An Overview of Sector Governance



Looking beyond the value chain to build high performing and resilient agriculture sectors

aidenvironment
iied
Sustainable Food Lab

Building high performing and resilient sectors requires looking beyond the value chain and improving the governance of a sector

The last two decades have seen an increasing emphasis on company and supply chain driven approaches to promote sustainable production and trade of agricultural commodities such as cocoa, coffee, cotton and staple crops. Some of these initiatives have achieved remarkable success, with benefits to both farmers and commercial partners. While they have resulted in 'islands of success', many others struggle with the systemic issues including price volatility, unaffordable—and therefore missing—services for farmers, and a lack of transparency. Increasingly, supply chain actors realize that to reach sustainability at scale, value chains need to be part of high performing and resilient sectors. To address the roots of poor performance, scaling up supply chain interventions alone is not sufficient. These challenges often require a coordinated approach that is valuable for the sector as a whole and also boosts the success of individual supply chain projects.

This paper will share our findings on how improved sector governance can drive sector transformation leading to stronger sector performance with benefits for traders, processors, exporters and which supports more sustainable livelihoods for farmers sector-wide. In this paper, we focus on smallholder dominated agricultural sectors, in which a sector refers to single commodity at national level. However, the authors believe that the principles of sector governance presented in this paper can also be applied at different intervention levels (e.g. a sub-national jurisdiction or landscape), multi-commodity contexts as well as agricultural sector governance in general.

Why does sector governance matter?

Agriculture and agricultural supply chains are still central to addressing rural poverty. Worldwide, more than 850 million people live on less than $1 per day. These poor households are concentrated in rural areas, and most of them depend on agriculture for a substantial part of their income. Strong sector governance can provide the conditions and incentives for small-scale farmers to produce with more benefit and less risk, contributing to poverty reduction and environmental protection. It can also help to provide a more stable sector that is more competitive and attractive for trader and agri-businesses supply chain investment.

This Overview of Sector Governance pulls from a larger report by the same authors which develops an analytical framework and analysed 13 case studies in different commodity-country contexts to obtain a better understanding of specific sector governance instruments and to support the development of a methodology to facilitate sector diagnostics from a governance and performance perspective. See Resources on page 10 for more information.

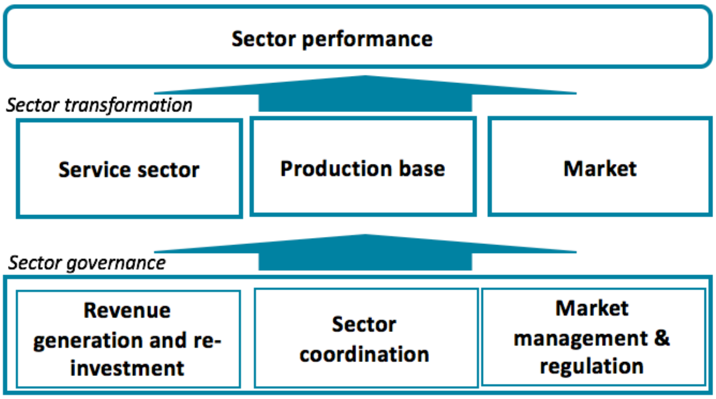
Defining sector governance

Sector governance is the coordinated management of a sector as a whole which can include a collection of rules, stakeholder involvement and processes to manage for common/shared interests. **Sector governance** is broader than government, covering non-state individuals and institutions, including the private sector. It has three main functions:

Sector coordination: Alignment of key stakeholders around a shared vision and strategy, monitoring of progress, and promotion of learning

Revenue generation and re-investment: Sector-led generation of revenues and re-investment in service delivery, the production base, market management and sector coordination

Market management and regulation: Systems and rules governing trade, price, quality, demand and supply, traceability, sustainability, producer organization and service provision



Sector transformation

Improving sector governance, in coordination with private sector and civil society investments, can contribute to the **transformation** of the:

Producer base: consisting of viable and sustainable production systems and the organization of producers around service delivery, market access and agency at sector level

Service sector: consisting of professional and inclusive service delivery models (e.g. research, extension, input provision and finance)

Market: consisting of mutually beneficial trading relationships, fair pricing, incentives for quality and sustainability, traceability

Sector performance

Sector governance, along with efforts of other actors, drives sector transformation, leading to improved **sector performance** in terms of:

- Competitiveness
- Inclusiveness
- Innovation & adaptation
- Resilience
- Resistance to rent seeking
- Profitability
- Transparency
- Sustainability

Why now?

