

Outgrower schemes

This note provides guidance on the design and implementation of outgrower schemes to achieve mutually beneficial outcomes for investors and smallholders.

Outgrower schemes have gained prominence as a business model that can benefit both smallholders and investors. Such schemes can improve smallholders' access to markets, finance, infrastructure, and improved growing techniques; can enhance investors' access to land, labor, and quality produce; and can improve investor–community relations. Associated risks include overdependency, exploitation of power differences, entrenchment of inequalities, lower-than-expected production, and side-selling. Achieving the potential benefits and minimizing the associated risks requires careful design and implementation.



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RESPONSIBLE AGRICULTURAL INVESTMENT (RAI)

KNOWLEDGE INTO ACTION NOTES

The **UNCTAD–World Bank Knowledge Into Action Note Series** is a compendium of practical, thematic guidance documents for use by governments, investors, and other stakeholders in the implementation of responsible agricultural investment principles. Background and a complete list of notes are in *Note 1: Introduction*.



WHAT DOES FIELD RESEARCH SHOW?

Diverse modes. Schemes vary considerably, ranging from nucleus estate models that combine investor and outgrower production, to pure marketing contracts in which the farmer manages inputs and retains ownership up to the point of sale to the investor. All models involve mutual commitment and sharing of risk between smallholders and investors, thus requiring careful management of the complex relationships between smallholders, investors, and local communities that have differing capabilities, knowledge, expectations, priorities, and interests.

Diverse outcomes. Outgrower schemes have been operated with varying degrees of success. At their best, these models ensure that local growers benefit from the presence of commercial investors by facilitating access to markets and finance, improving postharvest storage and transportation, and rewarding improved farming practices. Equally, investors gain access to land, labor, and good-quality produce. Well-designed and executed schemes build trust between investors and communities and promote good working relationships. At their worst, these schemes create dependence on the investor (which can do more harm than good if the investor fails and leaves); growers can be financially constrained by reliance on expensive inputs; investors may exploit power differences in quality assessment and pricing mechanisms for products. From the investor perspective, a major risk is that the quality and quantity of required produce is not supplied, often due to side-selling, such that investors do not benefit from the resources employed in training outgrowers and supplying inputs.

Unsuccessful investments. An early and realistic assessment of investor capabilities and the viability of the proposed business model is important (see *Note 6: Screening prospective investors*). Many investors faced financial and/or operational difficulties, especially when introducing new business models or crops to a region. This in turn exposed outgrowers to risk as they had come to depend on investors as buyers for their produce.

Projects running into difficulty were not always able to fulfill promises about procurement and prices. Projects that had a clear business model and built upon existing initiatives and established capabilities were more likely to be successful. In some cases, investors waited to introduce outgrowers until the overall viability of the business model had been proven.

Dialogue and consultation. The design and implementation of schemes had substantial impacts on smallholder and community welfare. There is a strong social and financial case for proper conduct of consultations with communities and other external stakeholders, and this has financial and operational benefits for investors. Trusted intermediaries can play a role in this process (box 1). As with broader consultations, there is a risk of entrenching existing power structures by speaking only with the wealthiest or most developed smallholders. Attention needs to be given to integrating marginalized smallholders into the process (for further information, see *Note 15: Community engagement strategies*). Negotiation and design of the contract with outgrowers is also important, and guidance is available for both investors and outgrowers on suitable contractual arrangements (see References and resources).

Box 1. Examples of good practice identified in the fieldwork

Trusted intermediaries. The presence of trusted third parties, such as public interest lawyers or nongovernmental organizations, helps to mitigate the power differences between the negotiating parties, as well as promote more inclusive consultations and beneficial outcomes. This presence was, however, rare in the consultations observed in the fieldwork. For a rice investment in Ghana, the community itself employed lawyers to help draft an agreement following consultations; the lawyers also acted to ensure that all members of the community understood and were satisfied with the terms.

Price negotiations. In Indonesia, the price paid in each region for fresh fruit bunches of palm oil is set monthly through a multistakeholder process, involving members of the provincial plantation agriculture department, company management, and representatives of cooperatives. Those present use a predetermined formula to fix the price; and one variable, the oil extraction rate, is the subject of much negotiation each month. Once a price is agreed, a formal notification is signed by the government, company, and outgrower representatives, obliging the investor to pay the set price.

