

5 DESIGNING THE ORGANIC PRODUCTION SYSTEM

The basis of your business is the farmers, and their production. You depend on the way that they farm. This chapter describes what organic farming means in practice and what you need to consider to be sure that the farmers become, and continue to be, good organic farmers.

5.1 WHAT TYPE OF ORGANIC FARMING?

Some organic businesses start from the idea that farmers in their area already use only a little or no chemical inputs, because these are not available or not affordable to them. If their farms were certified organic, the rationale goes, they could at least get a better price for their products, without changing much in their way of farming. On closer inspection, however, one may realise that the farmers do not use fertilisers and pesticides for the simple reason that it would not pay off. The money they could get from possibly increased yields would hardly cover the costs of the inputs, and there is a risk that they will lose more money or become indebted in case the crop fails. Maybe the remoteness of their location makes inputs very expensive, or they lack access to markets where their products fetch a reasonable price - or both. By not using external inputs farmers thus act in a risk avoiding and economically rational way.

Once farmers get a better price for their produce, which is likely when they are certified organic or Fair Trade, the situation changes. The use of fertilisers and pesticides to increase yields could - theoretically - become profitable. The temptation to use these inputs therefore increases with the price they get for their crop. Introducing Fair Trade prices in conventional farming can thus result in a higher use of fertilisers and pesticides. In organic farming, farmers get the organic premium precisely because they are not using agrochemicals. They need to find organic ways to increase and maintain their yields. An “organic by default” approach, without training farmers on how to improve their (organic) farming practices, is thus not very likely to succeed in the long run. Even if farmers can be stopped from using chemical inputs, without proper organic management yields are likely to remain low.

Sustainable farming systems

Compliance with organic standards does not automatically imply that the production is sustainable. Without proper organic management that takes care of improving soil fertility and eco-system stability, an “organic by default” production is not sustainable. Innumerable examples have shown that well-managed organic farming systems can deliver reasonably high yields without depleting natural resources²⁷. In some low production contexts, a low-input-low-effort strategy may be appropriate, but in most situations organic farming means more intensive farming (in the sense of active soil fertility management and pest management, application of manures etc.). This requires that farmers get appropriate training and technical advice on how to do productive organic farming.

27 See Pretty, J. (ed), 2005. *The Earthscan Reader in Sustainable Agriculture*, Earthscan, London. Nemes, N., 2009. *Comparative Analyses of Organic and Non-Organic Farming Systems: A critical assessment of farm profitability*. FAO Rome. <ftp://ftp.fao.org/docrep/fao/011/ak355e/ak355e00.pdf>

Although an organic business may start from an “organic by default” situation, within two to three years it is crucial to shift to active sustainable organic farming. Otherwise organic certification will make poor farmers only a little less poor, and only for a while. Introducing modern organic farming methods can improve the overall performance of a smallholder farm. This is of concern for the company or cooperative organising the farmers for marketing their produce. If yields per farmer are low, you need to organise more farmers for a certain production volume. This incurs higher costs for extension, internal control, certification, transport, etc. than when fewer farmers with higher productivity are involved. If the premium is the sole motivation for farmers to shift to organic production, they may easily drop out once premiums go down.



Agro-forestry system with coffee, pepper, coconut and fruit trees in India (Source: Helvetas)

Proper farming practices and specifically soil fertility and nutrient management are also crucial to achieve good product quality - which is a key success factor for being and remaining competitive in the market. It is better to base your business on skilled organic farmers that have good yields of food and cash crops - farms with a future! - rather than pursuing an “organic by default” approach.

Commodity approach versus crop diversity

Many organic farming initiatives start with a focus on one commodity or value chain. This seems logical from a specialisation point of view – having a focus on being efficient, knowing the production technology, the business, the market (see chapter 6.3). On the other hand, there are several reasons why organic projects should think of crop diversification from the beginning:

- Crop rotation and intercropping are important strategies in an organic farming system to keep soils fertile and prevent pest populations from building up.
- Crop diversity helps farmers to reduce risk - if one crop fails or market prices drop, other crops can compensate for the loss.
- Crop diversity is an important factor in improving food security.
- If the business can sell several crops, the overhead cost share (for extension, certification, management etc.) for each crop is reduced, making the products more competitive in the market.

Even if the project is built around one lead crop, it is therefore important to include suitable rotation or associated crops that can ideally be marketed as organic. The same extension system that was primarily built to support farmers in growing their organic cotton or cocoa in a good way could also cover the production of maize, cassava or chillies.

Organic farming in Mali

Mobiom - the umbrella organisation of organic farming cooperatives in Mali - was mainly set up to organise the production of organic cotton. They soon realized that there is some demand for organic sesame and shea nuts - crops which were already grown by most of their farmers. Mobiom hence included these crops in the extension activities in order to improve their yields and quality, and to ensure that they can be certified organic. They found a buyer for the sesame who locally cleans the harvest and exports it for processing into sesame oil. In order to be able to sell not only shea nuts but also shea butter, they built a small shea butter processing plant. Today, sesame and shea contribute about one third of Mobiom's turnover. Without this diversification, the costs of extension and certification per unit of produced cotton would be too high to be cost competitive in the market. In 2009, when there was an oversupply of organic cotton in global markets, Mobiom decided to temporarily reduce the cotton area and to shift some of this area to the production of sesame and fonio, a traditional cereal for which there is high demand in the domestic market. A next step will be to promote a leguminous crop like peanuts or beans grown in rotation with cotton and sesame, which will help to improve soil fertility and thus yields.

Ways to good organic farming

How exactly do you do good organic farming? Each crop and farming system has its own peculiarities when it comes to organic production methods; nevertheless, there are some common features of good organic farming *systems that can serve as a checklist*:

- Crop diversity in time (crop rotation) or space (intercropping), involving leguminous plants
- Use of sufficient volumes of organic manure such as farm yard manure, compost or green manure, ideally produced on the farm itself
- Integration of animal husbandry in the farming system
- Recycling of all kinds of biomass and crop residues, instead of burning it
- Careful soil cultivation that does not lead to soil erosion and that preserves soil moisture
- Preventive measures to manage pests, diseases and weeds
- The absence of any synthetic fertilizers, pesticides, growth regulators and GMO

There are several guides and manuals that can help you to set up good organic farming systems. IFOAM has published a series of training manuals that cover organic production in the tropics in a comprehensive way²⁸. Practical guides on the production of specific crops are available for free at the IFOAM Training platform²⁹. The United Nations Environmental Program UNEP is developing an e-learning course on organic farming.³⁰

Access to know-how alone, however, does not make good farming. It is crucial that the know-how is transferred to the farmer in an appropriate and effective way. The extension system of the organic initiative needs to ensure that the know-how is applied in practice. How this can be done is covered

28 www.ifoam.org/growing_organic/7_training/t_materials/6_gen_publications/gen_publications_main.php

29 www.ifoam.org/growing_organic/7_training/t_materials/training_materials_main_page.html

30 Check www.unep-unctad.org/cbtf -> Organic agriculture

in detail in chapter 7.3. The implementation of certain organic farming practices can also form a part of the agreement that the farmer signs with the cooperative or company.

