

CASE STUDY 7

INCLUSIVE BUSINESS IN NEPAL'S AGRICULTURE SECTOR – LESSONS LEARNED

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CHALLENGE

The High Value Agriculture – Inclusive Business (IB) Pilot Project (HVA-IB Pilot Project) was initiated by IFAD and SNV in Nepal to test and learn how the Inclusive Business approach developed by SNV in Latin America could make a difference in linking remote farmers to markets in Nepal, a country with an economic climate and a business sector much less developed in most cases compared to Latin America. These lessons learned would then be applied in a much larger IFAD funded project called High Value Agriculture Project in Hills and Mountain Areas (HVAP), which is due to start January 2011 in Nepal's Mid-West region, the least accessible and poorest part of Nepal. The HVAP will be implemented by the Ministry of Agriculture and Cooperatives and SNV will provide technical assistance and implement the market linkage component of the programme.

Since the IB approach is new for Nepal, IFAD funded a pilot with USD 200,000 programme budget while SNV contributed with its advisory services. This case study focuses on lessons learned to date and highlights some "work in progress" issues relating to the IB concept.

CLIENTS

The stakeholders of the project are characterised by the context of Nepal. The service providers (NGOs or LCBs) in the remote Mid-West have capacity for group formation, promotion of production, mostly steered by funding opportunities while they have little idea about market linkage, working directly with companies, meeting market requirements, etc. Also the anchor companies involved were not very different from an average Nepali company: they have long experience working with farmers, they are opportunistic and switch products, and invest little in production. The producers in the Mid-West are largely subsistence farmers and are not organised. They cultivate some cashcrops only when living in the vicinity of roads.

METHOD / SNV INTERVENTION

SNV in Latin America and the World Business Council for Sustainable Development (WBDS) define Inclusive Business (IB) as a profitable, sustainable and proven model that seeks to mitigate poverty by incorporating lower income communities (Base or Bottom of the Pyramid [BoP] segments) within the value chain of larger and more established companies, while not losing sight of the ultimate goal of businesses, which is to generate profits (www.inclusive_business.org). The BoP can be generally defined as those 2.5 billion people worldwide living on less than USD 2.5 per day (http://en.wikipedia.org/wiki/Bottom_of_the_pyramid).

These low-income communities have potential to enhance companies' profitability by filling one or more important roles: as employees (new labour markets), as producers (new sources of supply), as distributors (new distribution networks), or as consumers (new markets for affordable goods and services). In this pilot, the focus is on BoP as producers and suppliers of products required by companies.

The key elements of the IB approach are:

1. The starting point is the company. This should be an enterprise led initiative.
2. IB needs to be linked to the core business of enterprises, differentiating this approach from charity and philanthropy and some cases of Corporate Social Responsibility.
3. The goal of IB should be a profitable and sustainable business with social and economic inclusion leading to a win-win situation for the company and the identified lower income communities.

The SNV Latin America approach focused on the selected anchor company as its main client in the IB ventures, quite understandable as fee-for-service was an important aim of each IB deal. This is evident in its various IB manuals, which,

logically presented and packaged many tools and ideas to attract companies able to pay for these services.

But in Nepal, SNV saw more opportunities of applying the IB approach in a project framework: donors were showing interest in the approach while the private sector here is much less developed than in Latin America – and consequently would have less paying power for SNV's TA component. In the pilot and HVAP the different steps are described as following:

- a) agri-business selection and assessment;
- b) preparation and assessment of the value chain business plan;
- c) participatory selection of potential producers or farmers;
- d) social mobilisation of farmers and group/cooperative formation;
- e) facilitation of contracting;
- f) provision of required infrastructure, tools, equipment, etc. on basis of (partial) grant and/or credit;
- g) training of farmers in cultivation, processing, quality enhancement, value addition;
- h) supervision of contract fulfilment;
- i) marketing support;
- j) baseline and post-intervention surveys.

