Upgrading to compete in a globalised world: What opportunities and challenges for SMEs in agriculture in ACP countries?

13th Brussels Development Briefing
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On 23rd September 2009, CTA and other partners convened the 13th 'Brussels Development Briefing' - part of a series of bimonthly Development Briefings on ACP-EU rural development issues. Around 90 participants gathered in Brussels to discuss the opportunities and challenges for SMEs in agriculture in ACP countries.

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Introducing the 13th Brussels Development Briefing, H.E. Ms Brave Ndisale, Chair of the ACP Committee of Ambassadors highlighted the contribution of SMEs to employment, growth and sustainable economic development and the need to strengthen the sector in order to foster competitiveness. The Ambassador stressed that SMEs can play a strategic role in agriculture-based economic systems like ACP countries, where most of the poor live in rural areas and where income generation not only from agricultural production but also from agro-processing, trade and service activities can complement agricultural wages and thus contribute to risk diversification. Nevertheless she recalled that SMEs are facing big challenges due notably to both the financial and productive crisis. Moreover the global agri-food sector is increasingly dominated by vertically coordinated global value chains, the raise of standards (food safety standards, product and process standards etc) and the power of retailers. At the same time, demographic growth, urbanization processes, non-food use of agricultural products, higher incomes and changing diets are increasing the world demand of commodities and food, thus creating markets in developing countries, growth opportunities and new niche and specialized markets. In her words globalization imposes new conditions and rules for competitiveness in international markets and the imperative for SMEs is to link up with other actors, both at the local and at the global level, and find new ways to interact and learn. Many of the difficulties SMEs face, due to their size and limited access to resources, could be overcome by promoting links between them both horizontally, into clusters and networks, and vertically, in value chains. This could enhance local firms' capabilities and access to distant markets and generate upgrading of technological and human capital, as a result of a greater exposure and access to information, business practices and technologies. H.E. Ms Ndisale concluded by calling governments and donors to support investment in Research and Development, infrastructure and services, improved regulatory frameworks and business environment.

Mr. Luca Marangoni, from DG Development at the European Commission, recalled the prominent function of micro and small enterprises in every economy, and particularly in developing countries, along with their key role as an engine of private sector-led growth. He then stressed that, compared to larger enterprises, SMEs have proven to be more flexible and therefore capable to absorb economic shocks. His remarks focused on three main areas: (i) regional integration; (ii) access to financial and non financial services; (iii) business linkages. While acknowledging that debates on regional integration in the context of ACP countries are dominated by EPAs, Mr. Marangoni emphasized that a wider issue to be taken into account is the integration of regional factors of competitiveness (infrastructure) in Regional Indicative Programmes funded by the EDF. Within this context, the regulatory framework for public-private partnerships and the reduction of technical barriers to trade should be as well considered. Moreover, the cooperation between regional businesses and regional institutions should be enhanced in order to harmonize reform efforts among member states of such

institutions. As a result, new business opportunities can originate by expanding regional trade and new value chains can be developed and enhanced. He pointed out that also the non tradable sector can be a mean to support local markets and to contribute to the development of ACP countries. Concerning SMEs access to financial and non financial services, he stressed their importance in order for ACP enterprises to upgrade to international standards and recalled that in the past those services were more supply than demand driven. Currently, private financial service providers are emerging, but they are still limited both in number and for the relevance of the services offered. In his words, finding a way to deepen the access to such services in rural areas is a big challenge. Finally, he remarked that horizontal and vertical business linkages are to be considered the core of the value chains and a tool to create opportunities for the formation of clusters for SMEs, thus originating competitive advantages. Mr Marangoni pointed out that in the past African SMEs have been unable to work together due to the absence of strong institutions to facilitate such linkages. He emphasized that governments and donors should promote the creation of clusters by supporting infrastructure and providing subsidies and tax incentives. At the national level, SMEs and policy makers should work together and international technical assistance should be directed to improve business environment, production standards and create market linkages.

