from government, academia, production and the community. The Working Groups

¹⁷⁴

<http://www.undp.org/content/dam/undp/library/Environment%20and%20Energy/Green%20Commodities%20Programme/GCP%20Costa%20Rica%20OUS.pdf>

¹⁷⁵ <http://www.pnp.cr/index.php/en/faqs>

include: 1) Supervision and Enforcement of National Law; 2) Market Economic Incentives; 3) Use and Control of Agrochemicals; 4) Soil Use and Conservation and 5) Small and Medium Enterprises.

The Platform's activities have been split into two phases. The first (Oct 2010 to April 2014), involved a series of plenary meetings to discuss the actions needed to improve the sustainability of the sector and to produce an 'Action Plan for Strengthening Responsible Production and Trade of Pineapple in Costa Rica.' Four meetings were held in this period. Approximately 900 people from over 50 organizations and institutions participated in the various activities developed during the first phase of the project.¹⁷⁶

In the latest meeting, the final draft of the National Action Plan for Production and Trade of Pineapple in Costa Rica was presented. It is the first action plan created by government, producers and the private sector. It was endorsed by government in 2016. The Action Plan will guide the actions of the public sector, the private sector, and buyers to improve environmental and social performance of the pineapple produced in Costa Rica during the next 5 years.

There were challenges initially in developing the shared vision and joint strategy, but the process was adapted to address these: 'the discussions in the plenary and working group sessions were not moderated and facilitated based on a predefined methodology and the opinions of participants were recorded through minutes that did not respond to a rigorous format of information systematization. These flaws began to emerge in the second plenary in November 2011, and forced the Steering Committee of the Project to work on a review of the methodology used in the dialogue: in 2012 some methodological consultants were hired, and they began to use [a] matrix, based on the logical framework methodology for the gathering the information'.¹⁷⁷ For example, the National Chamber of Pineapple Producers and Exporters initially rejected the Action Plan (despite heavy participation in the plenary meetings) on the grounds of: the methodology used to develop the plan and the representation of producers.

The second phase focusses on the implementation of the action plan. Participants of the platform aim to keep the plan up-to-date based on previously executed actions. A number of actions started in 2013.

A monitoring committee has been put in place and formalised via government decree to oversee implementation of the Action Plan (signed in March 2016). The committee consists of business, government and civil society.

Inclusiveness – Some groups have refused to participate fully (communities and labour unions) in the process, because of perceptions of dominance of business (large producers, specifically) and an ability to reconcile some issues, e.g. freedom of association. There has been a lack of representation of small and medium-sized producers.

The Platform has experienced challenges in bringing together government ministries with sometimes conflicting agendas (MINAE, responsible for overseeing conservation and preservation of natural resources and MAG, responsible for promoting competitiveness and development of agricultural activities in the country), however these ministries were able to agree on priority issues and common goals.

¹⁷⁶ National Platform of Responsible Production and Trade of Pineapple in Costa Rica. Undated. Systematization of Experiences and Dissemination of the Dialogue Process Conducted under the Framework of the National Platform of Responsible Production and Trade of Pineapple in Costa Rica. Systematization Document.

¹⁷⁷ National Platform of Responsible Production and Trade of Pineapple in Costa Rica. Undated. Systematization of Experiences and Dissemination of the Dialogue Process Conducted under the Framework of the National Platform of Responsible Production and Trade of Pineapple in Costa Rica. Systematization Document.

Sustainability – The platform’s key focus is on improving the sustainability of the sector. Success remains to be seen, but strong buy-in of key stakeholders and government endorsement/leadership are positive signs. However some actions (e.g. those that are the responsibility of producers) are voluntary. Nevertheless, the Platform has raised various issues for discussion that could affect legislation (and improve sustainability) in the entire agricultural sector. For example, the obligation to hold a license for the application of agrochemicals, the establishment of a system of public and periodic monitoring of land use in production landscapes, or inter-institutional coordination for inspection of plantations).¹⁷⁸ Other actions in the plan include: better practices on use of agrochemicals; better practices on soil use and conservation; measures for climate change mitigation; national dialogue on labour rights; and incentives for promotion of good agricultural practices.