Agri-business, NGOs and donors have largely focused interventions on the value chain in support of legal and standards compliance, sustainability, productivity, and quality. These initiatives often produce positive results, but do not bring the systemic changes that are required to tackle issues that can make or break sector performance, such as price volatility, natural resource depletion or long-term security of supply. Sector governance helps to drive a sector that can positively impact farmers and agri-business, as well as boost the success of individual supply chain projects aimed at improving sustainability, productivity and farmer livelihoods.

Common Sector Weakness

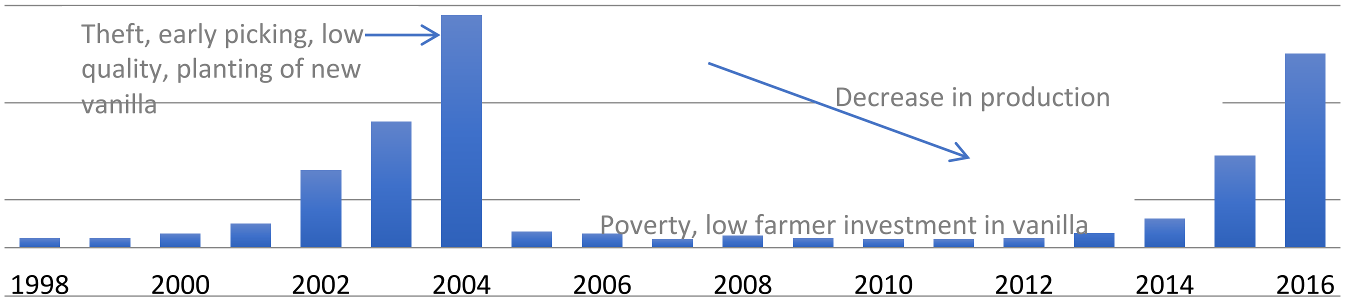
- Price volatility (boom & bust)
- Production volatility
- Poor quality management
- Weak organization of small-scale producers
- Poor service provision
- Informal trade
- Elite capture and rent-seeking

Negative Impacts

- Bad quality reputation
- Reduced security of supply
- Negative environmental and social impact
- Reduced incentives for supply chain and farmer investment in production
- Temporary “pilot project” life span and donor reliance
- Temporary lifespan of effective supply chain models
- Lack of revenue collection from informal trading
- Continued reputational risk for brands

The undermining effect of price volatility in the vanilla sector
Vanilla is an agroforestry crop well suited to small scale family farms in topical zones. Vanilla buying companies have steadily invested in programs with farmers to improve vanilla production and address challenges such as food insecurity (now reaching 20% of farmers). However, the sustainability of supply and livelihoods is challenged by extreme volatility, which is amplified by concentration in a single origin, vulnerability to cyclones, delays in supply and demand response, and lack of market information. When prices are high, quality suffers as trade in immature vanilla become commonplace. High prices and low quality reduce demand even as growers expand production. During resulting low price periods, farmers often face economic challenges and underinvest in production, leading to the next boom and bust cycle.

Madagascar Vanilla Boom & Bust Cycle



Sustainable Vanilla Initiative (SVI) ***– a new industry initiative that complements value chain programs by addressing sector governance***