For this two-year pilot, three companies were selected from different sectors to maximise learning. Required demand by these three companies were organic fruit (apple), vegetable seeds (five kinds but mainly carrot seed) and chiuri oilseeds (large seeds from the natural available butter tree (*Diploknema butvracea Roxb*)). The first two products are from Jumla district which lies 2000m above sea level and which for five months per year is only accessible by plane or by a five-day walk as the monsoon makes the only dirt road inaccessible. The Chiuri seeds grow in the forests of Surkhet: between 600m and 1200m above sea level with a wider network of rural roads but only one all-weather road.

OUTCOME

By the end of 2010, nearly three quarters through the project period, the major outcomes are:

Organic apple: This value chain now includes three cooperatives with 200 'fully organic certified' farmers and 150 farmers certified 'organic in conversion'. Another six cooperatives with 110 farmers joined this year in the marketing of non-certified, but organic 'by default' apples (truthful labeling). Together they sold 68MT of apples to the anchor company, a Kathmandu wholesaler. The apple supply chain was greatly upgraded: with support of the project for the first time in Jumla's history, apples are graded and priced differently, pruning has become the accepted norm as it leads to larger and thus better priced apples, boxes are standardised and organic pest management and manure production has been initiated. Most likely an additional 50MT of apples finds its way to the market through other channels, altogether quite a (organisational) challenge as more than 90% is being flown out in airplanes from this remote area. In 2009 there was still another actor in between the anchor company and the farmer groups: the District Chamber of Commerce and Industry; but in 2010 the nine cooperatives organised themselves under the District Cooperative Federation and this time they were directly involved in the post harvest management and air transportation and also signed a contract directly with the Kathmandu based wholesaler.

Vegetable seeds: After a disappointing first year, this year (2010) an amount of 2,6 MT vegetable seeds is under contract production, a great increase compared to the 700kg production of 2009. However, the company's requirements are above the 10 MT. Also the company is now much more engaged and regularly comes to monitor production and has built a stronger relationship with the 150 farmers who are organised into one cooperative. Due to the company increasing its prices with every visit and stronger support and monitoring by the project, farmers have become much more interested in the vegetable seed farming. Although disaggregated data show that only 33% of the beneficiaries of services provided by the NGO are women, in 2010 it is all women who have signed the contracts between the groups and the company.

Chiuri: Previously approximately 25% of the naturally available chiuri seeds (actually look more like large beans) were used for local and traditional oil extraction, the oil is used either for cooking or for adulteration of ghee (clarified butter – a profitable but illegal business). Now in 2010, for the first time people

IMPACT

have a new channel to earn income from the large volumes going to waste. Eight cooperatives signed contracts to supply chiuri beans with the company which produces a much higher quality oil out of it, a valued ingredient for soap and skin creams. Although the contracts totalled 24MT, finally 31 MT was delivered by 1040 households. The company provided 25% payment in advance to the cooperatives, and the Cooperative Development Bank provided another 25% as loan for the required working capital. The company is already hinting towards a demand of 50MT for next year. As chiuri is a non-timber forest product collected from national and community forests, a major challenge was to organise the 'paper work' related to permits and taxes (royalties) to export this or any NTFP for that matter from one district to another. Initial Environmental Examination (IEE) is required to establish harvestable amounts (which do not damage the natural stock of chiuri trees) but the project did not manage to do in time. This caused delays in delivery, which upset the company as its two international buyers were kept waiting for their delivery. While the chiuri value chain is by far the most social and gender inclusive value chain of the three (73% of the beneficiaries are women, Dalit or *janajati* (ethnic groups); partly also because of more ethnic groups in this district compared to Jumla), the transaction costs, i.e. the 'paper work' and IEE are made unnecessarily high by the restrictive environment.

