

LINKING SMALL-SCALE FARMERS TO AGRIBUSINESS:

THE ECONOMICS OF CONTRACTING

by

Kurt Sartorius

Submitted in partial fulfilment of the requirements for the degree

DCom

in the

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By

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Degree: DComm
Department: Agricultural Economics, Extension and Rural Development
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ABSTRACT

The globalisation of markets and the industrialisation of the farm sector have profoundly influenced the structure and performance of agricultural supply chains. Whilst, the opportunities of an expanded range of market niches for farmers is evident, the requirements for size and continuity, in many instances, preclude smaller farmers in developing countries. The principal research question addressed by this study is, whether or not, small-scale farmers in developing countries can be linked to agribusiness partners by way of a contracting arrangement in order to take advantage of some of the opportunities presented by the new paradigm. This study proposes that a “fresh approach” to the design of smallholder contracting models can be adapted. This approach incorporates combining the lessons of history, the use of the new institutional economic theory and a case study methodology to form the basis for the design of a proposed contracting model. Two case studies are employed to test the research questions. The first case study involves two smallholder contracting arrangements in the Swaziland and South African sugar industries. The second case study is an example of contracted micro-growers in the South African timber industry. The results of the study are as follows: Firstly, the transaction characteristics of the surveyed grower-processor supply operations appeared to influence the governance structures required by their agribusiness partner to coordinate the respective activities. Secondly, the results suggest that the transaction

cost of raw commodity supply chains is a function of historical, social and physical variables in the prevailing institutional environment. Thirdly, the results demonstrate that smallholders generate incremental transaction cost for the agribusiness partner in comparison to larger suppliers. The reasons for this primarily include the differential levels of start-up cost, as well as, the need for incremental levels of agribusiness inputs with respect to the growing, harvesting, delivery and administration activities involved. Fourthly, the results suggest that smallholders can compete with larger growers with respect to the cost efficiency of production. The principal reason for the competitive performance of the smallholders was a result of contracting out for facilities costs as opposed to the internalised nature of this cost in the agribusiness operations. Finally, the case studies appeared to confirm that the institution of contracting has allowed large numbers of small-scale farmers to overcome the barriers of entry to certain industrial crops. A series of proposals for the design of a smallholder agribusiness contract farming model were then developed. The study developed the proposed model on the basis of assuming that a smallholder contracting arrangement can be treated as a strategic investment decision. The model, therefore, configures the contract farming investment decision into the strategic process. A key feature of the model is the use of activity based costing in order to trace differential transaction cost to the contracted growers. The proposed model can, therefore, highlight the differential cost of smallholder contracting or the cost savings of a farmers' association. The identification and quantification of incremental smallholder cost can be used by agribusiness as a basis to lobby the state for assistance with respect to start-up cost or, alternatively, as a basis to charge back incremental cost to the contracted growers. The study concludes that smallholders can be linked with agribusiness on an economic basis but only if measures are taken to reduce incremental transaction cost.

DECLARATION

I declare that this thesis is my own work. It is submitted for the degree of Doctor of Commerce to the University of Pretoria, Pretoria. It has not been submitted before for any other degree or examination in any other university.

Kurt Sartorius
July, 2003

DEDICATION

To my wife Hetty, Benn and Lana
You are my world

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ABBREVIATIONS AND ACRONYMS

ABC	Activity Based Cost
MCS	Management Control Systems
ROCE	Return on Capital Employed
TCE	Transaction Cost Economics
OS	Organisation Structure
TC	Transaction Characteristic
SSA	Swaziland Sugar Association
SSMA	Swaziland Millers Association
MCS	Management Control Systems
SCGA	Swaziland Growers Association
MSCO	Mhlume Sugar Company (Swaziland)
EU	European Union
US	United States
SACU	South African Customs Union
SADC	Southern African Developing Countries
NFA	Nyakafto Farmers Association
VFA	Vuvulane Farmers Association
SACA	South African Cane Growers Association
SAMA	South African Millers Association
TSB	Transvaal Sugar Company