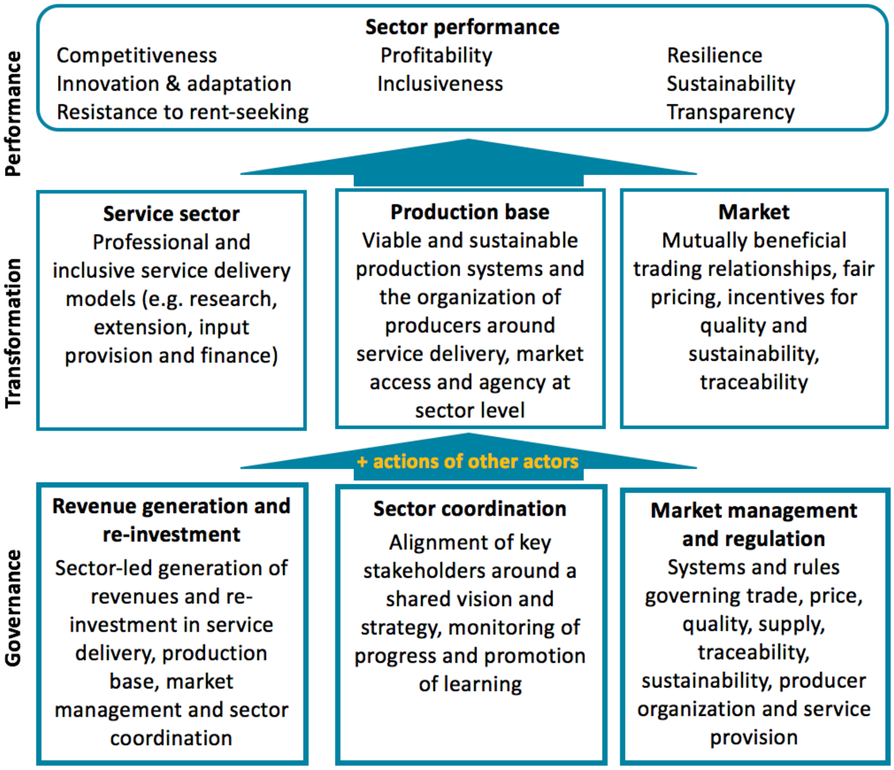
•*Sector Coordination*: SVI is working to strengthen local forums that can anchor cross sector dialogue and solutions

•*Sector Professionalization:* SVI is supporting private and public sector regulation to help “professionalize” the industry to protect quality and promote transparency, including: enforcement of campaign (harvest) dates, child labor code, quality standards, systems of registration.

•*Sector Stability:* SVI is working to support growth of production in multiple origins, greater transparency of market information, and other strategies to reduce volatility

Sector governance, along with efforts of other actors, drives sector transformation, leading to improved sector performance

Well-organized and coordinated sector governance that generates revenues and manages the foundations of the market – in combination with the investments and behaviors of actors throughout the supply chain – can lead to a better organized and effective service sector, production base and market (sector transformation). These, in turn, contribute to an increased likelihood of a high performing sector that is competitive, profitable and sustainable (sector performance).



What does a high performing and resilient sector look like?

Interviews and analysis across multiple tropical commodities pointed to diverse characteristics of a high performing and resilient sector that is likely to be more beneficial to both smallholders farmers and agri-business.

A high performing and resilient sector is:

- **competitive**: has a good reputation and performance in world market (price and quality)
- **resilient**: reduces the risk and absorption of shocks related to price volatility and climate variability
- **profitable**: allows producers, workers and supply chain actors to capture a fair share of end value enabling re-investments in the sector and farm
- **innovative and adaptive**: is flexible to respond to market trends, adds value and develops differentiated products based upon origin and quality attributes
- **sustainable**: protects the environment, respects labour rights and builds human and environmental capital
- **inclusive**: provides opportunities to the most vulnerable to participate in the market with access to services
- **resistant to rent seeking and elite capture:** protects against inequitable sharing of resources and profits down the value chain
- **transparent**: operates within legal frameworks with transparent or traceable supply chains

How does sector governance contribute to sector performance?

Sector governance + actions of other actors

Revenue generation & re-investment

Sectors that are able to generate their own revenues can re-invest that money in service delivery, the production base, market management and sector coordination.

Key Tools:

- *Revenue generation: levies, taxes, subsidies and trust funds*
- *Re-Investment: investments and subsidies in research, extension, input distribution, quality management, price management and stabilization, social and environmental programs, market promotion and the functioning of the coordination bodies themselves*

Shared vision, coordination & monitoring

When key stakeholders are aligned around a shared vision and coordinated in their activities, they are better able to work together to increase the impact of their work. Using monitoring tools to measure progress and promote learning the sector can prioritize and change strategy based on what is needed.

Key Tools:

- *Sector platforms and coordination bodies*
- *Sector strategies*
- *Producer and sector level monitoring and evaluation (M&E) systems)*

Market management & regulation

Sectors that have mechanisms to determine the basic rules on trade, prices, quality, traceability and sustainability are better able control the market in a way that is mutually beneficial to buyers and farmers by promoting quality, reputation and sector growth.

Key Tools:

- *Commodity exchanges, price setting, stabilization funds, buffer stocks*
- *Quality standards, control mechanisms*
- *License mechanisms, trade registries*
- *Sustainability standards, spatial planning, moratoria*
- *Cooperative regulation, contract farming protocols*

Drives sector transformation

Organization of the service sector

Investments in the service sector help to build professional service provision with viable and inclusive delivery models that can cater to producers' and supply chain actors' needs, such as technical assistance, inputs, and finance.