Microfinance. An investor signed an agreement with microfinance institutions to provide farmers associations with loans. In the first year (2012) 148 loans were made, followed by 885 in the second year. These loans were used for a variety of purposes, among them buying computers and other equipment, and covering plowing costs, which were US\$19–23 per acre. The level of loan recovery was 95 and 98 percent respectively.

Source: UNCTAD–World Bank Survey of Responsible Agricultural Investment Database.

Land use and land rights. The need for clarity on both sides is particularly important in regard to access to land and the rights of the communities and individuals involved. Disagreements about land can undermine trust and lead to extensive delays and negative long-term consequences for both businesses and local communities.

Price determination and quality assessment. Outgrower schemes should benefit farmers through more stable prices and reliable, timely payments. Price determination and quality assessment are, not surprisingly, contentious issues. Many options for price determination are applied (for example, spot market prices, direct negotiation, pre-agreed schedule of prices linked to quality and/or volume delivered, revenue-sharing formula, and government rates). Careful consideration of the appropriate pricing mechanism is required, drawing on existing guidance documents (see References and resources). Of fundamental importance is that outgrowers understand the price determination mechanism and perceive it as fair and transparent (see box 1).

Improving performance. If productivity and quality can be increased through the scheme, then both outgrowers and investors benefit. Achieving this requires multiple initiatives on the part of the investor, the government or both, including provision of training and extension services, access to finance, and production inputs (such as seeds, fertilizer, and machinery). Access to finance was a major constraint for most outgrowers, and several investors operated financing schemes to help outgrowers afford inputs. Carefully designed incentives such as quality-based pricing and options for purchasing additional product can induce outgrowers to improve performance and can minimize the risk of side-selling.

Managing uncertainty. Agriculture investment and production takes place in an inherently unpredictable environment. Few schemes had adequate risk management or mitigation strategies in place. Fair and clear contracts contributed to more stable schemes, especially when complemented by sustained, regular engagement between investors and outgrower. In some cases, this interaction has been successfully supported by government and/or civil society organizations. In some countries, agricultural insurance has been incorporated into outgrower agreements to help share risk, particularly against force majeure events. There was no evidence of such insurance in the investments, which is indicative of the underdevelopment of insurance markets in the countries of operation.

Flexible arrangements. Given the inherent uncertainties in markets and production, adjustments are often required to investment schemes and to the contractual arrangements between outgrowers and investors. Transparent adjustment processes and mechanisms are essential to maintain trust. For example, some contracts included the potential for renegotiation of certain elements of the contract to be included in the agreement if obligations cannot be met for reasons beyond the control of either party.

Grievance and disputes. Even where consultation and dialogue with outgrowers was effective, grievances and disputes inevitably occurred. Contractual arrangements that included grievance mechanisms and clear dispute resolution procedures were better able to deal with issues in a fair and transparent manner, to mutual acceptability (See *Note 19: Grievance redress mechanism*).

Community organization. Investors are more able to engage effectively with communities and farmers when local organizations—such as farmers associations—are strong, often supported by civil society organizations. One site in Tanzania employed large numbers of outgrowers who were initially represented by a handful of farmer associations, based on geographic location. Over time, weak governance and management of the associations caused fragmentation into many separate groups. This created logistical problems for the investor to co-ordinate and negotiate with different groups, increasing costs of the business model.

Incorporating marginalized groups. The smallholders most likely to participate in outgrower schemes are those who already have the most resources or skills, so the schemes risk entrenching existing inequalities. Marginalized groups and, in particular, women are less likely to be involved. In 24 projects studied by the World Bank and UNCTAD, only 15 percent of outgrowers were women.

✓ ELEMENTS OF GOOD PRACTICE FOR INVESTORS

Initial stakeholder consultation. Investors should develop a strong relationship with outgrowers based on trust and communicate repeatedly and effectively with them about the company's future developments, to avoid raising expectations unrealistically (box 2). This is particularly important during the planning of the scheme, during the contract negotiation and signing stages (see *Note 15: Community engagement strategies*).

Ongoing dialogue. It is important to establish effective forums for communication between investors and outgrowers to build trust and reduce the chances of disputes arising.

Clear and fair contracts. Investors should draw on existing guidance documents (see References and resources) to develop fair contracts with outgrowers and should ensure that outgrowers understand and agree with the conditions therein (see *Note 8: Investment contracts*). Procedures for adjusting contracts and sharing risks and benefits should be established at the outset.