Wild collection

A quite different market segment is that of wild collection. This includes herbs, spices, nuts and mushrooms collected from forests, uncultivated land and pastures. It includes non-timber forest products (NTFPs) and medicinal plants. If wild collection meets certain sustainability and social standards, it can be certified organic and Fair Trade. There are also specific standards for wild collection.³¹ There is a growing market for these products in the body care, cosmetics and natural medicine industry.³²

Wild collection is a rather informal and unregulated sector, involving many collectors who often belong to the most marginalised sections of society. Linking collectors to organic and Fair Trade markets therefore has the potential to help the poorest of the poor, but organising them for reliable quality collection is not usually an easy task. Traditional or careless collecting practices may overexploit plant populations, especially when roots are collected. In many cases, collectors lack training on how to harvest in a way that ensures that this wild production continues. It is therefore important that collectors and buyers comply with sustainable harvesting rates. As it may involve large groups of collectors who harvest sometimes small quantities, it is quite a task to develop a not too expensive and still effective Internal Control System. Experience shows that wild collection is easier to manage when it is a side activity of an organic producer group that is already organised for certified organic farming.

5.2 MANAGING THE CONVERSION TO ORGANIC FARMING

At the beginning of a new organic production initiative, one of the important challenges is to motivate farmers to convert their farms to organic management. They will like the organic premium for not using chemicals. They will nod when you talk about the benefits for soil fertility, health and environment, but those may not be their own priority. The advantage of lower input costs is a better motivating factor. They will have to put in some work to improve their system and to maintain soil fertility, and therefore will have to change their way of farming. The main question for the farmers will be whether the conversion is economically viable, in the short and in the long term. A comparison of estimated gross margins for each rotation crop provides a first idea whether the conversion to organic makes sense from agronomic point of view.³³ Be careful not to be too optimistic with the organic yield and price that you may achieve.

When farmers start from an “organic by default” situation, the issue is usually to prove that additional labour input and the move to a more intensive production system are profitable. Often the soil is exhausted and needs application of organic manure. Perennial crops may need pruning or re-planting, while with annual crops soil cultivation, weed control, and sometimes seed quality are issues. Measures like better mulching, including leguminous plants and use of some natural pesticides quickly lead to better yields. That makes it difficult to explain to the farmers that a more productive system uses

31 E.g. FairWild certification, see www.fairwild.org

32 See IFOAM/ITC, 2007. Overview of World Production and Marketing of Organic Wild Collected Products. www.intracen.org/Organics

33 A simple tool to calculate gross margins is available from www.organicandfair.org/oftcc/Publications/Publications.php

more nutrients, and that there is a need to bring in additional manure. Working on sustainable soil fertility and nutrient management is the biggest challenge for any organic farmer, bigger than the challenge of crop protection.

During the conversion period, technical advice should support farmers to adapt their farming system. Bottlenecks like the availability of organic manures or equipment to transport them, and leguminous crops in the rotation, need to be addressed (see chapter 5.3). There is usually a fear of pest and disease outbreaks but that very seldom happens. Much of this work with farmers takes place in groups, in guided discussions, assisted by field officers.

Coping with initial drop in yields

When farmers convert from intensive conventional farming in which fertilizers and pesticides are frequently used, yields are initially likely to be lower, at least during the first 2-3 years of the conversion process. Soils need time to re-build fertility, diverse agro-ecosystems need to be established, and farmers need to gain know-how and experiment with organic farming methods. An initial investment in soil fertility and nutrient management, e.g. by applying organic manure from outside the farm, can help to reduce or even avoid a drop in yields. Over time, yields usually increase in organic farming systems. Whether they are eventually lower than, on par with or even higher than in the conventional system depends on the intensity of the production system.

When there (initially) is a drop in yields, this is a severe obstacle to conversion, especially for resource-poor farmers. During the conversion period usually no or only a small organic premium can be obtained. There is not much of a market for in-conversion products. Some organic businesses, however, already pay farmers an organic price premium in the first two years of conversion, when that money is needed most urgently, to account for the loss in yield and to motivate farmers to continue. As Fair Trade certification does not require a conversion period, Fair Trade arrangements can be a way to get higher prices to farmers in the first years, if they are already organised, and provided that there is a Fair Trade market for the product in question.

Better prices can also be achieved when the initiative leads to 'immediate' improved product quality (see chapter 9.1) or more efficient market access. However, it is better to budget for paying a small premium and see it as an investment, rather than bank on immediate better prices. The early availability of an organic premium is a stimulus to pay more attention to farming.

Reducing the conversion period

For organic certification, the conversion period is between one and three years. Most standards require that crops have been under organic management and monitored by a certification body before the harvest can be sold as "organic".³⁴ If there is sufficient proof that no prohibited inputs have been used on a specific plot for at least two years, the certification agency can reduce the conversion period to one year after the start of organic management. Some certification bodies consider the starting point of the organic management the moment farmers register with a project or company, others from the time farmers sign a contract, again others from the first inspection. In any case, adherence to organic standards needs to be monitored also during the conversion period (field staff needs to be in place). Many certification bodies require two inspections before the first certification, one at the beginning of the cropping cycle and one before the first harvest.

³⁴ According to the EU regulation, for annual crops a conversion period of two years prior to sowing is required; see Article 36 in eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:250:0001:0084:EN:PDF

Choosing plots that have not received fertilisers or pesticides for some years has the advantage that the production can sometimes be certified organic from the first harvest onwards. However, these plots often are not very fertile (and were therefore left fallow), or are located far away from the farm. Clearing virgin forest land is definitely not an option in organic farming. Initiatives pursuing a quick-conversion strategy risk ending up with comparatively low yields, which cause high extension and certification costs per unit produced. Farmers may then drop out if yields continue to decline. It therefore pays off in the long term to engage in real conversion of formerly conventionally farmed land and not stay with a do-nothing scenario.