Dr. Hansjörg Neun, director of CTA, remarked that two preconditions are necessary for ACP local producers to export their products to foreign countries, particularly to Europe: the existence of an operational local market and the presence of the local producers on the regional market. Dr Neun stressed that only if these two elements are in place, export flows are can be envisaged and concerns about quality standards and financial requisites can be raised. He then remarked that each country has to define the best level of development to improve the livelihood oh its population and, on a similar basis, it is necessary to define the appropriateness of upgrading for those SMEs that will be able to participate in the local, regional and international markets.

Challenges for SMEs in agriculture

Alberto Portugal Pérez, from the Development Economics Research Group at the World Bank, addressed the impact of the financial crisis on trade

and foreign investment in ACP countries, providing some recently issued data. The financial crisis, he explained, has been inflicting an havoc on the global economy: since the outset of the crisis trade has fallen drastically, with world trade dropping by 30% on average in the first quarter of 2009.

The decline has been widespread across countries and products, largely reflecting the sharp drop in global demand, and exports from ACP countries made no exception. Recent data on the exports to the US, EU and Japan show that ACP exports flows to these markets, which account for more than half of ACP exports value, dropped more considerably than exports of other developing countries taken as a block. This trend has been accentuated by the sharp decline both in the demand and prices of the commodities they export. Foreign investment to ACP countries has also been expected to diminish sharply. The combination of foreign companies' reduced profit margins, difficult financing conditions and volatile commodities prices (of concern since FDI in ACP countries is heavily concentrated in natural resource sectors) have triggered a cut in FDI commitments for 2009–2012. Against this background, Mr Peres stressed that SMEs play a significant role in all economies, are key generators of employment and income and drivers of innovation and growth. Given their importance, they are essential for economic recovery. As a result of the crisis, SMEs have been confronted to a double shock: a dramatic drop in the demand for their goods and services and a tightening in their access to finance. Provided that access to finance remains one of the most important challenges for the creation, survival and growth of SMEs, the crisis has exacerbated this problem. In his words, among the policies supporting SMEs, a distinction should be made between policies addressing firm-specific constraints (technology upgrading, promotion of quality control, market development, network formation, and export promotion, skills development for workers, etc) and economy-wide policies to improve the business climate (regulatory reform, transparency, etc.). In this context trade enabling policies - such as trade facilitation granting preferential market access to ACP exporters - can be effective to counter falling trade flows as they can increase access to foreign markets and exports value, thus expanding the benefits of trade for SMEs. Moreover these policies can also have an impact on SMEs producing non-tradable intermediates and services.

Rafik Feki, from the Productivity, Quality, Enterprise Upgrading Unit of UNIDO, discussed the issues and challenges of SMEs competitiveness and upgrading. In an increasingly vulnerable and unpredictable

economic climate, hit by various crises (food, financial, climate, health, real estate, etc.) which have affected numerous sectors and countries, the agricultural and food-processing industry is undergoing far-reaching structural changes due to the globalisation of markets and changes in demand, which originated technological developments and changes in production processes. Despite the efforts made in recent years with a view to helping developing countries – and in particular ACP countries – to build a more competitive industry capable of positioning itself on international markets, the gap between the level of competitiveness of the sector in these countries, mainly made of SMEs, and that of developed countries is constantly growing. Apart from commercial infrastructures which are often weak, many SMEs in developing countries also lack the capacities to produce competitive goods which comply with the increasingly strict requirements of retailers and importing countries, with particular regard to product quality, food safety, the environment and working conditions. Moreover, as a consequence of the opening up of the markets, these SMEs start suffering the effects of competition, even on local and regional markets, with the more competitive imported products.

Restructuring and upgrading the industry in the ACP countries is, therefore, an indispensable pre-requisite for ensuring their integration in the global trading system. According to Mr Feki, SMEs in the ACP countries must overcome constraints linked to productive and supply capacities and reinforce their bargaining capacities in order to improve trade relations and comply with the various standards in force.