Key take-aways

- A strong vision for the sector now exists, which has been facilitated by the Platform. But there have also been disagreements, some of which have not been fully resolved (e.g. between employers and trade unions).
- The creation of an action plan and the representativeness of the process has been impressive. The need to stay flexible and reflective in the process was essential for ensuring maximum participation and buy-in to the action plan. Having a very clear objective – to create the action plan – helped to galvanise and focus efforts and discussions.
- The Platform has been effective in establishing a clear division of roles and responsibilities, and in displaying strong leadership from platform coordinator.
- The involvement of ministers and vice ministers from the two main ministries likely gave important impetus to the process and government endorsement of the action plan is likely to be significant in raising its profile and in encouraging actors to deliver on it.
- The lack of revenue generation which appears to exist may challenge the long-term sustainability of the platform, particularly to fund monitoring activities to hold actors to account for the actions they have committed to. Other instruments that may be used remain to be seen as part of the action plan.

¹⁷⁸ National Platform of Responsible Production and Trade of Pineapple in Costa Rica. Undated. Systematization of Experiences and Dissemination of the Dialogue Process Conducted under the Framework of the National Platform of Responsible Production and Trade of Pineapple in Costa Rica. Systematization Document.

XI. Palm oil in Honduras: A project coordination platform that became the driver for sector transformation¹⁷⁹

Background

WWF and SNV have been active in promoting sustainable palm oil production in Honduras for many years. Initially they had working relationships with several palm oil companies on an individual basis. A funding opportunity for Solidaridad's Farmer Support Program made them decide to propose a project as a consortium with 5 palm oil companies. The objectives of the consortium were to promote better management and RSPO certification within the palm oil companies and to strengthen relationships throughout the supply chain, giving priority to the implementation of inclusive business tools.

The collaboration between the consortium partners in the project design phase and first months of the project showed that the collaboration had a potential value beyond the direct project sphere. After a few months the project decided in 2013 to formalize the consortium and build a governance structure. Solidaridad became the main facilitator of this consortium. During the implementation of the project, the consortium was extended with new companies and three Ministries.

Key actor

The consortium members include 11 palm oil companies and cooperatives, representatives from the national Secretary of Agriculture and Livestock (SAG), and international conservation and social NGOs. It meets on a regular basis and has created a formal governance structure. The collaboration in the PASH consortium inspired palm oil companies to set-up an industry association (AIPAH). AIPAH's main activity is to negotiate contracts with end buyers for the collective membership. Knowledge exchange between members is another important activity.

Sector governance instruments

Alignment, coordination and accountability & association

- Sector platform
- Industry association

R&D & service provision

- Tool development

Revenue collection

Market management & promotion

- Environmental regulation

Key figures

- In 2013, approx. 18,000 smallholders (<10ha) represent 13% of the area under cultivation, medium growers (10 ha- 100 ha) cultivate 23% and large-scale 64%.
- In 2013, the palm oil sector represented 6% of national GDP and was expanding fast.
- In 2013, 70% of national production was exported

Sector performance

Sector alignment – While initially the consortium functioned as coordination and learning platform for the FSP projects of the 5 companies, it became an instruments which promoted alignment at sector scale. Soon other companies joined the platform, making its members represent 90% of the processing capacity in Honduras. The platform contributed to improved trust levels between private sector actors. Before the project, the Honduran palm oil sector was segregated in two major groups: the privately owned corporate group and the producers owned enterprises, and there was little interaction or trust between them. The PASH consortium improved relations and collaboration at between them. The platform resulted in a high level of industry participation, on-going dialogue and exchange of knowledge and experience. The consortium facilitated the development of a perception and appreciation of “shared interest” amongst producers. The identification of shared interest among industry actors has

¹⁷⁹ All information in this case is derived from Aidenvironment (2016); An evaluation of Solidaridad's Farmer Support Program.

led to self-monitoring within the industry, as well as an articulation of the need to develop policy around responsible expansion of oil palm plantations and related environmental impacts.