Success factors in the conversion process

Getting ready:

- Adequate training in organic agriculture and organic production methods
- Develop strategies to cope with initial drop in yields and higher labour requirement
- Competent and timely advice on organic crop management
- Regular exchanges with experienced organic farmers (role models)

Adapting the production system:

- Try out organic technologies on small plots to gain experience
- Identify suitable crop rotation and intercrops
- Ensure sufficient input of organic manure (if necessary from outside the farm) or other materials (like oil cakes)

Gradual conversion

Organic farming initiatives should think about whether they want to create opportunities for farmers to convert gradually to organic farming, enabling them to reduce the risk involved in conversion. New farmers could, for example, be encouraged to try out organic methods on part of their land before registering with the project. Although this will prolong the period until the farm can be certified organic, it might be more feasible and sustainable than converting in one single step. However, keep in mind that handling conventional, in-conversion and organic qualities of the same crop may be quite a challenge for your buying system.

5.3 CHALLENGES IN ORGANIC PRODUCTION

Organic production may face a number of challenges that need to be addressed. As outlined above, achieving sustainability of the farming system and a satisfying yield level is not always easy. Conversion to organic farming usually requires extra effort, and so working around the availability and distribution of labour can also be difficult.

Access to farm inputs and equipments

Organic production initiatives need to ensure that farmers get access to appropriate production inputs like seeds, pest management items and fertilisers that are permitted in organic production. It can be difficult for farmers to obtain seeds that are untreated and of varieties suitable for organic production. For soil fertility management, sufficient application of organic matter is crucial, especially

for achieving satisfying yields and good product quality. Many organic businesses therefore organise the required inputs on behalf of their farmers, or support them in producing the inputs on-farm.

Input supply requires that efficient and reliable logistics are in place, ensuring that farmers receive the inputs in time and at an affordable price. However, it is not sufficient for farmers to have access to inputs - they also need to know how to use them in the most efficient way. Extension services therefore need to train and advise farmers on when and how to apply the respective inputs. It should not be simplistic and top-down; farmers should be encouraged to experiment, to find out what is best for their situation (see chapter 7.3, Extension approaches that work).

Farmers may also need specific equipment for successful organic production, like sprayers for biopesticides, carts to transport organic manure, or infrastructure to produce good quality compost. The company or cooperative can help them to get suitable equipment and building materials by bulking orders or stimulating local manufacturing.

Organised supply of inputs and equipment, however, may keep farmers from trying out new techniques on their own. Support should thus be designed in a way that farmers still have options from which they can choose, and should stimulate rather than hinder innovation.



Transport of organic manure with donkey cart in Mali (Source: Helvetas)

Financial services for farmers

Costs for inputs in organic farming may be lower than in conventional farming, but many farmers nevertheless find it difficult to pay for inputs at the beginning of the cropping season. Some organic businesses therefore provide inputs on a loan basis. They deduct the value of the input at the time when the farmers deliver the product. Problems may arise when farmers sell their crop to someone else, or use the inputs on their food crop. When the cash crop fails for whatever reason and there is little income to deduct from, the farmer may become indebted. If the input supply is subsidised, farmers may not realise their real costs, which can lead to an inefficient use of the input. In short, input provision is a minefield, whether in organic or conventional agriculture.

Another frequently used system is where organic business or projects provide micro-credit to farmers for buying inputs, seeds, equipment or animals, or for paying hired labour. Handling a credit scheme yourself, however, is a complex and risky matter. It is better to invite existing micro-credit schemes which will appreciate that the farmers are already organised and under some management because of the organic venture.³⁵ The organic business may become involved in linking farmers with micro-credit schemes, and negotiate favourable conditions for them.

The organic business can promote saving, for example by paying the farmers into a bank account, or by stimulating the formation of saving groups. Micro-credit schemes and saving groups can also help prevent farmers from selling part of their crop on the open market due to immediate cash needs (see also chapter 7.5). The farmers are able to take out a little credit instead.

³⁵ Links to micro-finance institutions are provided at www.mixmarket.org/networks and www.microfinancegateway.org.

Managing co-existence with conventional farming

Ideally, all farmers in a village decide to convert to organic production. In situations where organic farms are located amidst conventional farms that use pesticides, fertilisers or GMO (genetically modified organisms), the organic farming initiative needs to take precautionary measures to avoid contamination from neighbouring farms. Contamination can be in the form of surface irrigation water passing through conventional fields and thus potentially carrying fertilisers or pesticides, wind drift from spraying pesticides, or pollen carried by wind or insects from genetically modified organisms to organic crops. According to organic regulations, operators need to ensure that there is no contamination. They leave it to the certification agencies to determine whether the risk is sufficiently well managed.

Different certifiers handle this in different ways. Most require that irrigation water shall not have passed through conventional farm land on which fertilisers have been used. In order to prevent contamination from the drift of pesticide sprays, usually buffer zones of some metres are required. However, selling off part of the crop as non-organic is a painful exercise. It is better to work with a buffer crop or hedge. Agreements with neighbours or within communities for not spraying the areas adjacent to organic plots, or only when wind is away from organic land are also options to solve the problem. In regions where governments organise mass spraying of specific crops, solutions need to be sought with the local authorities (see chapter 4.3).



Buffer crop of maize between organic and conventional fields in India (Source: Helvetas)

Co-existence with GMO?

When it comes to preventing contamination from GMOs, things become more complex. It is a requirement of organic regulations, based on consumer preferences, that organic products are free from GMOs. However, there are no clear and homogeneous rules yet on how to prevent pollen from a genetically modified crop getting in contact with an organic one. Each crop has different pollination characteristics - they may be open pollinated (e.g. alfalfa) or self-pollinating (e.g. beans, tomatoes), or pollen can be carried by wind (e.g. maize) or insects (e.g. cotton).

For crops in which the seeds are commercialised (e.g. cereals and pulses), there is an immediate risk that the harvest itself is already contaminated, whereas for crops in which leaves or fibres are used, the foreign genes will only appear in the harvest of the next generation when farmer's own seed is used. Reasonable minimum distances therefore depend on the crop and on whether farmer-saved seeds are used for the next crop.

Analytical tests to check for the presence of specific genes in seeds or plant material are highly sensitive. Operators run the risk of getting 'de-certified' if GMO contamination is detected in the field or in the final product. Contamination with GMO material can also happen during transport or processing. A lot of research still needs to be done. Coordination amongst certifiers on how to handle the matter in a reasonable and uniform way is a necessity. Increasingly now, slight contamination is accepted, as long as it is deemed accidental.

Summary of recommendations

- Ensure that good organic farming practices are applied. An "organic by default approach" is neither sustainable nor profitable in the long term.
- Even if the business is built around one main crop, take care that rotation crops and intercrops are also covered by the extension system and that they find a good market.
- Get inspiration from existing guides and manuals on organic production, and ensure that the know-how is applied in practice.
- Address bottlenecks in organic production and find ways to support farmers' incomes during the conversion period.
- Motivate and train farmers in sustainable soil fertility management, especially when starting on soils of low fertility.
- Assist the farmers in trying organic methods on part of their land before fully converting, even if this prolongs the time until the certified produce is available.
- Ensure that farmers have access to appropriate inputs and equipment. Stimulate experimentation with locally available materials.
- Take care with providing inputs or equipment on credit and with handling micro-credit; rather link farmers with existing micro-credit schemes and encourage saving among farmers.
- With your certification agency, identify suitable measures that enable co-existence with conventional farming.