Two service providers were hired and supported with advisory services from SNV to implement all the steps mentioned above, and this was their first experience of IB or any other form of market-linkage. For both of them this was a steep learning curve: helping meet market demands/requirements needs a totally different mindset than subsidised service delivery. Issues such as timing, quality and quantity make or break the relationship with the company. In addition, it is necessary to deal with the distrust companies have for NGOs. Although the service providers are only providing temporary support to the value chain, they are now definitely more capacitated to start facilitating development of other value chains.

The following table provides an idea of the impact achieved in each of the value chains:

		Pre-project	2009	2010	Remarks
Organic apple	Price	NRP 10/kg	NRP 35/kg for certified in conversion, NRP 25/kg for non-certified organic.	NRP 30/kg and NRP 25/kg + profit sharing by the cooperatives	In 2009 the market price was high due to low production in the whole Himalaya region. The profits of cooperatives can be re-invested or turned out to members.
	Volume	Non-organised trade - data not available	35MT certified 15 non-certified + other traditional channels	68MT + other channels	Volumes are largely limited by the air transport limitations. Already 2000 MT of marketable apple is available, but the majority goes to waste.
	#HH	NA	207	460 from 9 cooperatives	Many other, non-organised farmers also benefited from the price increase. 10.000 HH in Jumla have already started planting saplings and would benefit from the current value chain upgrading.
Vegetable seeds	Price	NRP 280/kg	NRP 335/kg	NRP 350/kg	Price of carrot seed
	Volume	NA	700 kg	2,6 MT (currently under production)	2009 contract was actually for 6,5 MT - which turned way to optimistic with the relatively lower prices.
	#HH	NA	51	150	
Chiuri	Price	NA	NA	NRP 35/kg	Price at delivery point Surkhet district headquarters, between NRP 20-25/kg at cooperative gate.
	Volume	NA	NA	31 MT	
	#HH	NA	NA	1040	

NA: not applicable; HH: Households; NRP: Nepalese Rupees; MT: Metric Ton

A major part of the achievements is the establishment of formal contracts as this encourages the farmers to achieve the right quality, price and quantity (information availability with actual market linkage), focusing project investments at quickly making substantial improvements in both volume and quality, post-harvest upgrading, and last but not the least, organisation of producers to achieve the necessary volumes. Of course also IB remains business focused: trust building is between producers and the company is crucial, and price is an all determining factor. Because of the organised manner of IB, large volumes, high quality can be achieved which leads to higher prices – and that all in a relatively short time.

Already some of the targets of the HVA-IB pilot project have been achieved with still one harvesting season ahead before the end of the project. Although the long term impact is still to be seen, there is a strong impression that IB can kick start new or quickly upgrade existing value chains.

Although many other lessons were learnt, for example about organic certification, in this case study the focus is on applying the Inclusive Business approach. Major lessons learned are:

LESSONS LEARNED

Drivers for applying IB

Related to the Inclusive Business approach, it became clear that different SNV offices have highlighted different advantages to this approach:

- a) Originally in SNV Latin America IB was marketed as a product offering tailor made solutions to the private sector. The solution would in one way or the other involve linking the company with the BoP.
- b) Later in Vietnam, IB was presented, indeed not to companies but to donors as the way to “mobilise private sector investment for poverty alleviation”. It made a case to the donors that if they only funded for advisory services, i.e. for a relatively small amount, a much bigger difference can be made in poverty reduction as funds available for investment with the private sector worldwide is much more than what the development sector has at its disposal. SNV’s TA contribution would ensure that the private sector investment would benefit the poorer segments of the BoP.
- c) Here in Nepal, during the design of the larger HVAP, it was presented as the way to make an agricultural project market-led, something still many project designers are struggling with. To increase your market guarantee ‘first find a company with a certain unfulfilled demand for inputs/raw material, then link it through a contract to producers, and only then start supporting (increased) production’. And also in Nepal, where companies usually would not go to remote areas because of low volumes, low quality and high transaction costs, the additional argument is that IB can kick start a value chain ‘as already in the first harvest the farmers can meet the minimum requirements of at least one company as all – producers, company and project - are clear about what needs to be achieved, when and how’. So in Nepal, an IB project would rather not capacitate/support companies as long as they buy, quite opposite to the Latin America and Vietnam model. Also in Nepal, IB is just the start of a larger scale value chain development (see also below: crowding in).