The consortium's invitation to the Ministry of Agriculture and Livestock Ministries has resulted in an intense public sector engagement. Some of the results of this engagement are:

- The guidelines for best environmental management practices for palm oil that have been developed in the projects have become a condition for new plantations to obtain a legal permit.
- Based upon discussion in the Consortium the Government has withdrawn its expansion ambition in oil palm cultivation (from 150k ha to 200k ha) and replaced it by one of intensification
- The government promotes RSPO certification and is considering to adopt the RSPO standard in its regulation (meaning 100% will be certified);

The platform also enabled better communication between the RSPO and member companies.

Competitiveness – The companies and government believes that RSPO certification is considered by the industry and the government as a way to increase competitiveness of palm oil from Honduras on the international market. The field projects resulted in increased yields and improvement management efficiencies.

Sustainability – The PASH consortium and related projects have contributed to the RSPO certification of several palm oil companies and more strict environmental regulation for new plantations.

Inclusiveness – While the consortium includes 90% of the national production capacity, including cooperative processing plants, it remains a challenge to involve unorganized smallholders in such processes.

Key takeaways

- The building of consortia between companies, key NGOs and the government facilitated crowding-in, sector alignment, higher trust level, knowledge sharing and public policy influence. However, it takes time and good facilitation skills to build the initial trust level between the stakeholders needed to make it a success.
- The initial focus to share lessons learned related to the implementation of field projects helps to create buy-in from companies.
- The model does not include a model for revenue generation. This will increase the challenge to reach out and provide services to unorganized farmers, unless a donor steps in.

XII. Sugarcane in Brazil: Spatial planning as mean to promote sustainability and competitiveness

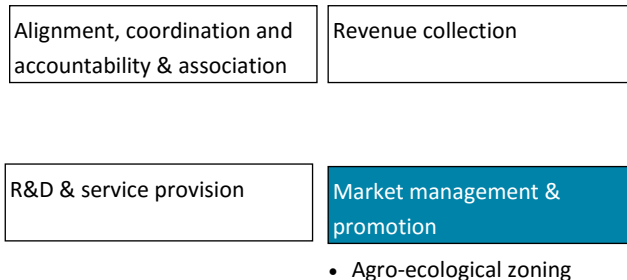
Background

In September 2009, the Brazilian government established the National Agro-Ecological Zoning (AEZ) plan for sugarcane by presidential decree (6.961/2009). Based on a technical study coordinated by the Agroenergy Division of Brazilian Agricultural Research Corporation (EMBRAPA) the AEZ was launched to secure Brazil's place as a sugar/ethanol producer on the international market while addressing growing concerns that the expansion of the Brazilian sugarcane frontier was destroying the Amazon rainforest and other sensitive biomes.¹⁸⁰ The AEZ was drafted in a bill (6077/2009) which remains to be approved by federal representatives and senators.

Key actor

The AEZ is a technical-scientific instrument built from the knowledge of environmental capabilities and vulnerabilities of a particular region. It considers soil characteristics and climate risks related to the requirements of the crop (rainfall, temperature, occurrence of frosts and short summer droughts). Of all Brazil's land, 7,5 % (64.7 million hectares) were deemed suitable land for sugarcane cultivation. This land was divided into classes of suitability, in which low productivity pasture and agriculture land as well as degraded lands are given priority.¹⁸¹

Sector governance instruments



Key figures

- Brazil is by far the largest producer and exporter of sugar, accounting for approx. 20% of global production and 34% of global export.¹⁸²
- The majority of production comes from a few hundred industrial-scale mills, complemented by production from tens of thousands smaller scale landowners.

Sector performance

Sector alignment – The ZAE Cana is a Presidential Decree, and not yet a full law. It can therefore only operate as a voluntary guideline for stakeholders who want to expand sugarcane production. It has however contributed to an alignment of conditions set in a number of policies including:

- Guidance of public and private funding: Following zoning guidelines, the National Monetary Council published on November 26 two resolutions (3813 and 3814) forbidding state and private banks to fund new sugarcane plantations and processing companies in the Amazon, Pantanal, Upper Paraguay Basin, indigenous lands, areas with declivity higher than 12% or those with native vegetation and reforestation.¹⁸³
- Guidance for Installation of new ethanol plants
- Guidance for environmental license procedures
- Guidance for federation States' policies.