6 PLANNING AND MANAGING YOUR BUSINESS

In the end, the success of any organic production initiative depends on whether you are able to run it as a sound and profitable business. Some entrepreneurs get a long way working on intuition, but sooner or later everyone needs to think through their business in an organised way; have a strategy, a plan, an organisation, proper financial management etc. In this chapter you will find some guidance and tools for developing the most crucial aspects of a business strategy and plan. They will help you to make better decisions concerning the set-up of your business, to defend your sales prices when negotiating with buyers, to apply for investment and trade finance, to monitor the performance of your business and to adjust it to a changing market demand.

6.1 DEVELOPING A BUSINESS STRATEGY AND PLAN

Some entrepreneurs and producer organisations are scared by the term business plan – they are afraid of a big, theoretical and inflexible thing. Everyone knows successful entrepreneurs who never prepared a business plan, but succeeded because they had the strategy and figures in their head. There are also experiences with projects which had a 100 page business plan written for them by a hired expert, but completely failed because the plan was not realistic, or not understood and not internalised. Developing a business plan is crucial for an organisation in which more than one person is involved, such as a producer organisation. It will help the organisation plan its activities in order to generate a better income for the involved producers. Once the business has started it will help you monitor the progress and profitability of the business and to adjust your planning where necessary; in short it will help you to get and keep your business on track.

A business strategy

Any business needs to have a fairly clear idea how it wants to develop. Whether you call this a business plan or not, and to what level of detail you develop these ideas depends on the size of the business, whether you have investors or a management body to answer to, or on the need to convince banks or donors that your business case is viable. If you have an existing business and want to start an organic unit or expand your production capacity a feasibility study, cost price calculation or adaptation of your existing business plan might be sufficient.

The minimum you need in terms of a business strategy is to have fairly well thought through ideas on the following points:

- What is your **core business** (products, processing, trade)?
- What is your **market**, who are your **competitors** and how can you compete with them?
- How do you **organise** your business (legal and organisational structure, who does what)?
- What will be the **size** of the operation (number of farmers, production volumes), and what **growth** do you envisage over time?
- What are the estimated **costs and revenues** over some years, and when will you break even?
- What **price** do you need to get for your product(s) to cover your costs, and to make a reasonable profit reflecting the risks you take?

- What **finance** do you need to start your business, and where will you get it from?
- How will you manage your **cash flow**, and how do you propose to bridge possible shortages of cash at certain times?
- What **marketing** activities do you need to take up, and what resources do you need for this (see chapter 10.1)?
- What **risks** are involved in doing this business, and how can you reduce them?
- What happens when you miss the projections you made; what is your **plan B**?

Preparing a business plan

The extent to which the business plan is written out largely depends on the requirements of the agency providing the finance. If you want to apply for a loan, investment or other external finance, a fully-fledged business plan is clearly needed. You need to convince the bank or investor that your business idea is viable and that the investment will result in a profitable, sustainable business. In this case it won't be sufficient for you alone to be convinced; the case needs to be properly presented and documented so that it convinces others. In addition, a business plan is a valuable planning and strategy development tool that will help you to be successful in doing business.

A good starting point for a business plan is to conduct a SWOT-Analysis of your business idea (Figure 10). In this process you do not only analyse the strengths, weaknesses, opportunities and threats of your current business, but also take into consideration the situation in the market (preferences, trends), the position of competitors, and the prevailing business environment (legal framework, services). Strengths can be used to capture opportunities, while weaknesses may pose threats to your business idea.

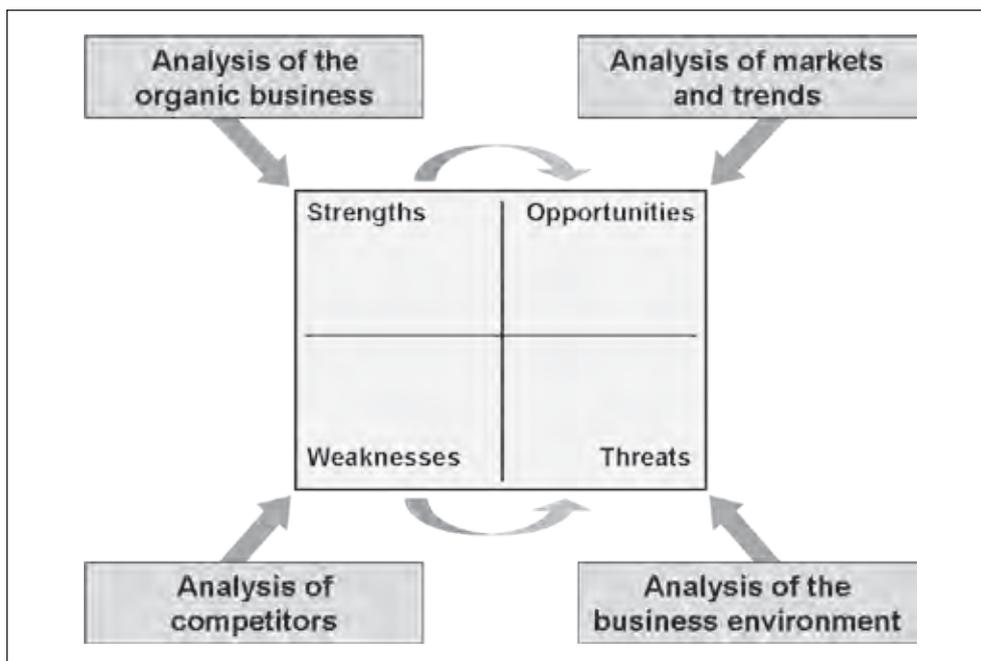


Figure 10: SWOT-Analysis of the organic business idea

Starting from the SWOT-Analysis, you can develop the business plan step by step. An outline of a simple business plan for an organic business is provided in Annex A3.1. Sources that provide general guidance on business planning are listed in Annex A1, Business planning and management.

A business plan is not of much use if it is not understood by the people who are supposed to implement it. Developing a business plan needs to be a participatory process which helps those involved to gain an in-depth understanding of the business case and its challenges. They will then know almost 'off by heart' what the direction is for the next few years. The process of developing the plan happens in loops of brainstorming, analysing, structuring, testing, revising; it is more important than the final document itself.

Successful businesses do think through their plans themselves. It may be a good idea to involve an external expert in developing the business plan, to get an outside view of your business model as well. Make sure that you keep ownership of the process, and that you understand each aspect of the plan - especially the financial ones!