Although all three have the same three key principles mentioned earlier, these three different arguments for applying IB lead to substantial differences in the details of implementing IB, to such an extent even that SNV Latin America would probably say that the work we do here in Nepal is not real IB.

IB versus contract farming

The easiest short cut for describing IB as it relates to the agricultural sector is the ‘promotion of contract farming with a win-win situation for both producers and company’. But there are many cases in Latin America, India and elsewhere, where contract farming is characterised by exploitation of farmers by the companies, in several cases even leading to suicide among farmers. Probably in most of these cases, the farmers entered into contractual production out of free will and at the start assessed it as a beneficial opportunity only to find themselves getting further into debt.

In the pilot we believe that we have some factors which reduce the exploitation tendencies found elsewhere: a) the cashcrops only forms a small part of the livelihood strategy of the farmers and subsistence farming remains an important strategy for the participating farmers; b) all the above three products require little external inputs certainly compared to the value of the products, and if so these are not supplied by the company (with exception of the foundation seed for vegetable seed production); c) embedded services provided by the companies are limited (only a financial advance before the harvest of apple and chiuri); d) niche market or high value products hopefully allow for larger profit margins for producers which again would hopefully put less pressure on producers to enter into strong dependency relationships with the anchor company, compared to low cost bulk products; f) involvement of cooperatives could act as a buffer to exploitation tendencies as they improve the bargaining position and can link farmers to alternative input suppliers, finance, information and marketing channels.

A cost/benefit analysis of the production under the IB modality should clarify that at least it is more profitable for the poor than the previous production system or crop and further analysis should show that the required inputs/working capital can be fairly easily managed by farmers themselves or at least be obtained from parties other than the company.

This said, there is still a great urgency to learn more from contract farming in the past and how we can make sure that SNV is contributing to positive, long term, pro-poor value chain development.

Company selection

There was no systematic way of selecting companies for the pilot. For the large HVAP, a more elaborate selection process has been established as it needs to be working with many more companies. Rather than applying the Private Sector Mapping as promoted in Latin America, HVAP will invite companies through advertisements to workshops where the selection process is explained as well as what the project outcomes can mean to them. Interested companies can then submit their business proposals to be assessed by the project. This would allow for fairer competition, and also reduce chances of being accused of promoting unfair competition. While the approach still needs to be rolled out for HVAP, the pilot provided two lessons on company selection and engagement. In the organic apple case, our preferred anchor company, an organic vegetable wholesaler was pushed aside by a stronger fruit wholesaler: although the latter was less interested in organic certification, its requested volume and offer of advance money was just more attractive to the apple producers. The lesson is to select a leader company in the subsector: less chance of competitors interfering in dealmaking at the initial stage (see 'crowding in' below) and hopefully also opportunities to achieve a larger impact.

Companies which have invested in processing (e.g. chiuri oil processing) might be more sustainable partners than those which only buy and sell (e.g. in case of apples). Naturally projects and producers would prefer companies that have long term interests.

Another lesson is to make clear agreements as early as possible with the companies, e.g. a MoU, on the possible roles of the project and the company. In Nepal where the development aid sector is so all pervasive even companies will try to claim additional funding from the project in areas not of direct interest to the project, in exchange for their participation as a buyer in the project.