Organization of the production base

A coordinated sector can promote viable production systems and organize producers around service delivery, market access, and agency at the sector level.

Organization of the market

Market management helps to establish mutually beneficial trading relationships, fair pricing standards, managing quality, promoting sustainability and traceability of raw materials.

Leading to high sector performance

Increased sector performance should not only generate funds for investment in the sector, but also improve the climate for investment by supply chain actors, including producers themselves.

Competitiveness *Profitability* *Resilience* *Innovation & adaptation*

Inclusiveness *Sustainability* *Resistance to rent-seeking* *Transparency*

Taking a closer look: sector coordination

We've seen that the strong sectors always have some group that brings together stakeholders to set rules in the sector. These bodies develop a vision for the sector and a strategy to achieve shared sector goals and can:

- Develop a sector-wide vision and improvement strategy
- Identify needs, raise and align investment for sector improvement Advocate and inform policy
- Set sector rules that level the playing field for producers
- Monitors progress towards sector transformation, disseminate the lessons learned, and change strategy accordingly.

This is generally done through a **sector platform** or **coordination body**.

Sector Platforms

Sector platforms are generally voluntary and focused on alignment, learning, or the coordination of development efforts

Vietnam Coffee Coordination Board (VCCB), Cocoa Sustainability Partnership (CSB) in Indonesia, National Platform for Responsible Production and Trade of Pineapple in Costa Rica, Sustainable Palm Oil in Honduras (PASH)

Sector Coordination Bodies

Sector coordination bodies are state-sanctioned with a formal mandate to coordinate sectors and possibly manage markets.

The Inter-branch Cotton Association of Burkina Faso (AICB), Coffee Institute of Costa Rica (ICAFE)

Factors to consider

The ideal make-up of sector governance institutions will be determined by the context of the country and its producers.

Voluntary vs. mandatory: The drawback of many voluntary sector platforms is that they generally do not have the mandate or capabilities to raise revenues for re-investments in the service sector, producer base or to manage markets. Coordination bodies with a government mandate usually have a more formal mandate to manage sectors, which makes revenue collection, sector-wide re-investments and market management easier. However, mandatory coordination bodies are, by their nature, more political and complex.

Government involvement: A strong government role can facilitate the introduction of more extensive and far-reaching reforms. But, this can also be done with a strong management system apart from the government. In a weak institutional environment, sector governance is often more effective when placed at arm's length from the government, providing more opportunities for inclusive and transparent processes. Even then, however, some government mandate and buy-in is necessary.

Representation and governance: Sector platforms should aim for a balanced representation, which needs to be complemented by an effective governance structure, strong leadership and facilitation skills, and effective goal setting and learning capabilities.

Financial sustainability: Donor funds may be critical in the early phase of the establishment of sector platforms, but self-financing is a key challenge for durability.

Sustainable Palm Oil in Honduras (PASH)

PASH is a sector platform made up of palm oil companies, cooperatives, government representatives and international NGOs formally established in 2013 with the objective to promote better management and to strengthen relationships throughout the supply chain.

The collaboration in the PASH consortium inspired palm oil companies to set-up an industry association (AIPAH). AIPAH's main activity is to negotiate contracts with end buyers for the collective membership.

PASH successfully improved collaboration and built trust between the corporate group and the producer group in the sector by focusing on "shared interest". The identification of shared interest among these actors, and engagement with the public sector, has led to self-monitoring within the industry and an articulation of the need to develop policy around responsible expansion of oil palm and related environmental impacts.

Key to Success: Patience and good facilitation skills are necessary to build the initial trust level between stakeholders. Collaborative field projects resulting in concrete results enabled learning across stakeholders.

Challenges: The model does not include a mechanism for revenue generation which will increase the challenge to reach out and provide services to unorganized farmers, unless a donor steps in.

Revenue generation and re-investment

We found that more resilient sectors are those that able to continually invest in their production and quality. This requires the ability to generate revenue on a consistent basis at the sector level (removing dependency on donors or lead firms) and the capacity and desire to re-invest those funds in the sector in a way that furthers progress toward the sector vision.