A business plan is not only a feasibility check and a way to plan your business, it is also a management tool which helps you to focus on the most important aspects, to keep the core figures under control, and to help you adapt to the ever changing business environment. A business plan is also not a one-off exercise put in the drawer once the bank or the donor is convinced. You should live by it, implement it, periodically update the core figures at least, especially those concerning production volumes, costs and revenues, and check that it is still viable. Dare to adjust projections downwards if that will give you a more viable business case. Especially when one of your key drivers behind the business turns out not to be feasible, it is important to adjust your business case, inform your investors or financiers and discuss possible solutions.

6.2 SETTING UP YOUR OPERATION

This sub-chapter deals with what you need in order to start an organic business, or to convert an existing product line to organics. It also covers how you organise the different elements, and who plays which role.

Elements of the organic business

An organic business consists of several core elements that are interlinked with each other (Table 1). Obviously, first of all you need farmers from whom you will buy. Ideally, the farmers are not only producers but are also involved in post-harvest operations, in bringing the product together (bulking), and in ensuring the organic integrity and the quality of the production. Farmers need to be partners in your business - depending on the set-up of the business they can even be owners or shareholders of the business (see chapter 7.2).

The field staff is in charge of training the farmers on organic farming methods, and provides technical advice as per the farmers' needs. It encourages experimentation and supports farmers to exchange information among themselves. Extension is closely linked to the Internal Control System (ICS), which is a requirement for organic certification of smallholder groups. The ICS is a tool to manage the integrity of the organic production and ensures traceability during buying. The ICS can also be used to monitor and improve the quality of production (see chapter 8.2).

<i>Element</i>	<i>Functions</i>
Farms	<ul style="list-style-type: none"> • Active organic agricultural production • Participation in extension, ICS and quality management • Responsible for organic integrity
Extension system	<ul style="list-style-type: none"> • Awareness, training of farmers, information sharing • Technical advice, experimentation with farmers • Develop extension tools, incentives
Internal control system	<ul style="list-style-type: none"> • Internal control -> managing group certification • Separation, traceability • Quality management in primary production
Trade	<ul style="list-style-type: none"> • Providing inputs to farmers (optional) • Organising trade finance • Buying raw material from farmers • Logistics, storage • Selling / marketing the produce
Processing	<ul style="list-style-type: none"> • Cleaning, grading • First level processing (e.g. drying, grinding, pulping) • Further processing (optional) • Quality management in processing • Packaging
Administration	<ul style="list-style-type: none"> • Accounting • Data management • Contract management • Human resource development
Management	<ul style="list-style-type: none"> • Strategic development • Financial management • Representation, networking

Table 1: Core elements of an organic business, and their respective functions

The core of an organic business is the buying of raw materials from approved farmers on the one side, and the selling on of that product after some cleaning, processing and packaging on the other. In addition to dealing with the product, some businesses also provide inputs to the farmers, such as seeds, natural fertilizers or tarpaulins for drying (see chapter 5.3). The buying and selling activities include securing trade finance, logistics and storage.

Most organic businesses also engage in some kind of processing of the raw product as delivered by the farmers (see chapter 9.4). This may range from simple cleaning and grading, up to the production of finished products such as juices or honey in jars. Proper quality management at this level is crucial for being successful. Processing also includes the packaging of the product into units for sale (bales, bags, containers, boxes etc.).

The activities and transactions within the above mentioned business elements require a certain level of administration and management. An organic business requires a higher level of management than in a conventional agri-business of the same type and size. There is a lot more to manage and a lot less space to fiddle as there is an annual inspection (including of the books) for certification. You need to ensure that finances are properly managed and that production and sales figures are correct and available on time.

Running an organic business is almost never a one-man/woman show. You need to have a certain number of staff that will need to be managed (recruitment, employment contracts, training, incentives, etc.). “Human Resource Management” may seem to be a big term for small businesses, but it is not only about hiring and firing people. The quality of the staff determines the success of the enterprise, whether it is a cooperative or a private company (see chapter 7.4).

The management has responsibility to ensure that the system works, the plan is implemented and is also responsible for the enterprise’s strategic development. The management also represents the business to the outside world, and develops linkages and alliances with other stakeholders (see chapter 6.7).

In Annex A4.5 you will find a detailed checklist of what resources you might need for an organic business. It should help you not to forget any important elements. If an existing business develops an organic product line, many of these are of course already in place.

How do you organise your business?

How you organise the different elements of your business depends on the size and scope of your operation - the smaller it is, the less organisational units you may require. However, even if one person is in charge of several functions, it is still advisable to have a clear idea of the different organisational units. Extension and ICS may be organised in one unit, and similarly processing and trade (unless processing is a major activity of your business). The organisational chart (Figure 11) provides an overview on how the key functions of the business are typically arranged.

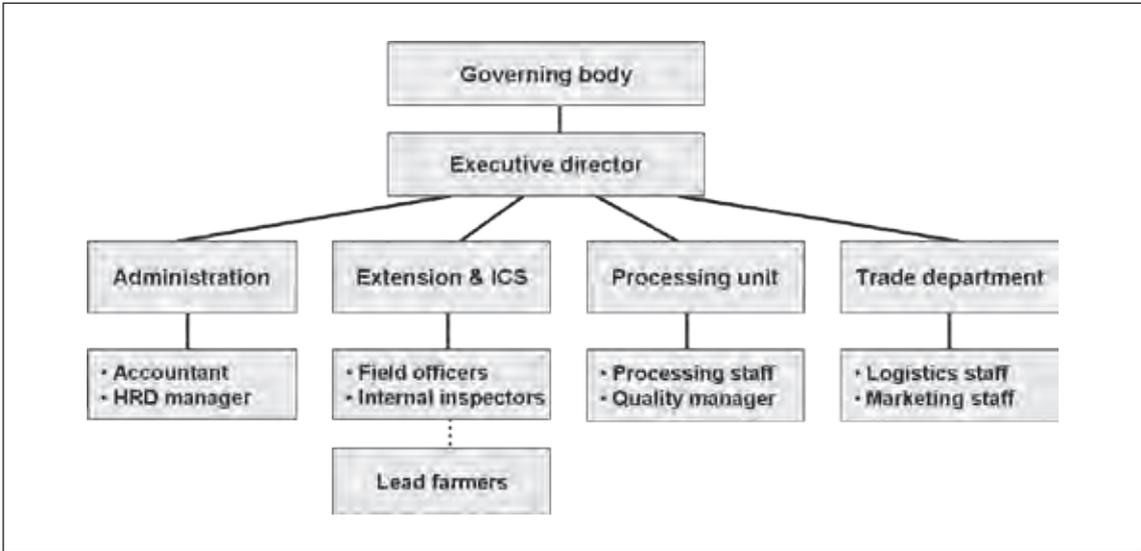


Figure 11: Example of an organisational structure of an organic business. Specific functions like processing and trade could also be outsourced.

