



Farmfit

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# COMMERCIALY VIABLE AND IMPACTFUL SMALLHOLDER SERVICES

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Insights for business

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November 2019





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## INTRODUCTION

Approximately one third of the world's 7.7 billion people depend in part on smallholder agriculture for their living. Many of these farming households have limited access to the global market economy and the goods and services it offers. This prevents them from investing in their farms and results in low farm productivity and low household incomes. It also has long-term implications for the resilience of agriculture-reliant families, with regards to food and nutritional security, poverty alleviation, education, and climate resilience.

From a business perspective, these smallholder farmers are vital to meeting the growing demand for quality raw materials, both in export and local or regional food supply chains. Companies are also starting to realize that the "aspiring poor" are potential clients for purchasing their goods and services - with 270 million smallholder farmers in Latin America, Sub Sahara Africa and Asia alone. Looking ahead, this market is expected to grow, and companies who are able to offer quality services and products to smallholders now, might reap the benefits of brand loyalty in the years to come.

While market opportunities exist, a few key barriers keep the private sector from investing in service provision to smallholder farmers. First, the challenging economics of smallholder farming often results in farmers being unable to pay for services, at least initially. Compounding this problem is the limited understanding of smallholder farmers' needs, due to a lack of quality data. This means there are relatively few value-adding services farmers are willing to pay for in the marketplace, even if they could afford them. High (perceived) risks and relatively few proven business models prevent large-scale commercial investment into the sector. Further, communication and organizational culture differences between value chain players, public sector, and investors slow the spread of best practices and joint learning.



IDH Farmfit is working to change this. We aim to catalyze a competitive marketplace of companies providing smallholder farmers with a choice of affordable, inclusive and high-quality services. For this we are building a common understanding of the key barriers and opportunities for providing smallholders tailored, high-quality services at scale, coupled with advice, technical assistance and de-risking finance to pilot new business models and partnerships. IDH Farmfit offers three core services:

### Farmfit Business Support

#### Tailored strategic advice and technical assistance

Since 2015, IDH has been optimizing its data-driven methodology that systematically analyzes and quantifies the business case for service provision to smallholder farmers - both from a company and farmer perspective. We call the models through which services are provided to smallholder farmers 'Service Delivery Models' (SDMs - see box below). The insights we gain through each SDM analysis are used to provide companies with tailored, strategic advice and technical assistance for prototyping more efficient business models.

### Farmfit Intelligence

#### Best practices, insights and tools to viably reach smallholders at scale

Since 2015, we have been developing and sharing sector-wide best practices and insights on how to viably reach smallholders at scale. These are accessible through the Farmfit Intelligence online portal, Annual Insight Report, webinars and more. In the near future, the portal will also offer tools to benchmark the performance of existing SDMs and visualize the impact and cost-effectiveness of adding or adjusting services.

### Farmfit Fund

#### Affordable de-risking finance - from working capital loans to equity investments

Since 2017, IDH has been providing high-potential SDMs with access to de-risking finance. In 2019, the Farmfit Fund was launched to provide a range of affordable financial instruments currently missing in the market - from working capital loans to equity investments. These products are available to pilot and scale new smallholder business models. The Fund's first-loss facility lowers the barrier for commercial finance to eventually step in and provide these financial products. With every transaction financed, the learning and best practices are shared broadly, building a competitive smallholder finance market.