In order to support the sector in ACP countries in this endeavor, the UNIDO is implementing a 3Cs approach which focuses on: i) enhancing the productive capacities of companies (C); ii) the conformity (C) of their products with standards and iii) market requirements and the connectivity (C) of these companies to markets.

In order to help SMEs to boost their competitiveness, the approach adopted is based on supporting the development of upgrading policies at the national level, by adapting institutional and regulatory mechanisms, strengthening the capacities of support structures, creating national expertise in upgrading and developing pilot projects to support companies.

SMEs in these countries have been able to benefit from strategic analyses which have enabled them to identify their strengths and weaknesses and define an action plan to improve their competitiveness. These companies also enjoy technical assistance and supervision on the implementation of these action plans.

The implementation of the upgrading plan, which is generally composed of capital and intangible investments helps to boost the capacities of the beneficiary companies. By mean of capital investments these plans should include activities relating to the modernisation of production facilities, the acquisition of laboratory equipment, the enhancement of IT systems, the improvement of storage and transport conditions, etc. With regard to intangible investments, the companies benefit from technical assistance focusing on different functions, like improving information systems, improving hygiene and working conditions, putting in place a quality and food safety management system, etc.

Professor Carlo Pietrobelli, Professor of Economics at University of Roma Tre, Italy briefed participants on the role of Clusters, Value Chains and Technological Capabilities Building.

He pointed out that in the present context of globalization, and even more in the current economic and financial crisis, the pressure to compete is especially strong for SMEs in developing countries. In addition, being "competitive" is often not enough, as the benefits deriving from exporting successfully are not equally distributed among the actors of

international trade, and therefore competitiveness needs to be looked at together with "upgrading", or getting a better deal from competitiveness. This in turn requires a remarkable process of innovation, which can take the form of upgrading of products, of processes, of functions carried out by firms, or that of inter-sectoral upgrading. The idea behind this approach is that the scope and extent of benefits deriving from international trade and competitiveness are not equally distributed among countries and firms, and that some activities and business functions offer better opportunities and generate larger "rents".

However, the upgrading potential of SMEs – as well as that of small farmers - often remains untapped, as they operate in isolation, are locked into uncompetitive production patterns and are unable to approach dynamic business partners that could bring in new expertise and know how. How can SMEs overcome this isolation, and operate in a business environment more favorable for their process of upgrading? The answer lays in two related and interdependent strategies: develop the linkages with local and distant partners, and invest in the creation and strengthening of technological capabilities. In the 1980s "clusters" of small firms were "discovered" in industrial countries, and their economic performance was studied to understand its determinants. Clusters and networks of small firms became of economic interest to policy-makers, donors and international organizations because they enjoy the collective efficiency that is produced by the (complex) equilibrium between competition and cooperation, and that is itself the result of external economies and joint actions. However, while the former (external economies) occur automatically and are associated to productive agglomeration, the latter (joint actions) are harder to achieve, but in turn produce the largest benefits. Since then, policies and programmes were carried out to support enterprise clusters and networks.

Since the late 1990s another paradigm of productive organization emerged, and the existence of the so-called "Global Value Chains" (GVC) was noticed. Indeed, small farmers and producers in developing countries had to interact more and more with larger firms and buyers, and access to international markets was often governed by these players and the standards and requirements they impose. Today global value chains are present in developing countries because of changes in national and international regulatory frameworks and in technology and management practices. They often represent one of the few options for local firms and suppliers to get access to larger markets and to new technologies.

Moreover, they choose different forms of governance - i.e. organization and coordination, but also distribution of power and rents - which in turn affect the upgrading perspectives of local small firms.

While the potential benefits from GVCs for medium-income developing and emerging countries are well documented, the studies dealing with the impacts of GVCs on low-income, poorer developing countries such as the ACP are scarce. Clearly, access to these value chains per se does not guarantee much, and efforts to develop local technological capabilities are essential. How can SMEs and small farmers benefit from such linkages?