Keep it as slim and simple as possible! In a small start-up, combine functions rather than hiring too many staff. The director, for example, can also manage accounts and marketing, and another person can be in charge of production and processing. Once the business grows you may hire additional personnel who take over specific functions.

Defining roles and responsibilities

For the smooth functioning of your business it is important that each person involved has a clear idea on his/her roles and responsibilities. Ideally, each person working in the company has a job description (or terms of reference) that clearly defines the duties and competencies needed (see texample in Annex A4.2).

Once the business gets bigger and more complex, it can be useful to document the main structures and processes in an operating or quality management manual. The manual describes how the business is structured and organised, who has which responsibilities, and how the main processes (production, extension, internal control, processing, trade etc.) are done. The text part of the operating manual refers to separate documents such as organisational charts, job descriptions, internal regulations etc. An example of a Table of Contents of a typical operating manual is provided in Annex A4.3.

Most certifiers will require that the procedures of the internal control system are clearly defined and documented. This can be done in a separate ICS manual, or integrated in the operating manual or the quality management manual. As the ICS usually involves documents such as forms, standards, checklists etc. which are updated from time to time, the manual helps to keep an overview of the different documents and versions that are in use (see chapter 8.2).

Preparing the operating manual helps you to think through the different aspects of your business, to identify ways of making it more efficient, and to keep an overview of the complex operations. The operating manual makes it easy for outsiders (e.g. the certification body or the bank) to get a clear idea on how you function. It also helps you to make new staff familiar with how your business works. Developing the operating manual and keeping it up to date may require time, but it also helps you to save time - and money!

6.3 DEVELOPING THE BUSINESS STEP BY STEP

This sub-chapter should assist you to identify and plan the necessary actions and investments in a timely way, so that you achieve the envisaged quantity and quality of products for sales.

What scale of production?

Defining the envisaged scale of the production is a crucial first step in planning the business. The scale of the production will determine the resources you require. Start small enough to be able to manage the operation and the financial risk involved, but large enough to reach sizable volumes in a reasonable time span. What volumes have you dealt with before? Is that kind of volume or twice that size the maximum that you can manage for the time being? In other words, is your plan realistic? Make sure that you do not produce or buy more than you can sell, but enough that you can satisfy the minimum volume of your first client.

Do you envisage reaching a scale that involves 50, 500 or 5,000 farmers? Are you planning for 10, 100 or 1,000 tons of production per year? How many staff do you need to employ, and how much capital do you have to invest? What is the time span? Of course, the different parameters are closely interrelated. Make a plan for the next 3-5 years in which you estimate the number of farmers and their expected production (based on average acreage and yields). The planning tool in Annex A3.2 can help you to plan these figures.

As reality is always different from the best prediction, it is wise to calculate an optimistic and a pessimistic scenario as well as what you actually expect to happen. This production plan is the basis for calculating costs, revenues and the break even point (see chapter 6.4). You need to revise it every year, inserting the actual volumes and costs incurred.

Minimum economy of scale

Assume that you achieve a 15% export premium on a good quality, certified organic product. With an export volume of US\$ 400,000 that means that you get US\$ 60,000 above the normal value of the product. All the extra costs that you need to make to get certified, to find the market, etc. should be subtracted. In the case where: you need half of that money to pay the farmers a higher price than other local buyers, certification costs US\$ 6,000 a year, your field staff costs US\$ 7,500, the extra measures to keep the organic product separate from conventional US\$ 3,500 and participation in the Biofach costs US\$ 6,000 a year, you are left with a US\$ 7,000 extra profit.

For a commodity like cotton or sesame, such an export value may be attained with, for example, a volume of 250 tons of the product. If each farmer on average produces 500 kilos and the capture rate is 50%, you will need to work with more than 1,000 farmers.

The time needed to set up an organic business

If you are not yet in business and start from scratch, expect to take 5-6 years for your organic business to be fully established. Even if you are converting an existing business to organic, or developing an organic division in a company, it will take usually 3-4 years until it is running smoothly. However, most investors and entrepreneurs expect their business to break even within three years. Introducing a new production method, crop or processing technology again requires considerable time, maybe 3 to 5 years, because most people involved need time to become familiar with the change, which usually happens through a trial and error process. Don't forget that the farmers also need to become familiar with the organic way of managing a farm, and need to trust that you will market their produce year after year. While they are having their first trial field experiences, you have to have made plans for the organisational structures.

Phases in developing the business

It is advisable to start small and fairly focused. Once you are able to handle a business on a small scale and if the market responds well, you can grow and/or diversify by adding components such as additional processing levels or other products. If you try to develop everything at the same time and on a large scale, you are very likely to fail. Growing rapidly because many farmers are eager to join can easily lead to a situation in which quality management and marketing are no longer ensured. Make a realistic plan for a period of 3 years to reach a first break-even point (it may actually become 4 or 5 years...). Only once you have reached this point, go for a next step of growth and diversification, which requires new investment. Most businesses go through phases of starting up, consolidation, expansion, and diversification (Table 2). This means that there is a continuous development.

<i>Phase</i>	<i>Main activities</i>	<i>Results</i>
Starting up	<ul style="list-style-type: none"> • Develop the idea into a real plan • Convince friends and donors to finance • Organise production, set-up the business • Develop market linkages 	<ul style="list-style-type: none"> • Farmers motivated • Certification achieved • First exports realised
Consolidation	<ul style="list-style-type: none"> • Same farmers, but more production • Streamline operations • Solidify business relations • Optimise cost price • Trade finance structurally organised 	<ul style="list-style-type: none"> • Efficient structures • Good staff • All costs covered • Reliable market links • Limited risk
Expansion	<ul style="list-style-type: none"> • More farmers, same products • Invest in growth of quality of product • Professionalisation of management, delegation of functions 	<ul style="list-style-type: none"> • Economy of scale • A profitable business • Re-investment of profit
Diversification	<ul style="list-style-type: none"> • Same or other farmers, new products • Invest in diversification of markets • Value addition and processing activities 	<ul style="list-style-type: none"> • Fixed costs borne by several products • Risks are spread

Table 2: Phases in developing an organic business

Diversification or specialisation?

Being successful in a specific business field requires a certain degree of expertise and thus specialisation. You need to know the specific production and processing technology to achieve high quality, and you need to know the specific market for the product. Most businesses therefore focus on one or few products. It rarely happens that, for example, an organic coffee business also includes vanilla in their portfolio, or that cotton businesses also deal with cereals and pulses, even though these crops combine very well in the field. Some companies feel better off dealing with only one product.