Revenue collection is generally done through *export taxes or levies* and therefore is more easily achieved with export commodities than crops destined for the domestic market. However, there is a lot of variation in the weight of the revenue collection and the extent to which it is reinvested in the sector or the governance structure itself. The ability to collect revenues to survive market booms and busts without needing recapitalization and to invest in the root causes of unsustainability at farm, landscape and sector level is key to sector performance.

Typical sector investments include: *research, extension, input distribution, quality management, price management, price stabilization, social and environmental programs, market promotion and the functioning of the sector platforms or coordination bodies themselves.*

Factors to consider

Re-Investment: Coordinated reinvestment in research and service delivery can have widespread impact on yield and quality. However, for re-investment to lead to a more sustainable production system, significant investment is often needed, particularly where there is a need to rejuvenate tree crops—an expensive activity that does not bear fruit for several years depending on the crop.

Inclusivity: Sector-wide access to services, rather than access being limited islands of technical support paid for by lead firms or donors, is critical to the inclusive development of smallholder agriculture.

Many sector-wide investments are insufficient to reach all producers with high quality services. In this case, sector governance institutions can help to create the alignment and tools necessary for other actors to co-invest in service provision, for example, by mandating companies to provide inputs and technical assistance to all their smallholder suppliers.

Accountability: Sectors that are able to ensure transparent and accountable management and decision-making around revenue collection and re-investment are better able to avoid rent-seeking and elite capture.

Kenya Tea Development Agency (KTDA Ltd)

The Kenya Tea Development Agency Limited (KTDA Ltd) was incorporated in June 2000 as a private company having evolved during liberalization from a government authority. Equity and shares of KTDA are owned and purchased by smallholders of tea and the governance and management of KTDA-owned tea factories are carried out by officials elected by smallholders.

A levy is applied by KTDA at the point of processing, which funds its extension services, inputs and credit for producers. KTDA have focused on extension services that emphasize high quality plucking and processing techniques and have succeeded in accessing premium quality export markets.

Aside from its core business related to tea, KDTA has also sought to innovate to ensure sustainability in energy provision needed to run its factories, via investments in hydropower and its own fuel wood tree nurseries. It has also established subsidiaries that provide additional services to its farmer shareholders, such insurance and microfinance.

Keys to Success: The model has an effective infrastructure for collection of funds and for reinvestment of those funds back into the supply base without burdening public resources.

Challenges: There has been some dissatisfaction on the part of the farmers of KTDA services (inputs, collection, processing, transparency of price setting, and marketing).

Market Management and regulation

Competitive and resilient sectors are frequently enabled by good crop quality management, low price volatility and well-organized production bases. A body that is able to govern the sector in this manner, and promote the market in line with the sector vision, can increase value of the product to both the farmer and buyer.

Sector governance bodies have a variety of tools they are able to use to manage and promote the market:
Sector governance bodies use tools at the sector level that can lead to better sector performance in line with the sector vision (e.g., promote more stable pricing, protect quality and reputation, increase returns to farmers and promote market growth). Some of these may be supported by the funds raised and reinvested by the sector governance institution.

Price: *commodity exchanges, price setting, stabilization funds, buffer stocks*
Quality: *standards, control mechanisms*
Supply management: *production / import quota, farmer exit incentives*
Supply Chain Transparency: *license mechanisms, trade registries*
Promotion: *branding and marketing of national sector*
Sustainability: *social and environmental regulation, standards, spatial planning, moratoria*
Organization: *cooperative regulation, contract farming protocols*

Factors to Consider

A closer look at pricing mechanisms: Many tropical commodity sectors, including coffee, cocoa, rubber, vanilla, etc., struggle with price volatility, often experiencing extended periods with prices below sustainable levels for farmers. Price stabilization mechanisms can help to reduce price volatility, increase value capture by the producer, and improve supply chain transparency. However, these strategies need to be well thought out as mismanaged tools can have negative impacts on the sector.

Politicization: An important condition for success is that price setting and stabilization schemes set prices and contributions on a non-political basis. Price setting is very sensitive as different stakeholders will have conflicting interests. This requires a good governance model and clear decision-making procedures based on a price-setting formula.

Price fluctuation: The stability of price mechanisms may be threatened by long-term declines in market prices. Price setting mechanisms cannot be set in isolation of supply and demand, as intentional price management can risk promoting an increase of production beyond the market demand leading to a destabilization of the market.