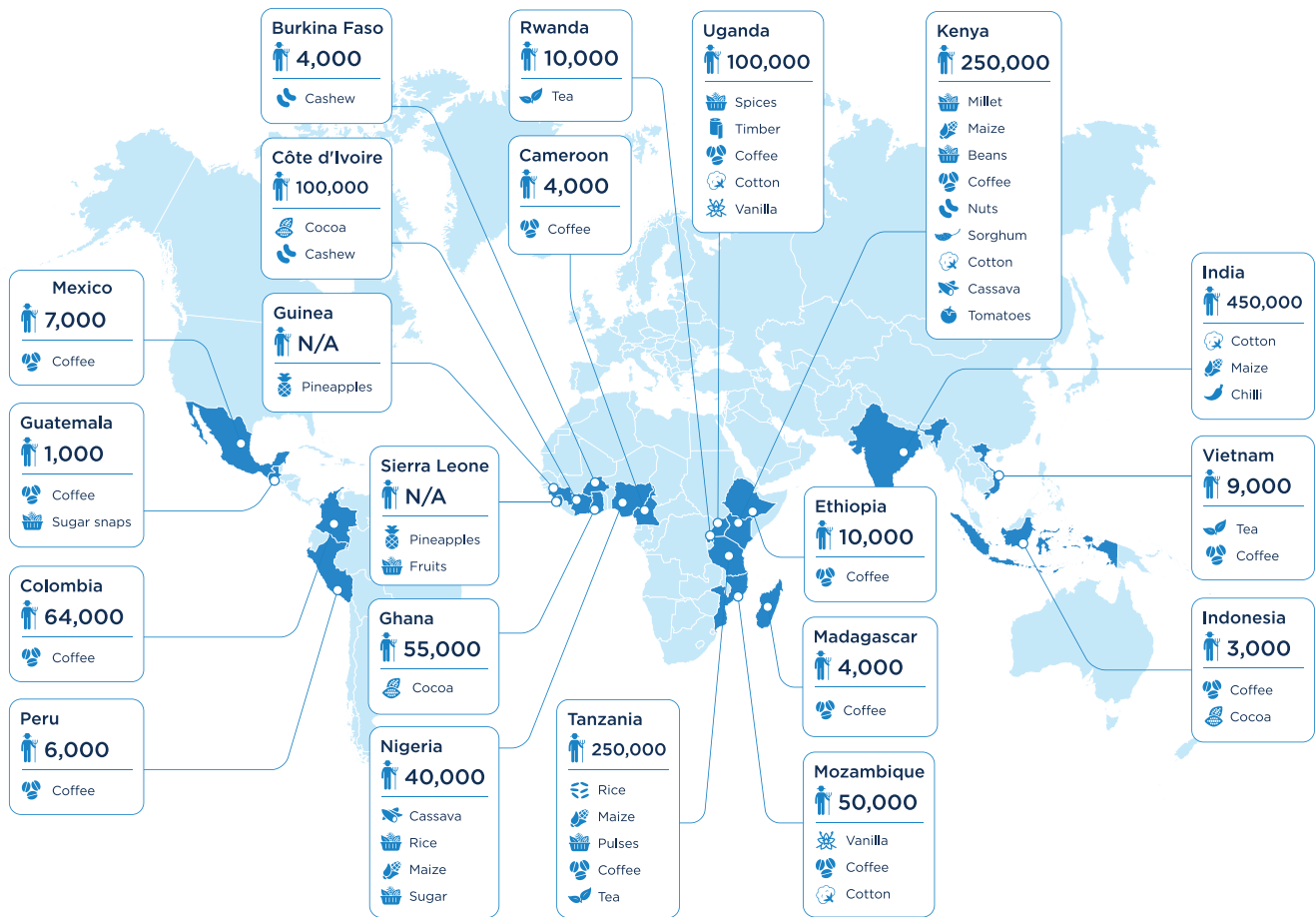
**SDMs** are supply chain structures, which provide services such as training, access to inputs and finance to farmers to improve their performance, and ultimately their profitability and livelihoods.



To learn more about how Farmfit can help your business, visit:

[www.idhsustainabletrade.com/farmfit](http://www.idhsustainabletrade.com/farmfit)

**COUNTRIES, FARMERS, COMMODITIES AND COMPANIES ENGAGED WITH IDH FARMFIT**



In this Insights Brief we share high-level insights and practical examples that businesses, investors and donors can use in understanding, designing and improving their (support to) smallholder service delivery models. Later in 2019, IDH Farmfit will publish our full Insights Report, which elaborates in detail the high level insights we have uncovered in the 50 studies of SDMs we have completed over the past five years. The studies took

place across a wide range of commodities, geographies, SDM scales, and farming models, limiting our ability to thus far conduct in-depth comparative analyses and draw sector-wide conclusions. Consequently, the insights in this report are preliminary. However, they will continue to grow. Over the next 5 years IDH Farmfit will analyze more than 200 SDMs to further substantiate and deepen the insights available to our partners.

# STRATEGIC LENSES FOR BUILDING AN SDM

In order to make sense of the widely diverse landscape of serving smallholder farmers we introduce four lenses that alone or in conjunction inform the design, limitations and performance of an SDM.