On the other hand, diversification helps farmers to improve the farming system (rotation), to enhance food security and to reduce production risks (see chapter 5.1). It allows businesses to spread certification and management costs over different products, and reduces their vulnerability to market fluctuations. Diversified business operations allow more flexibility when reacting to

the changing business environment. Diversification, however, also has its limits. Developing new crops and markets requires new investments and specific know-how. There is a risk that it distracts management capacity from the core business, and that you get into fields which are just not your “cup of tea”.

Organic businesses should therefore weigh carefully the pros and cons of taking up diversification options or focusing on the existing product portfolio (Figure 12).

An alternative is to collaborate with other companies that deal with some of the other products. An organisation of cotton producers in Burkina Faso, for example, collaborates for the quality control, collection, processing and marketing of shea nuts with a local company specialised in shea butter processing.

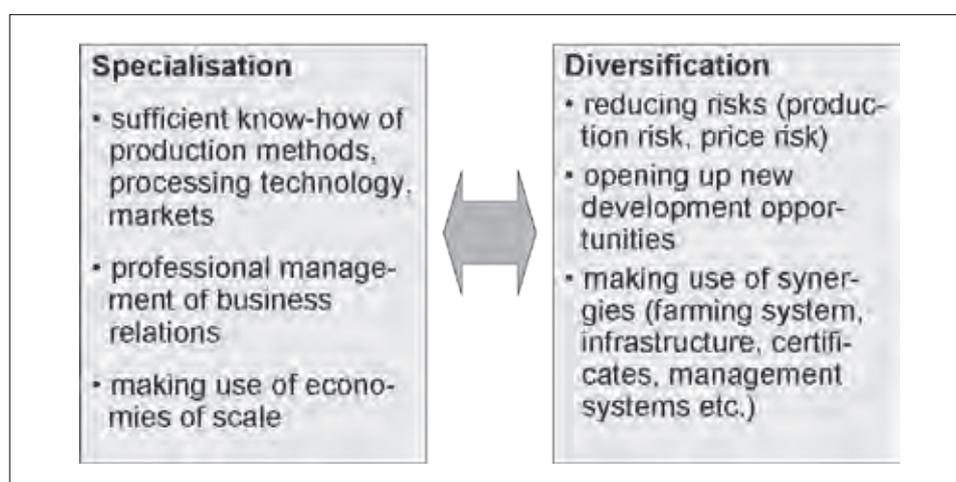


Figure 12: Specialisation versus diversification of an organic business

6.4 FINANCIAL PLANNING AND MANAGEMENT

Finance is one of the most important elements in any business activity. Although it is usually not the most favourite aspect people like to deal with, financial planning and management is not something you should leave to an accountant. If you have a solid financial plan then a major part of the business planning process is done. Financial planning is the financial translation of the detailed activities and their financial requirement. It makes you aware of all the costs involved and allows assessment of whether and when your business will break even. It helps you to keep finances under control and avoid running out of cash.

Your business needs to compete on price with others who can produce the same product and quality. You therefore need to operate your business in a cost efficient way, and to produce good quality for a low price of production. In order to assess and monitor your price competitiveness you need good insight in your total costs. Even if you are an existing enterprise that adds on an organic business line or replaces an existing activity, you need to calculate all costs of production and of doing business.

Types of costs

You can divide your costs into variable and fixed costs:

Variable costs are expenditure that varies with the production volume. Variable costs increase when production increases, and fall when it decreases. Examples of variable costs include the purchase of raw materials, packaging, or labour directly involved in processing. For instance if for the production of 10 litres of pineapple juice you need 10 pineapples and 10 bottles, then for the production of 1000 litres of pineapple juice you need 1000 pineapples and 1000 bottles. The costs of the inputs go up in direct proportion to the volume of production.

Fixed costs are expenses that do not vary depending on your production volume. Examples of fixed costs are rent of premises, certification fees, depreciation costs of equipment, salaries of extension staff and management etc. Whether your production is 10 tons of cotton or 100 tons of cotton that year, the rent for the building you are hiring will be the same. In the case of pineapple juice; the machine you use for producing the juice will cost the same in depreciation whether you produce 100 litres or 10,000 litres.

Your variable costs go up gradually, while your fixed costs increase or decrease in steps, for example when you change your office building, buy new equipment or hire additional staff. Costs for extension, ICS and certification are semi-fixed/semi-variable costs; they are not directly linked with the output, but increase to some extent when more farmers are included. When the fixed costs are relatively high, it is especially important to look for maximum use of what those fixed costs stand for.

Cost price calculation

The cost price is the total of all variable and fixed costs divided by the number of produced units (e.g. per kg cocoa beans or per litre of sesame oil). Initially, when production volumes are still small, the cost price per unit is high. With growing volumes that support fixed costs, economies of scale bring your cost price down (Table 3). Examples of cost price calculations are given in Annex A3.3.

It is especially important when you are planning a new business that you calculate the cost price. It is of course much easier for an existing business, involved in the conventional business of the same product, to work out the extra costs that come with the organic project.

During the planning phase, exact costs are not usually known and therefore need to be estimated. There are often costs which are not sufficiently anticipated; especially for logistics. It is therefore wise to include a certain contingency in your cash flow planning, and to build up sufficient reserves. It is very important to keep close track of what the real costs are and redo the calculation as soon as the first season is over. Businesses should update their cost price calculation every year, and it becomes a tool to improve the efficiency of the operation.

<i>Volumes (kg)</i>	<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>
Production volume (raw material)	50'000	120'000	250'000
Production volume (final product)	40'000	96'000	200'000
<i>Cost price (EUR per kg)</i>			
Purchase of raw material from farmers (incl. premiums)	1.00	1.00	1.00
Bulking and transport of raw material	0.10	0.07	0.04
Turnout factor final product per raw material input	80%	80%	80%
Raw material cost per final product output	1.38	1.33	1.30
- Revenues from second quality output or by-products	-0.08	-0.08	-0.08
Cleaning, processing and packaging	0.18	0.14	0.13
Personnel cost (salaries, travel of extension staff etc.)	0.50	0.31	0.20
Certification cost	0.13	0.06	0.04
Marketing cost	0.13	0.06	0.04
Office cost (rent, material, electricity, phone etc.)	0.10	0.05	0.03
Depreciation of equipment	0.05	0.02	0.02
External services (e.g. auditing, consultancy)	0.08	0.03	0.02
Financial cost for loans (including trade loans)	0.08	0.05	0.04
<i>Total cost price (EUR/kg)</i>	<i>2.53</i>	<i>1.99</i>	<i>1.72</i>
<i>Sales price</i>	<i>1.80</i>	<i>1.80</i>	<i>1.80</i>
<i>Margin</i>	<i>-0.73</i>	<i>-0.19</i>	<i>0.08</i>

Table 3: Cost price calculation with different volumes (generic example)

Sales margins

The sales margin is the difference between cost price and sales price. Each type of business has its own margin. The higher the investment and the risk, the higher the margin needs to be. Margins on processed products are usually higher than on raw materials. The margin is not simply profit in the sense of money put in somebody's pocket; it is a safety net that helps a business to survive in bad times, and it is needed if a business is to grow. In organic value chains in developing countries a margin of 10-30% is quite common. This margin can not be expected in the first year, but only when the business is consolidated.