During the **debate of panel 1,** chaired by Mr. Paul Engel, director of ECDPM - the European Centre for Development Policy Management in Maastricht, key issues raised were the role of quality as an essential element that ACP products should integrate and the need for infrastructure in order for SMEs to meet quality standards. Another key point raised was the development of local and regional markets for agri-food products and the need to upgrade these products, at the national level in order to meet exporting standards and to enable these products access the value chains.

The need to take into account the South-South dimension of the food crisis was also pointed out. Keeping in mind the regional and local dimension, international organizations' and governments' efforts should focus on ensuring safety nets and covering basic needs for vulnerable population, therefore contributing to the redistribution of food and creating new demand or local SMEs.
The need to help local businesses in ACP countries becoming more competitive on their local market has been emphasized, since they start facing the competition of the European imports. Consequently, strengthening capacities of local agricultural SMEs in order to remain competitive on the local and regional markets is key and needs additional upgrading of quality standards.
It was pointed out that improving efficiency of local SMEs is a tool to strengthen domestic and regional markets; domestic markets better serve the nutritional purposes of a number of countries and this can be achieved by improving the national standards infrastructure. Moreover, SMEs and the development of private sector are part of poverty reduction programs and enhancing the capabilities of firms and small farmers contribute to sustainable development and reduce the reliability on external resources.
Another remark was that SMEs in developing countries seem to live in a permanent credit crunch and concerns on how to provide better credit to SMEs and which are the possible ways to overcome challenges were raised. The situation of credit crunch at SME level in developing countries is not new: should put in place measures and policies to make their economies more attractive and as a result create a better business environment.
The role of information and communication in raising awareness among SMEs concerning their role in the policy making process was also raised. Furthermore, with alternative forms of energy offered by agricultural products feeding the population represents a challenge for SMEs in the agricultural sector.
Finally, two additional elements were brought to the discussion: the regional integration processes in Africa and the need to benefit from assistance from the public sector and donors to further develop clusters, achieve standards to compete on international markets.

New opportunities for the ACP private sector in times of crisis

Vincenzo Galastro, from IFAD illustrated the African Agriculture Fund (AAF), an initiative of the Agence Française de Développement (AFD), the African Development Bank (ADB), the Alliance for a Green Revolution in Africa (AGRA), the International Fund for Agricultural Development (IFAD) and the West-Africa Development Bank (BOAD). The Fund is a new US$ 500 million private equity fund established to focus on food production and distribution throughout the continent of Africa.

Mr Galastro explained that the Fund seeks to address a « missing middle » in African agro-enterprises, notably providing private equity (1 to 10 millions $ investments) and venture capital (> 1 million $ investments) to African agro-enterprises, two categories of investments which are not available. The Fund will target the entire range of food related agribusiness from primary agriculture, through processing to services and infrastructure. In addition to the main large scale private equity transactions, the Fund will include a team focused on investing 20% of the Fund in SMEs and rural micro-finance. 80% of the Fund will be invested in large-scale private equity transactions; with 20% spread across SMEs and rural micro-finance.
The Fund, Mr Galastro explained, foresee three main categories of investment financing: i) Equity and quasi equity products; ii) Two windows of financing enterprises: a small-medium size company financing window offering investment between US$ 0.15 M and US $4M and a large company financing window for investment up to US$15M and iii) a Technical Assistance Facility (TAF) aimed at strengthening the management and the technical capacities of small scale farmers and SMEs to access to the resources of the AAF and of the business development financing and at developing the capacities of the agricultural financial sector in order to provide efficient services to SMEs). Up to US$ 13 million has been earmarked as donor funding to the AAF as a Technical Assistance Facility.