Monitoring, grievance mechanisms, and dispute resolution. Contractual agreements need to be followed up with monitoring and clear mechanisms for resolving disputes and/or redressing grievances, such as mediation or arbitration, to enable disputes to be resolved quickly when they arise. Further guidance on contractual form and content is available in FAO (2017a).

Land use and access. Investors must understand the complexities of land use and access to land, particularly when land users may not have clear legal claims. As well as working closely with governments and local communities, investors should also consider working through trusted third parties such as public interest lawyers and nongovernmental organizations (see *Note 11: Respecting land rights and averting land disputes*).

Project phasing. In some cases, it is advisable to phase project implementation, to build on existing experience and scale up gradually.

Pricing mechanisms. Investors should adopt fair and transparent pricing mechanisms and procedures for assessing the quality of produce. This also means that ensuring that outgrowers understand and accept those mechanisms and procedures.

Technical support. Provision of technical support to outgrowers is advisable, including follow-up visits, to ensure improved output, quality, and incomes. Moreover, investors can achieve more effective technology transfer by mainstreaming outgrower schemes into project design and by identifying and acting on gaps in knowledge and specific training needs (as well as gaps in capital requirements for adopting the requisite technologies) (see *Note 23: Technology transfer*).

Access to finance. Investors can improve access to finance for proposed outgrowers, including devising mechanisms to improve outgrowers' ability to afford loans taken.

Integration of women and marginalized groups. Consider specific programs to improve the participation rates of women and other marginalized groups (see *Note 20: Empowering women* and *Note 21: Participation of youth*).

Box 2. Key requirements for successful outgrower schemes

- Careful pre-investment evaluations of the business plan, sustainability, and benefits for participating farmers and communities
- Early-stage community consultation, particularly with respect to community impacts and access to land
- Written contracts, with effective monitoring and grievance procedures
- Efforts at multiple levels to improve the productivity and quality achieved by smallholders
- Processes for managing risk in responding to changing circumstances
- Support for community engagement and capacity to engage

Source: UNCTAD and World Bank.

✓ ELEMENTS OF GOOD PRACTICE FOR GOVERNMENTS

Project assessment. Governments should, as part of screening procedures, assess the financial capacity, agricultural experience, and technical expertise of potential investors as well as their experience and capacity in dealing with local communities (see *Note 6: Screening prospective investors*). The business plan should be assessed for its sustainability and viability, as well as its congruence with local and national development goals. The most successful investors are those with long-term practical experience and a successful track record in agribusiness in developing countries.

Contractual agreements. For some business models, it may be appropriate to annex the agreement between investor and outgrowers to the overall investment agreement between the government and the investor. Investors should be encouraged to make investments that contractually commit to developing outgrower schemes where these are appropriate for the enterprise.

Monitoring. The performance of investors and outgrower schemes should be regularly monitored, against agreed measures (see *Note 9: Monitoring investments*).

Enabling environment. Governments should draw on existing guidance (such as FAO, 2017a and 2017b) to create a stable, conducive environment for the operation of agricultural investments that employ outgrower schemes. (For guidance on the overall environment for agricultural investment, see *Note 5: Creating an enabling environment*.)

Integration of women and marginalized groups. Concerted strategies should be developed to include those marginalized groups that are unlikely to benefit from investments without a targeted intervention—for example, women, youth, and inward migrants (see *Note 20: Empowering women* and *Note 21: Participation of youth*).

Engage civil society and farmers associations. Governments should encourage other actors, including civil society organizations and farmers associations, to assist both investors and communities in building relationships and establishing mutually beneficial outcomes.

Community engagement. Help to develop the capacity of communities and outgrowers (current and prospective) should be provided to enable communities to engage with investors and with governments.

Insurance markets. Support should be provided to develop agricultural insurance markets that can provide outgrowers and investors with protection against force majeure events.

REFERENCES AND RESOURCES

This Note is complementary to the literature and guidance documents to which many organizations have contributed, a selection of which is provided below. Further resources are provided in *Note 2: Additional resources*.

AGDEVCO (2017). [Smallholder Outgrower Schemes](#). (AgDevCo: London).

BMZ, FEDERAL MINISTRY FOR ECONOMIC COOPERATION AND DEVELOPMENT. (2013). [Contract Farming Handbook: A Practical Guide for Linking Small-Scale Producers and Buyers through Business Model Innovation](#). (GIZ: Berlin).

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