¹⁸⁰ Manzatto C, Assad ED, Bacca JFM, Zaroni MJ, Pereira SEM. 2009. Sugarcane agroecological Zoning. To expand production, preserve life and ensure a future. Embrapa Soils.

¹⁸¹ Theme page: Agroecological Zoning. Website embrapa (<https://www.embrapa.br/en/tema-zoneamento-agroecologico/nota-tecnica>)

¹⁸² OECD/FAO (2015), "Sugar", in OECD-FAO Agricultural Outlook 2015, OECD Publishing, Paris

¹⁸³ Ninõ de Carvalho, P. ELLA Policy Brief: Sugarcane Agro-ecological Zoning: Greening the Expansion of Ethanol. ELLA, Practical Action Consulting, Lima, Peru (2013) 8 pp.

Some experts have the opinion that the AEZ should become an enforceable law to empower public authorities to punish illegal expansions out of AEZ Cana, instead of just the technical guideline it is now.¹⁸⁴ Others claim this is not necessary as the philosophy of the AEZ has already been consolidated and it became de-facto a norm.¹⁸⁵

Competitiveness – The AEZ has identified the more suitable areas for sugarcane expansion from an agro-economic perspective which positively influences productivity and farmer returns. Criteria for the exclusion of areas include:¹⁸⁶

- Lands requiring full irrigation
- Lands without soil and climate favourable conditions
- Land with declivity equal to or higher than 12% (where mechanization is not possible)

Sustainability – In addition to agro-economic considerations, environmental considerations have been at the core of defining suitable areas. The AEZ excludes the following areas:¹⁸⁷

- The upper Paraguay river basin and the Amazon and Pantanal biomes
- Lands requiring full irrigation
- Lands with primary vegetation
- Protected Areas and indigenous reserves
- Lands with high conservation value for biodiversity

Key takeaways

- Effective spatial planning instruments can provide assurance to customers that their sourcing does not come from ‘unsustainable’ areas and can concentrate production on those areas which are most suitable from an agro-economic point of view. It provides a lot simplicity compared to the hassle of value chain and certification alternatives, as long as it is enforced.
- Even if a spatial planning itself does not become a full law, it can become a de-facto norm if it is used as reference in other policies.
- Other spatial planning instruments that exist are: voluntary and mandatory moratoria, mapping exercises for High Conservation Value Areas (HCVA), mandatory set-asides for the production of a certain commodity (e.g. rice in Indonesia).

¹⁸⁴ Kaup, Felix. "The sugarcane complex in Brazil." *The role of innovation in a dynamic sector on its path towards sustainability*. Cham, ZG: Springer (2015).

¹⁸⁵ Almeida, Mateus. "Analysing the Brazilian Sugarcane Agroecological Zoning: Is This Government Policy Capable of Avoiding Adverse Effects from Land-Use Change?." (2012).

¹⁸⁶ Rosillo-Calle, Frank, et al., eds. *The Biomass Assessment Handbook: Energy for a Sustainable Environment*. Routledge, 2015. P221

¹⁸⁷ Rosillo-Calle, Frank, et al., eds. *The Biomass Assessment Handbook: Energy for a Sustainable Environment*. Routledge, 2015. P221

XIII. Tea in Kenya: Successful privatization of a parastatal with smallholders at its core

Background

The Kenya Tea Development Agency Limited (KTDA Ltd) was incorporated in June 2000 as a private company having ultimately evolved during liberalisation from a government authority (the Special Crops Development Authority, originally established in 1963).¹⁸⁸ The role of KTDA is to collect, process tea and market tea on behalf of smallholders in the smallholder tea sub-sector, who make up the Agency's shareholders.¹⁸⁹

KTDA is of interest to sector governance because of its combination of effective instruments to improve quality, value retention for small farmers, revenue generation and reinvestment, and its strong performance in terms of sustainability. It is also highly inclusive.

Key actor

Equity and shares of KTDA are owned and purchased by smallholders of tea and the governance and management of KTDA-owned tea factories are carried out by officials elected by smallholders.