André Dellevoet, Executive Manager of the Africa Enterprise Challenge Fund (AECF), illustrated the experience of the AECF which goal is to promote pro-poor growth in Africa, thereby increasing employment, livelihood opportunities and incomes and to reduce poverty. Its purpose is to catalyse private sector entrepreneurs in Africa to innovate and find profitable ways of improving market access and functioning for the poor – especially in rural areas. The AECF will focus on sectors particularly important to the poor - finance and agribusiness. The (repayable) grants will support innovative ways of expanding financial services to rural areas and new ways of distribution to reach poor clients. In the past, Mr Dellevoet explained, similar programmes have been successful in delivering banking (i.e. savings, loans and transactional services) and non-bank (i.e. insurance) financial services to consumers in rural areas using innovative distribution methods and technology solutions. Improved access to financial services benefits the poor directly, as users of these services and indirectly, through financial deepening which is a causal factor in increasing growth and the incomes of the poor. In the agribusiness sector, grants from the previous challenge funds were successful in catalysing local supply chains, creating effective demand for the produce of smallholder farmers and supporting firms that provide intermediary services to small farmers and better access to input and output markets and transfer knowledge (extension) and information; and introducing new production methods and establishing local production processes where none existed before. These interventions directly benefited large numbers of the poor as producers, as well as employees of rural farmers and agribusinesses. The indirect benefit of these projects was also substantial through replication. Within these sectors, the focus will be on pushing forward innovation frontiers touching rural areas. This could include projects with an entirely rural focus or projects that would benefit both the rural and urban poor. Mr Dellevoet underlined that the first projects under the AECF seem to confirm the soundness of this approach and provided some examples:

1) Moninet; the introduction of innovative mobile banking and payment services in East-Africa, benefiting some 800.000 clients with access to financial services at a reasonable cost by the end of year 3 of the project;

2) The Ghana Grain Partnership; the development of a maize value chain in Ghana, which will benefit 10.000 smallholders by substantially increasing their incomes;

3) Smallholder cocoa improvement in Sierra Leone; benefitting 16.000 farmers by increasing their incomes;

In his words, during the first year of the AECF's operations, the Fund has already built up a portfolio that will benefit over 4 million smallholders and their families. The donors who have already agreed to contribute to the AECF are the African Development Bank (AfDB), the Consultative Group to Assist the Poor (CGAP), the UK Department for International Development (DfID), International Fund for Agricultural Development (IFAD), and the Netherlands Ministry of Foreign Affairs, (NMFA). Other donors may join in due course. Until now, the Fund disposes of a start-up capital of 36 million USD. It is hoped that this will grow to 100 million USD in 3 years.

Experiences from the private sector: scope and need for upgrading

In panel 2, three SMEs from Africa and the Caribbean presented their concrete experience and illustrated their successful strategies as to increase market access. Mr Hasit Shah briefed participants on the experience of the **Sunripe Group** from Kenya, an independent grower, processor and exporter of fresh fruits, flowers, vegetables & Organics. Sunripe is a

vertically integrated diversified group of companies that incorporate farming, processing, freight and logistics, and serve over 25 nations with fresh produce daily. The group has gained significant experience over the past 40 years in the organic, horticulture and floriculture industry and remains a dominant player within East Africa being the largest exporter of fresh organics from the region. The group employs over 2200 persons who produce, process, pack and export about 40 product lines of fresh vegetables, fruit and flowers to 25 countries year round and ensures sustainable production with total regard for the environment. All products meet all aspects of food safety, security and legal requirements for each country: BRC, ECOCERT, LEAF and GLOBALGAP and are the largest exporter of fresh organics from East Africa. Part of the vertical integration involves total control of the logistics chain and as a result our Freight In Time (FIT) was developed. FIT now has freight operations in Burundi, Rwanda, S. Sudan, Tanzania, Kenya and Uganda.

Mr Shah explained that the company re-invests all profits to ensure R&D supports newest product lines and invest into the cold chain and farming/processing operations. All packhouses are BRC higher level accredited and the majority of the production is GLOBALGAP compliant. In Mr Shah words, working in 25 countries requires a good understanding of clients needs and delivering product 52 weeks of the year. This requires massive planning and farming over a 1000 km radius and involves value addition at the processing plants. The company works closely with research institutions and technical teams to implement IPM practices where possible to reduce the use of crop protection chemicals. The company is committed to reduce emissions, increase recycling of waste and ensure proper crop rotations, tree planting, water harvesting, reduction in packaging and reduced use of energy.