Colombian Coffee Growers Federation (FNC)

FNC is a state-sanctioned, farmer governed national federation created to raise the sector's economic and social performance. The FNC's purchase guarantee is a critical component of its model. Growers have the option to sell as much of their output as they choose at an established (and daily communicated) minimum fair price based on international prices. The purchase guarantee ensures a fairer distribution of power between buyers and sellers by providing a point of leverage in price negotiations. The FNC argues that this ensures farmers can receive the highest price and the largest share of value.

Moreover, the FNC offers farmers two contract forms that can protect them from price volatility (or speculate on higher prices).

Keys to success: The FNC's producer-centered approach has been central to the design and implementation of its model and helps to ensure its relevance for farmers. Its democratic structure allows for high levels of accountability to farmers and limits rent-seeking.

Challenges: The purchase guarantee is a significant drain on resources available for direct reinvestment and is becoming a drain on public resources. If it cannot adapt, the model is likely not sustainable.

ICAFE – Sector coordination at arm's length from the government

A case study in sector governance

Many sector platforms or coordination bodies utilize some, but not all of the sector governance main functions (sector coordination, revenue generation and re-investment and market management). ICAFE, the sector coordination body for coffee in Costa Rica, is an example of a mature sector body that implements a comprehensive set of instruments that promote high sector and producer performance.

The ICAFE was established in 1933 as regulator and supervisor of the coffee sector in Costa Rica. It is a state-sanctioned, non-governmental organization with significant producer representation.

Sector Coordination

ICAFE's management is at arm's length from the government and its effective governance structure has increased trust levels between stakeholders. ICAFE's vision and strategy has a strong emphasis on inclusiveness. The majority of the board are representatives of producers.

Revenue generation and re-investment

The collected levy enables investment in **research and input programs** targeting control of pests and diseases and the renovation of plantations. It also functions as a central coordination point for donor funding, for example for mitigation of climate change. ICAFE's role in organizing technical assistance is limited, which is mainly done by the government, supply chain actors and other donors.

Market Management and regulation

An important component is ICAFE's price policies. Farmers receive (at least) a **minimum farmgate price** based upon the New York exchange prices and are paid an annual weighted average of this price. This has resulted in more stable farmgate prices and guarantees farmers receive 80% of the export price. Margins are also set for washing stations and exporters. The price structure includes a fee for a **stabilization fund** which compensates farmers when prices drop below cost of production by more than 2.5%. The price policies also allow the collection of a levy (1.2%) which is used by ICAFE for its running costs as well as investments in research, quality management, and market promotion.

ICAFE implements rigorous **national quality standards and control mechanisms**. It has also limited choice of varieties to 100% Arabica. This high quality, in combination with active marketing by ICAFE of the Costa Rica brand, means its coffee receives one of the highest premiums on the world market. Despite these premiums, the Costa Rica coffee sector is struggling to remain competitive due to higher labour costs and alternative livelihood options.

The price and quality policies are supported by a **license system and trade registry** which includes all farmers, value chain actors and trade transactions. ICAFE closely monitors the transactions. The transparency of this system also facilitates credit provision by commercial banks and washing stations.