## PRIMARY BUSINESS OBJECTIVE



Service-focused SDMs, have the primary business objective to sell services to smallholders, whereas sourcing-focused SDMs, provide services to smallholder farmers mainly in support of their core objective of securing quality supply. Inherent differences exist in these two SDMs. As opposed to service-focused SDMs, sourcing-focused SDMs:

- Face boundaries to scale. They are limited by the number of farmers cultivating; the specific crop in the region, as well as the company's access to market and trade finance;
- Are not exclusively dependent on service revenues as they can recover part of the costs of service provision through revenues from increased quality and quantity of supply;
- Often have an existing infrastructure which they, or other service providers, can leverage for service provision
- Are able to guarantee market access to the farmer.

## FARMING MODEL



The characteristics of a farm, such as size and location, heavily influence the structure by which SDMs source from and provide services. Three farming models we have identified are; block farms, where smallholders are invited onto contiguous, developed farm land to farm small parcels; commercial company farms that serve smallholders in their direct surroundings; and loosely scattered smallholder farms. While companies are often not able to freely choose between these models, it is important to realize that each farming model offers a different degree of control over the land and harvest, where more loosely organized and structured models have the least control, and more centrally organized and structured models have the most control. In contrast to loosely organized models, more centralized models (such as block farms):

- Tend to be smaller in scale due to limited available land and high capital costs;
- Are more costly per farmer as more advanced and expensive services (e.g. mechanization) are implemented;
- Benefit from more predictable and better quality supply as the SDM exerts greater control on the practices and inputs applied and is able to prevent side-selling;
- Need to address the risk of farmers being less involved due to limited (sense of) ownership.

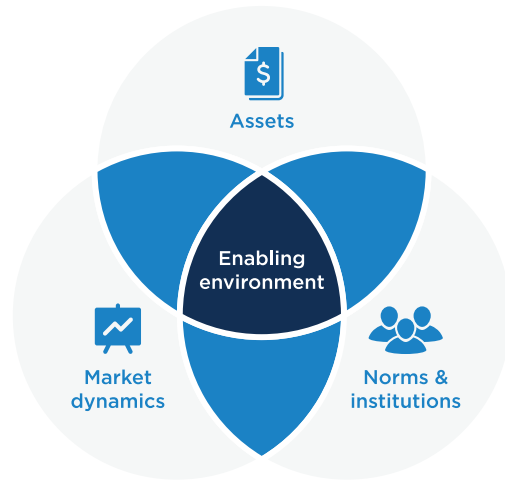
## CROP TYPE



Another factor influencing the design and performance of an SDM is the type of crop, where we observe clear differences between cash and food crops. SDMs in food supply chains:

- Have limited possibilities to generate revenues from premiums as these value chains have lower sustainability demands than export crops;
- Tend to provide low-cost, high-volume services as they source from large numbers of subsistence farmers who are less well organized and operate on small(er) margins;
- Differ in their impact potential, for example, increased productivity can contribute directly to solving regional food security and nutrition issues.

## ENABLING ENVIRONMENT



Finally, the enabling environment – consisting of market dynamics, norms and institutions, and available assets such as infrastructure and technology – plays a crucial role in determining the possible strategies an SDM operator can adopt. In the next years, Farmfit will survey all partner companies to systematically map (and where possible cost) key barriers to, and enablers of, SDMs to advise individual companies and inform policy making.





# INSIGHTS

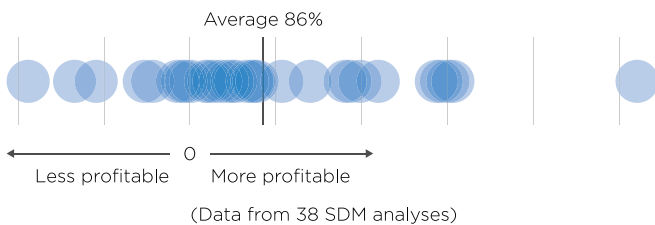
## INSIGHT 1

### WHILE MOST SDMS IMPROVE SMALLHOLDER PRODUCTIVITY AND PROFITABILITY, THIS SEEMS HIGHLY DEPENDENT ON THE DEGREE TO WHICH COMPANIES “KNOW THEIR (FARMER) CLIENTS”

As smallholder families see their incomes improve they may be able to invest more in their farms, which in turn provides an opportunity for businesses to provide additional services and realize more value. In researching the effectiveness of SDMs, we see that in general, SDMs are successful in increasing farm productivity and profitability. On average SDMs increase smallholder incomes by more than 80%.