Mr Denis Noel illustrated the experience of **Noelville Ltd.**, a family owned company in

Grenada, producing herbal and organic products. The logic behind is to overcome the fact that often developing countries export raw materials, as coco and nutmegs, and import finished products at a higher price. As managing director of the company, Mr. Denis Noel illustrated an alternative use of nutmeg, traditionally known as a food item, which his company employs to produce pain relief products. He pointed out the success of his products in countries like Russia, Australia etc. and called for assistance in his efforts to get access to the EU market. Mr. Noel insisted on the fact that a lot of agricultural products can have different uses, other than food, and highlighted the need for R&D notably in the herbal sector. In his words proper planning this sector could contribute significantly to the development of Caribbean economies and bring substantial benefits to the region.

Ms Juliette Newell, Managing Director of **Tijule Ltd.,** presented the experience of her company, a medium-size Jamaican agro-processing company which has

been processing exotic fruits and vegetables for export since 1984. The primary objective of Tijule, Ms Newell, stressed, is the use of local raw materials and the generation of employment in an area characterized by a low education status. She recalled that the company has faced from the beginning several challenges as the lack of funds, equipment, market and financing related problems but she managed to overcome them. Although the SME is trying to maintain high quality standards as it exports 90% of the production, it has stricken by the economic crisis. For that reason, Ms Newell stressed the need for financial assistance in order to upgrade her company in terms of training, market research to develop new products, support in maintaining their certifications which at present are obtained on an annual basis, reorganizing the factory layout to bring it to international standards and improve efficiency.

During the **debate of the panel 2** chaired by

Mabousso Thiam, Director of CDE, the issue of the role smallholders can play for SMEs and SMEs contribution to poverty reduction were raised. Mr. Shah from Sunripe Company in Kenya pointed out that working with smallholders is indeed difficult but his company managed to create a long term relationship with these actors by regrouping them in small clusters, and ensuring the technical assistance necessary for them to grow the crops. Setting up fixed programmes and fixed prices helped them avoid speculations and insured a fair share for the small producers.
Ambassador of Grenada stressed that SMEs is often seen as a sector with a high rate of failure and called for some testimonies on South-South cooperation. In response Mr. Paul Engel argued that at some point it is important to cope with failures in order to build capacities, innovate and develop new businesses. On this point Mr. Shah's added that lack of capitalization represents the first reason for which businesses didn't succeed in Africa. Incidence costs are very high and should be better taken into account when starting a business on the continent. A second big problem for SMEs failure is the cash flow management. It was also pointed out that when it comes to South-South trade flows (with Russia, Middle East, India) the obstacles faced in accessing the European markets disappear, the requirements are less exigent and the payments are higher. Moreover, competition policies should ensure that different actors in the value chain got a fair share and that relationships between bigger and smaller players in the value chains have to be mediated by promoting Business Models in the interest of all actors. Finally, the issue of according financial assistance in dollars to SMEs that are not exporting and therefore are not able to sustain the debt in the long term was raised. From his point of view, Mr. Shah recognized that since the two main currencies collapsed (€, £) his company tried with different financial institutions to put in place instruments in order to mitigate exchange risks, but no concrete results were obtained up-to-now.

H.E. Mr. Patrick I. Gomes, Ambassador of Guyana drew the conclusions of the Briefing. In his words, a full understanding of the context of local, regional and international markets in terms of impacts and consequences in terms of access to capital and innovation is essential. SMEs represent vectors that will drive agriculture and rural development. A strong

interrelation between small farmers, R&D, innovation, diffusion will generate value and reinforce the value chain. It is imperative to have stakeholders involved in the policy making process at all levels and notably at early stages. Continuity, H.E. Mr. Gomes stressed, is the key element. Learning from past experiences, success stories and bringing them at international level create benchmarks and lead to further innovation. Finally, he reiterated that the understanding of the context represents an important precondition for success since, even if new opportunities like the South-South trade appear, challenges will always emerge.

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