Sector governance instruments

Alignment, coordination and accountability & association

- Accountable to its smallholder shareholders

Revenue collection

- Levy

R&D & service provision

- Research
- Extension services
- Credit

Market management & promotion

- Manages all sales for producers
- Liaises and negotiates with buyers on producers' behalf
- Sales promotions of teas to expand market share.¹

Key figures

- The smallholder tea sector covers approximately 60% of national tea production (approx. 260,640 of 436,300 tonnes in 2013)¹⁹⁰. KTDA covers a large majority of this.
- Valued at approximately US\$276 million (of US\$460 million in 2013).
- Approximately 550,000 smallholder farmers, and 66 factories (10% of Kenya's population).¹⁹¹

Sector performance

Value capture by farmers - Smallholder producers in Kenya get a much larger share of the value of tea when compared to producers in other African countries, improving farmers' market power and livelihoods. The producer share of made tea prices was three times higher than other East-African countries in 2009 (at 75%), and smallholder profits at least 10 times higher.¹⁹² This has been attributed to: farmer collective ownership of processing; training and access to inputs (offered by KTDA); pricing systems and supportive government regulation; quality of plucking and of made tea.¹⁹³ The farmers are paid: (1) A fixed monthly payment during the whole year per green leaf kilogram and (2) a final bonus

¹⁸⁸ <http://www.ktdateas.com/index.php/services/tea-management-consultancy-services>

¹⁸⁹ KHRC, 2008. Comparative study of the tea sector in Kenya.

¹⁹⁰ <http://www.fao.org/3/a-i4480e.pdf>

¹⁹¹ <http://www.ifc.org/wps/wcm/connect/5fa58180445b4102a1dbadc66d9c728b/KTDA.pdf?MOD=AJPERES>

¹⁹² Knopp and Foster. Undated. The economics of sustainability. Available at: <http://www.idh-oud.com/site/getfile.php?id=331>

¹⁹³ Knopp and Foster. Undated. The economics of sustainability. Available at: <http://www.idh-oud.com/site/getfile.php?id=331>

payment depending on the tea selling price and the performance/costs faced by the individual Factory Company (e.g. loans payments, commissions and future investments).

Competitiveness - KTDA have sustained and expanded their output of tea over time. 94% of Kenya's tea production is exported. In 2010, it was the world's second largest exporter of tea (behind Sri Lanka) and had a higher unit value than most of its competing producer nations. Its export volumes have increased over time, from 347,500 tonnes in 2011 to 415,900 in 2015, and it was the largest exporter of tea.¹⁹⁴

Kenya's reputation as a tea producer is high – it produces some of the best quality teas globally. This is attributed to environmental conditions, plucking and processing techniques. Producers are incentivised to produce better quality tea through increased price. The price received by Kenyan smallholder teas at the weekly Mombasa Auction remains consistently higher than the average of all teas sold at the auction by about 12%.¹⁹⁵

Revenue generation and reinvestment - A levy is applied by KTDA at point of processing, which funds its extension services, inputs and credit¹⁹⁶ for producers. However, there has been some dissatisfaction on the part of the farmers of KTDA services (inputs, collection, processing, marketing).

Value addition, innovation and adaptability - Aside from its core business related to tea, it has also sought to innovate to ensure sustainability in energy provision needed to run its factories, via investments in hydropower and its own tree nurseries. It has also established subsidiaries that provide additional services to its farmers, such as all types of insurance to its shareholder members and microfinance. The subsidiaries are investments made on behalf of the farmers. Dividends declared from profits made by these subsidiaries are paid to the Tea Factory Companies through KTDA Holdings Ltd. The factories in turn pay dividends to farmers.^{197 198}

KTDA has a clear dividend payout policy: 30% of profits must be made to its small farmer shareholders¹⁹⁹, via bonus payments. The value of the bonus depends on factories' revenue/performance – minus their costs. But in 2014, some farmers had not received their bonuses and chose to strike as a result. The inability of some factories to pay farmer bonuses have been attributed to liquidity issues in some factories and a decline in global tea prices. Farmers are blaming it on inefficiencies in the system with some concerns over mismanagement by the Board.²⁰⁰