#### INCREASE IN FARMER PROFITABILITY

Over a baseline farmer



However, as the figure above shows, we see significant differences in the relative impact created across SDMs. Digging deeper into the patterns to find out “what works where”, we have distilled two preliminary success factors driving SDM effectiveness:

#### HOLISTIC SERVICE PACKAGE

About half of the businesses analyzed offer basic services including training, inputs and (often) finance, whereas the other half provides a more complete (or holistic) package of services that often addresses the long-term needs of the farm and household. Our analyses show that:

- The addition of financial services increases the impact on smallholder livelihoods;
- Holistic services result in higher impact;

- SDMs offering holistic services are more likely to break even, likely because farmers are more willing to pay for a complete service package and because SDM operators can provide additional services at lower marginal costs by leveraging an existing infrastructure.

#### KNOW YOUR CLIENT

SDMs that know their smallholder farmer client and tailor their service provision to the varying needs of different farmer segments are more impactful and able to more easily recover their cost than those that provide all farmers with the same services. By providing more tailored services businesses SDMs:

- Create more impact per farmer as they are designed to address specific challenges such as improving farmer livelihoods, women’s market inclusion, climate resilience and food security and nutrition;
- Increase the probability of farmers being able and willing to adopt practices as they see the direct value;
- Reduce the risk of costly and/or complex services not being paid (back) or not being used effectively by the farmer.

#### STRATEGIC PARTNERSHIPS

Partnerships between different types of service providers are often required to deliver more effective holistic service packages to smallholder farmers. While almost all SDMs analyzed have one or more partners, formal partnerships with a joint, longer-term vision appear to create more farm-level impact and have a higher chance of recovering their smallholder investments.



## INSIGHT 2

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### THERE IS A SUBSTANTIAL OPPORTUNITY FOR COST-EFFICIENCY GAINS IN MOST SDMS

Businesses working with smallholders inherently face high transaction costs and low customer value (or production volume) per farmer, meaning that cost-efficiency is paramount for viable business models. In trying to understand how SDMs can increase farm-level impact while driving down costs we have observed two interesting dynamics.

#### **COST-EFFICIENCY**

Higher investments in smallholders do not necessarily equate to higher impact. Our data suggest that the costs incurred by companies in serving smallholder farmers vary widely, and bear no apparent relationship with either farm-level productivity or profitability increases. While some companies realize a high impact

at low cost, other invest heavily without realizing positive results in farm productivity and profitability, underscoring the need to further investigate the drivers of SDM effectiveness and cost-efficiency.

#### **STRATEGIES FOR DRIVING DOWN COSTS**

In our Insights Report we explore several strategies to realize gains in efficiency by focusing on economies of scope (including offering several services building on the same infrastructure), economies of scale (such as spreading fixed costs over a higher number of farmers or higher sourcing volumes), and increasing operational efficiency (through, for instance, empowering farmer groups to lead service delivery or digitizing services).



## INSIGHT 3

### THE BUSINESS CASE OF SDMS IS OFTEN UNCLEAR, LIMITING THEIR ABILITY TO ATTRACT INVESTMENT

We observe that most SDMs are not able to break even. On average, we see that SDMs recover 25% of their costs through direct payments for the services they provide; and an additional 18% by attracting grant funding to activities relevant to donors. Whether and how the remaining costs are covered remains largely unclear, as visualized by the sizeable grey area in the graph below. To improve and accurately reflect the commercial viability of SDMs we see two main strategies:

#### INCREASE SERVICE PROVISION REVENUES

SDMs need to find ways to earn a margin on or at least recover some of the costs of providing services. We identify key challenges that need to be overcome:

- Most sourcing-focused SDMs need to shift away from considering service provision as a separate cost center towards integrating it into the core of their business.
- Before the desired effect of increasing farm productivity and profitability materializes, many farmers are unable to pay for services, meaning