Contract facilitation

In the HVA-IB pilot project, the following process was used to facilitate negotiation on price and quantity:

- a) First meeting between company representative and producers' (cooperative) representatives to negotiate the price.
- b) With the agreed price, producer representatives go back to their members and collect the quantities their members are willing to produce against the agreed price. Members sign on a 'list of producers'.
- c) Second meeting between company and producer representatives where contracts are signed mentioning price, quantity and quality (with the list of producers and committed production quantities attached).

It is suggested that it is important to make sure that a draft contract is agreed/shared during the first meeting (to avoid surprises, e.g. on payment

STANDARD DATA

modalities). It is also important to make sure that the first and second meetings have the same producer representatives. If not, the newly involved producer representatives will want to renegotiate price and other issues (e.g. time of payment) already previously agreed.

Companies will tend to sign contracts as late as possible to limit risks. Programmes will need to manage this and will need to be able to quickly support the producers right after signing the contract.

The HVA-IB pilot project initially proposed to promote a system in the contracting process of farm-gate pricing based on market prices: if the market price goes up the farmers would also proportionally receive more – and the other way around but with an agreed minimum price. This became interesting in the apple value chain as the prices started to fluctuate more strongly, both up and down, but the cooperatives preferred a fixed price and let the wholesaler take the possible risks and gains of price fluctuation.

Crowding-in

The IB approach of Latin America is based on a strong alignment with the anchor company, especially if fee-for-services are part of the deal. Hereby, SNV loses the role of being an independent market facilitator and actual becomes a market player – a provider of business development services. This will limit SNV’s freedom to promote crowding-in, i.e. promoting other companies come into the value chain and to compete, most probably leading to higher prices and higher total volumes and number of producers. This larger impact potential would of course be of great interest to projects. IB applied in a project framework, where the project pays for the TA, one still wants to build a relationship of trust between producers and company and therefore, SNV would need to be trusted by both. But the alignment is less strong than in the case of fee-for-services. Trying to maximise impact, the question becomes when and how to promote crowding-in. The pilot project has no clear suggestions yet, except that it tries to promote crowding-in in indirect ways: while trying to maintain a good relationship with the anchor company, the project supports cooperative representatives to go and understand better the wider market, and search for other potential buyers/companies. This does not only allow for possible growth of the value chain and related larger impact, but also reduces the risks when things go sour and the original anchor company decides to pull out for whatever reason. Promotion of crowding-in also means that a successful IB case is not the end goal, but rather a start.

The following is to be included with all case studies:

- Start and end date of contract: July 2009-Sept 2011
- Consistence of team: SNV staff: Rik van Keulen, Ananta Ghimire, Govinda Rokaya, Padam Bhandari, Rolf Schinkel; LCBs: Surya Social Service Society (4S) in Jumla and Beautiful Nepal Association in Surkhet
- Number of PP-days already invested and planned to be invested per category: SNV staff: 190 PPDs and LCBs: 200 PPDs in 2010
- Relevant partnerships: IFAD, provider of programme budget
- Financial resources invested: IFAD: USD 200.000
- Client satisfaction and enhanced capacity scores as provided by the two involved Client-LCBs Surya Social Service Society (4S) Jumla and Beautiful Nepal Association (BNA) Surkhet:

Output Measurement	Rate on a scale from 1 – 4 (1 = poor, 4 = very satisfactory)	
	4S Jumla	BNA Surkhet
Client-CLB		
How do you rate the quality of advice?	4	3
How were our approach, style, and way of communication towards the client?	4	3
How do you rate the learning process of the client from the collaboration with SNV?	4	3

Do you have the feeling you (the client) are in control of the collaboration with SNV/sitting in the driver's seat?	3	2
Are/were the services/advice SNV delivers/delivered relevant for the targeted outcomes?	4	4
Total Score	19	15

Outcome Measurement	Rate on a scale from 1 – 4 (1 = poor, 4 = very satisfactory)	
Client-LCB	4S Jumla	BNA Surkhet
1. Lessons learned by the partner	3	4
2. How far the support of SNV has contributed to the progress and learning of the partner?	4	3