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A framework to facilitate institutional arrangements for smallholder supply in developing countries: An agribusiness perspective

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Abstract

The industrialization of agriculture and the potential problem of small-scale farmer marginalization calls for a fresh approach to the design of agribusiness supply chain arrangements in developing countries. The objective of the paper is to contribute to a better understanding of institutional arrangements that can promote stable smallholder agribusiness contracting arrangements in a developing country context. A case study approach, incorporating a transaction cost framework, is used to test whether trust can significantly change the contract characteristics of supply. The results suggest that although the presence of trust can influence the contract characteristics of a supply arrangement, it may not be significant because of other factors in a developing country context. Bearing this in mind, a number of institutional arrangements are recommended in order to promote more stable contract conditions.

Keywords: Smallholder; Transaction characteristics; Trust; Power

Introduction

The industrialization of agriculture in many developed countries has resulted in the tighter alignment of supply chains and promoted the emergence of fewer larger farms.

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It has been suggested that this trend could exclude small-scale farmers in developing countries from profitable niche markets. In this respect, it is also argued that smaller operations, not linked with agribusiness, will have increasing difficulty in gaining the economies of size and the access to technology that is required in order to be competitive (Kandiwa, 1999; Boehlje and Doering, 2000; Reardon and Barrett, 2000; Stanton, 2000; Unneveher, 2000). Furthermore, it is often problematic for agribusiness to ignore larger suppliers and include small-scale farmers in high risk supply chains because of the incremental transaction cost (Runsten and Key, 1996; Rehber, 1998; Key and Runsten, 1999; Kirsten and Sartorius, 2002).

This reality, combined with the search for appropriate policy options for pro-poor agricultural growth, provides a major challenge in many developing countries. The objective of the paper is to contribute to a better understanding of the variables that influence the preferred choice of smallholder-agribusiness contracting arrangements in a developing country context. More specifically, this paper will demonstrate how trust and other conditions can influence the structure and cost of smallholder contracting supply arrangements. The principal research question is whether an investment in trust in a smallholder-agribusiness raw commodity supply arrangement can significantly influence the choice of the most suitable contract arrangement in high risk conditions. This paper argues that agribusiness firms in developing countries can make a major contribution in assisting smallholders to overcome the barriers of entry to the commercial farm sector. Our paper, which takes an agribusiness perspective of the problem, provides a complimentary approach to the policy options and institutional arrangements for pro-poor growth suggested by Dorward et al. (2004). In addition, it contributes a further perspective to the operationalization of transaction cost economics that is complimentary to the approach of Williamson (2000).

The importance of looking for ways to successfully include smallholders in the agribusiness supply chains of developing countries is underlined by the high rate of failure of small-scale farmer contracting projects in these countries (Watts, 1994; Little, 1994; Glover, 1994; Von Braun and Kennedy, 1994; Runsten and Key, 1996; Delgado, 1999). In this regard, the problem of smallholder exclusion is especially problematic in Southern Africa where historical legacies have contributed to the exclusion of small-scale black farmers in the commercial farm sector (Bundy, 1979; Kirsten and van Zyl, 1996; Mbonga et al., 1990; Machethe et al., 1997; Van Zyl and Kirsten, 1999).

The study uses a case study methodology to test the principal research question because of the qualitative nature of the data, as well as the opportunity to explore a wider range of variables that influence the success of smallholder contracting arrangements with an agribusiness partner. A case study in the sugarcane and timber sectors was specifically selected because both of these industries have a long history in Southern Africa of engaging with small-scale suppliers.

An outline of the remainder of the study is as follows: Section "A transaction cost framework" develops a transaction cost framework that can be applied to the analysis of the case study. Section "The transaction cost of supply: a case study in the southern african sugar and timber industries" introduces a case study in the sugar and timber industries of Southern Africa. Section "Does the level of trust significantly influence the choice of contract structure?" tests the principal research question. Section "Institutional arrangements and policy to reduce transaction cost" suggests some institutional arrangements and finally, Section "Summary and conclusion" outlines a summary and conclusion and the direction of future research.