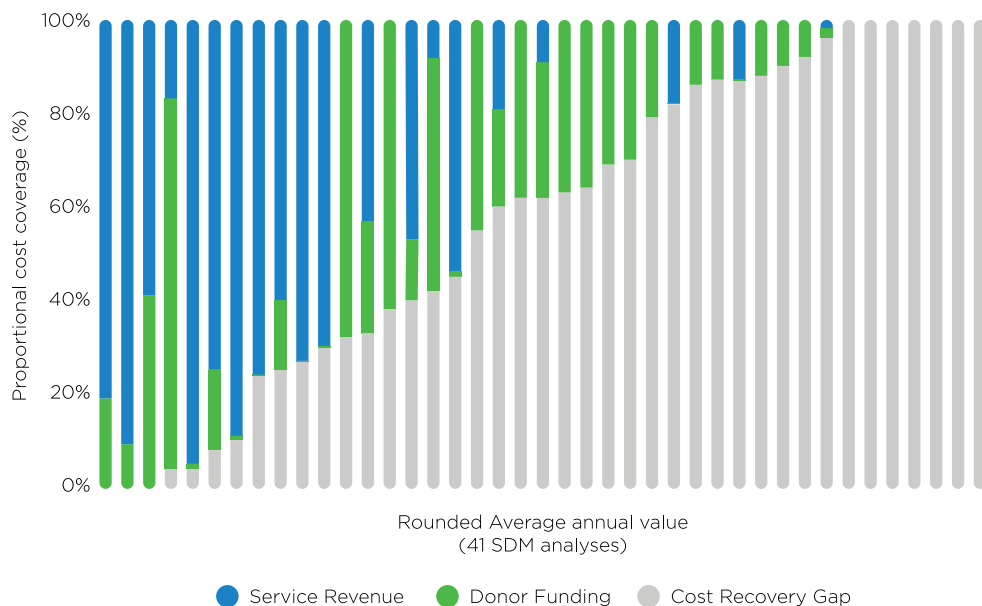
that especially new customers are often unprofitable and a long term view is required to increase service revenues.

- Where farmer ability and willingness to pay for services is low, SDMs can charge or share costs with other value chain partners that are benefiting from accessing those farmers or deriving value from services provided.
- Parts of the costs of service delivery are (still) difficult to commercialize, requiring some SDMs to pursue grant funding from donors.

#### ACCOUNT FOR ADDITIONAL VALUE GENERATED BY THE SDM

Services provision also generates value in other parts of the business, for example through higher sourcing volumes, better qualities sourced, decreased sourcing costs, and increased brand equity. SDMs that seek investment need to systematically quantify and attribute those value streams to the SDM in order for investors to accurately assess the commercial viability of these SDMs.

### MOST SDMS HAVE A COST RECOVERY GAP



## INSIGHT 4

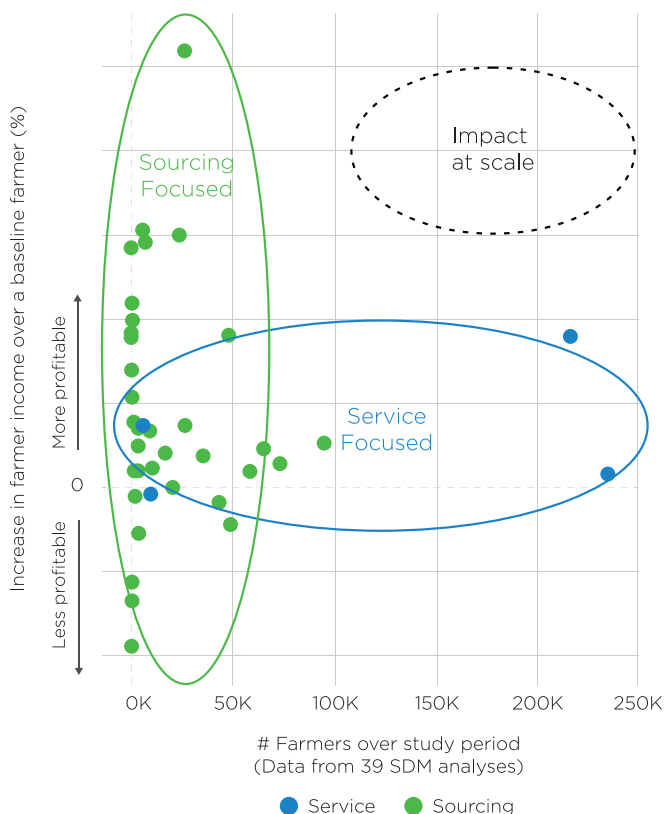
### PARTNERSHIPS BETWEEN DIFFERENT TYPES OF SERVICE PROVIDERS ARE REQUIRED TO CREATE IMPACT AT SCALE

So far we have mainly reflected on what drives the effectiveness, efficiency and viability of service provision to smallholders. To create real market transformation, however, SDMs need to reach scale, either combined or individually.