Sustainability - Increasingly, sustainability (via Rainforest Alliance certification) has also become a key part of KTDA's model, though this has been driven by Unilever and a number of donors. The KTDA model offers an infrastructure that facilitates certification (e.g. organisation of producers around factories for group certification, auditing etc. and the delivery of technical assistance). In 2013, Rainforest Alliance has certified 54 factories in sustainable agriculture practices while the Fairtrade Foundation has certified

¹⁹⁴ <http://www.fao.org/3/a-i4480e.pdf>

¹⁹⁵ http://www.ktdateas.com/pdfdocuments/KTDA_Brochure_Booklet.pdf

¹⁹⁶ KTDA purchases fertilizers that are extended to farmers on credit. Repayments are spread over 12 months with deductions taken from monthly payments for the farmer's tea deliveries. KTDA subsidiary Greenland Fedha lends up to 67% of the value of the tea a farmer delivers. Between 2009 and 2013, 52,000 farmers received loans to buy farm inputs, tools and equipment, improve tea farming, and support micro businesses. The Agency also sources external loan capital for expansion of existing factories and construction of new tea factory projects and co-ordinates repayment. It also receives and invests tea sales proceeds on behalf of the factories, and makes payments to growers.
http://www.ifc.org/wps/wcm/connect/f097d4004ff4df23a8c0ff23ff966f85/FT-Award-Shortlist_KTDA.pdf?MOD=AJPERES

¹⁹⁷ http://www.ktdateas.com/pdfdocuments/KTDA_Brochure_Booklet.pdf

¹⁹⁸ KTDA has a clear dividend payout policy: 30% of profits must be made to its small farmer shareholders, however farmers are not always satisfied with the bonus payments received (see below), and concerns have been raised about possible corruption.

¹⁹⁹ http://www.ifc.org/wps/wcm/connect/f097d4004ff4df23a8c0ff23ff966f85/FT-Award-Shortlist_KTDA.pdf?MOD=AJPERES

²⁰⁰ http://www.ipsos.co.ke/NEWBASE_EXPORTS/Unilever/140327_The%20People%20-%20Thursday_16_6bfb6.pdf

13 factories for Fairtrade. Sustainable practices have enabled farmers to increase yields by 36% on average and receive premiums from buyers of certified teas.²⁰¹

Inclusiveness – Almost all 550,000 smallholders in Kenya are part of the Agency. Barriers to entry are low – you have to sell to one of the KTDA factories, and become a shareholder through deductions made to your tea sales. Farmers are not obliged to join the KTDA, however, and do in theory have a choice of market channels (there are other factories linked to estates, for example, that they can link to), though in practice geography – distance to deliver tea which must be fresh – may be a constraint to farmers delivering to other, non-KTDA, factories.

The structure, governance and ownership of KTDA provides opportunities for smaller-scale, remote farmers to participate in tea production and trade (including women), and to invest in wider tea businesses (e.g. by allowing them to own shares of factories for processing).

Key take-aways

- The KTDA emerged from a parastatal, but was successfully privatized with smallholders at its core.
- KTDA has succeeded in producing high quality tea that fetches a premium on world markets and in ensuring farmers obtain higher value shares than their neighbouring competitors. They have focused on extension services that emphasise high quality plucking and processing techniques and have succeeded in accessing high quality export markets, predominantly in the UK and Europe. They've kept pace with growing demands of buyers around sustainability, ensuring all of their producers are compliant with Rainforest Alliance production standards, and a small minority are also Fairtrade certified.
- The model offers an effective infrastructure for collection of funds and for reinvestment of those funds back into the supply base and is not a burden on public resources.
- KTDA offers a platform for representation of smallholders which is otherwise lacking in Kenya – smallholders have indicated that they are not well represented at the Tea Board of Kenya, the East African Tea Traders Association, nor the Mombasa tea auction. However they have argued that sometimes their representation at the KTDA through regional directors is ineffective or compromised.²⁰²

²⁰¹ http://www.ifc.org/wps/wcm/connect/f097d4004ff4df23a8c0ff23ff966f85/FT-Award-Shortlist_KTDA.pdf?MOD=AJPERES

²⁰² http://www.fao.org/fileadmin/templates/mafap/documents/technical_notes/KENYA/KENYA_Technical_Note_TEA_EN_Jul2013.pdf