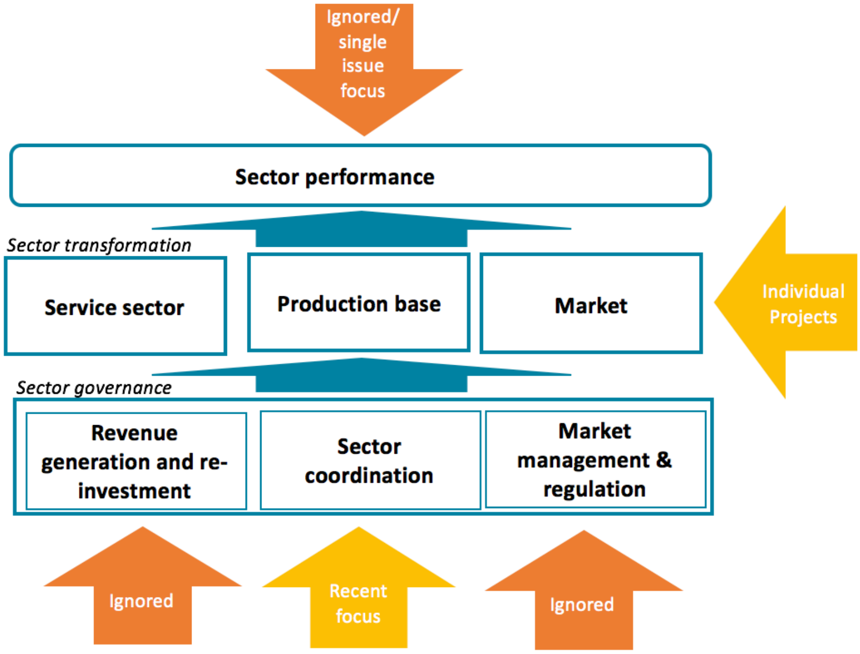
Factors for Success

- The combination of price setting, stabilization, supply chain transparency and rigorous quality management result in high yields, high quality and premium prices on the world market.
- ICAFE's management at arm's length from the government makes it less vulnerable to the effects of political regime changes. In combination with the absence of donor dependency, because of its revenue collection model, makes it a very sustainable model.
- Some identified critical success factors of this model are a result of an enormous political capital and a strong commitment by the board in promoting and protecting the interests of farmers. Trust levels between stakeholders are high because of a lengthy historical relationship between participants and the governance boards of the ICAFE, which have a democratic and representative structure.

The Current State of Sector Governance

It is often the combination of sector governance and transformation instruments that lead to a high performing and resilient sector. Individual instruments are often not enough. Without knowledge of the sector's needs, buy-in from sector stakeholders, and/or the resources or knowledge to implement sector governance, many actors are trying to transform the sector or their supply chain through traditional development projects. These types of projects (business development services, farmer organization and cooperatives training, sustainability standards, contract farming, etc.) are difficult to scale to the sector level without strong sector governance in place.

There has been a recent focus on better collaboration, coordination and monitoring within sectors. However, revenue generation and re-investment and market management are largely ignored or not tackled for fear of disrupting the market or unwillingness on the part of key stakeholders.



What can you do to support sector governance in your field?

Applying a sector governance lens to your work

Think about the challenges that you face every day. Many common field-level challenges could be partially addressed by improvement at the sector level. To better understand the change needed and the levers to pull, it's time to work with others to formulate a sector transformation strategy that would catalyze solutions to seemingly intractable problems:

- High volatility
- Endemic quality problems that threaten the country reputation
- Many unorganized smallholders and loose trading relationships
- Lack of inclusive extension services
- Commodity market where it is difficult to create distinctive value add through supply chains

Who can participate in sector governance?

- **Sector platforms** – multi-stakeholder platforms which congregate around one or more commodities and pursue sector transformation by improved coordination, sector-wide investments and policy development.
- **Producer country governments/ coordination bodies** with a public mandate to coordinate sectors – improving the effectiveness of their strategies in building performant sectors.
- **Donors & development organisations** – interested to support the systemic changes that are required to transform sectors.

Where to start?

Introducing a more coordinated sector governance approach is not something to be tackled overnight. It requires a committed process in which engaging key stakeholders is of crucial importance.

Take action

- Organize relevant stakeholders for consultation, alignment, **strategy development** and co-investment
- Conduct a **sector diagnostic** to identify needs and opportunities for improved sector governance and sector performance:
  - A sector diagnostic tool can be used to: 1) assess the current level of sector performance and identify its main strengths and weaknesses, 2) inform strategies to enhance the effectiveness of sector governance, and 3) assess progress in improving sector performance by conducting a baseline and subsequent repeated measurements. *For more information contact Jan Willem Molenaar (see below)*
- **Develop a shared vision and a strategy** based upon these insights distinguishing short and longer-term priorities
- **Start implementing the strategy** with a focus on maintaining alignment and measuring progress, and use this as a basis for further improvement of the strategy.
- **Monitor** the effectiveness of strategies on sector governance and performance for further improvement

The ownership of such process can be institutionalized in a voluntary sector platform or a more formal governance body. Depending on institutional strength, these bodies could be managed within or at arm's length of the government.

Learn more

- **Learn** from other the experience from other countries and sectors
  - Read the full paper, including case studies, that informed this Overview: Reaching beyond the value chain: How sector governance can improve the performance of agricultural commodity sectors
- Reach out to those working in sector governance to talk about your specific sector
  - Contact the authors of this paper for more information:
    - *Jan Willem Molenaar, Aidenvironment: molenaar@aidenvironment.org*
    - *Don Seville, Sustainable Food Lab: dseville@sustainablefood.org*
    - *Bill Vorley, IIED: bill.vorley@iied.org*

Good sector governance provides a better foundation from which all actors can have more successful value chain initiatives, and can also drive sustainability outcomes directly for both producers and buyers.