Most businesses we analyzed have been able to create value for smallholders, and several have been able to reach a scale above 50,000 smallholder farmers. However, very few models are able to simultaneously engage a large number of smallholder farmers and deliver high impact. This observation is reflected in the figure below, which shows that sourcing-focused SDMs have a high potential for increasing farmer productivity and profitability, but are generally limited in scale. In contrast, service-focused SDMs might be able to scale more easily, but their impact appears to be dependent on the degree that off-take can be guaranteed.

#### FARMER IMPACT AND REACH DIFFERS

For each type of SDM operator focus



We believe that in order to realize the Farmfit vision of an open marketplace where companies compete on quality and prices to develop millions of smallholder farmers as loyal clients or business partners, it is not enough if individual SDMs become effective, efficient, and financially sustainable; what is needed is to create impact at scale is companies working together and competing within and across SDMs. Collaboration ensures a wider variety of complementary services can be provided while competition on price and quality is needed to improve affordability and quality services.

We observe three promising trends for how SDMs can benefit from working together towards providing effective, impactful services at scale:



#### Strategic partnerships

Increasingly, we see strategic partnerships forming around complementary services and competencies to ensure more effective and efficient service provision, e.g. between off-takers and service providers or input and finance providers.



#### Technology platforms

Innovative technology solutions are emerging as facilitators of strategic alliances that help to streamline transactions among partners in a cost efficient, reliable, and transparent way.



#### Supply chain managers

We have seen new innovative players emerge that fill the critical role of missing middle in smallholder value chains. They specialize in (1) servicing smallholder farmers; (2) acting as a strategic sourcing partner to large off-takers; and (3) as a strategic distribution partner to input providers and financial institutions.



# TAKEAWAYS FOR BUSINESS

The IDH Farmfit analysis has shown that providing services to smallholders can be both profitable and impactful. However, not all SDMs improve smallholder productivity and livelihoods to the same degree, and only a few models are demonstrably viable from the company's perspective. To attract investment and develop a viable market, we suggest that businesses rely on a combination of approaches:



## Add value to farmers

Understand farmer needs in order to tailor service packages for effective delivery. This approach creates more value at farm-level and increases farmers willingness and ability to pay for services.



## (Im)prove commercial viability

Explore opportunities that would generate service revenues and implement a more structured approach towards quantifying and optimizing the value created by the SDM.



## Drive down costs

Implement strategies to overcome inherent high transaction costs and uncertainties, creating increasing cost-efficiencies over time.



## Partner to scale

Work with complementary partners to ensure effective and efficient service provision, and capture a broader range of benefits.



## NEXT STEPS

Given the insights we have uncovered with 50 partner companies over the past 5 years, we believe that cracking the code on commercially viable and impactful service delivery is possible. IDH is increasingly confident that Farmfit can create actionable insights, tools and partnerships that accelerate the scaling and spread of business models and create shared value for companies and farmers.

However, IDH Farmfit cannot achieve its vision on its own. To create a competitive marketplace for smallholder farmers which provides equal access for women and men and protects farmers from food insecurity and the negative effects of climate change, partnerships are needed. Agri-businesses, service providers, investors, development actors, and governments need to work together to take profitable and impactful models of service provision to scale. We hope you'll join us on this journey.



Get in touch to find out how Farmfit can partner with your business.

[farmfit@idhtrade.org](mailto:farmfit@idhtrade.org)

## Are you interested in:

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### Receiving regular updates on insights?

Go to [www.farmfitIntelligence.org](http://www.farmfitIntelligence.org) to find our full and upcoming Insights Report, to be published near the end of 2019 and practical examples of SDMs overcoming certain challenges in working with smallholders.

### Support in assessing and improving your smallholder engagement business model?

Reach out to us to plan a call to discuss how our SDM analysis can benefit you, and whether your SDM is eligible for such an analysis.

### Understanding how we can support you in implementing and financing your SDM?

We'll put you in touch with one of our Farmfit Fund managers, to discuss what SDMs we consider financing and the financial instruments we have available.

### Exploring ways in which you can collaborate with our partners?

Get in touch to assess whether there is a fit and discuss opportunities.