Breaking even

The break even point is the level of production and sales where total revenue of sales is equal or above total costs (variable and fixed). After determination of variable costs, fixed costs and selling price, you can easily determine the break even point of your operation. If you want to estimate the volume needed to reach break-even you can use the following formula:

$$\text{Total fixed cost} / (\text{sales price per unit} - \text{variable cost per unit}) = \text{break-even volume}$$

You should calculate the expected costs and revenues over a period of time to assess the profitability of your business (Table 4).

In organic businesses you have a conversion period. Usually you cannot sell the product as certified organic during the first one or two years. At the same time you have all the costs of putting field staff in place, an ICS, certification, and you probably have to pay the farmers some premium to motivate them. This means that the first two years are almost always a period in which you make a loss.

<i>Profit and loss calculation</i>	<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>
Cost			
Purchase of raw material from farmers (incl. premiums)	50'000	120'000	250'000
Bulking and transport of raw material	5'000	8'000	10'000
Cleaning, processing and packaging	7'000	13'000	25'000
Personnel cost (salaries, travel of extension staff etc.)	20'000	30'000	40'000
Certification cost	5'000	6'000	7'000
Marketing cost	5'000	6'000	7'000
Office cost (rent, material, electricity, phone etc.)	4'000	5'000	6'000
Depreciation of equipment	2'000	2'000	3'000
External services (e.g. auditing, consultancy)	3'000	3'000	4'000
Financial cost for loans (including trade loans)	3'000	5'000	7'000
Taxes	0	0	2'000
Total cost (\$)	104'000	198'000	361'000
Revenues			
Revenue from sales of main product	72'000	172'800	360'000
Revenue from sales of second grade or by-product	3'000	7'200	15'000
Interests on bank account	200	300	500
Total revenues (\$)	75'200	180'300	375'500
Profit / loss (\$)	-28'800	-17'700	14'500

Table 4: Example of a profit and loss calculation

Once you are able to sell certified organic product, the situation looks better. However, often you will have expanded from the initial producer base to a larger one, which requires additional resources for extension, ICS and certification. First time marketing costs may also be higher than in a consolidated situation. In the third or fourth year, when you are able to sell larger volumes of your product as certified organic you should be approaching the break even point. Most organic businesses turn profitable within 3-5 years. The length of the conversion period, the complexity and the overall size of the business are the major determining factors (see chapter 6.3, The time needed to set up an organic business).

In the following years you try to make the business more efficient, by optimising your cost price and marketing approach. This is when you start earning money. However, when reaching the initial break even point, you should already start thinking of adding another product or investing in scaling up your operation (Figure 13).

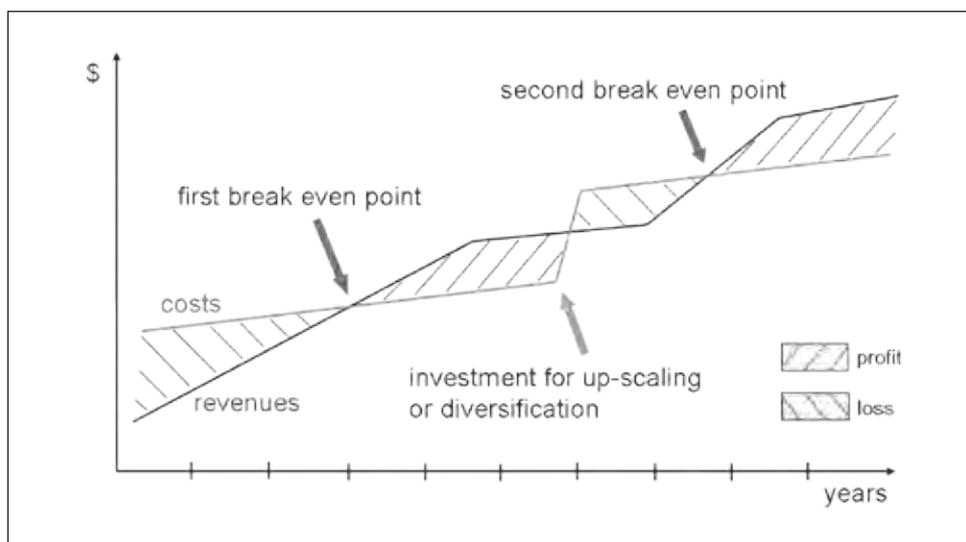


Figure 13: Break even of costs and revenues; new investment

Sensitivity analyses

Cost calculations are normally based on real costs (existing business) or assumptions (start-up business). It is good also to analyse what happens when one or more of the factors changes considerably. This could be positive or negative changes. Typical changes are fluctuations in the currency exchange rate, but also higher or lower yields or changing market demand. A shortage of the crop may increase local prices above what you have planned to be the organic premium price. Increases in cost of diesel and energy have surprised many businesses in the recent past, so if you want to reduce your risks, you need to make a sensitivity analysis. This means that besides the normal case you calculate a best and worse case scenario. Table 5 provides an example of a sensitivity analysis.

<i>Factor</i>	<i>Normal case</i>	<i>Best case</i>	<i>Worst case</i>
Yield		+ 10%	- 20%
Exchange rate Cedi/EUR		+10%	- 10%
Transport cost		- 5%	+ 20%
Marketing cost		- 5%	+ 20%
Result cost price	0.86	0.75	0.99
Sales price	1.03	1.05	1.00
Profit/loss	0.17	0.30	0.01
Profit %	17%	29%	1%

Table 5: Example of a sensitivity analysis

It is unlikely that all these factors will change for the better or the worse at the same time. You can also calculate worst and best case scenarios for each single factor.

Cash flow management

For any business activity it is important to plan your financial needs in order not to have a working capital shortage at a crucial time in your production or trade process, which would block your business activities. Throughout the year there are significant changes in cash flow. The best way to get insight into your financial needs is by planning your incoming and outgoing cash flow on a monthly basis (Table 6). You have to pay your office staff and the field officers on a monthly basis. Some organic businesses provide their farmers with inputs, like seeds and organic fertiliser at the start of the season. It can be quite an investment and it may take 10 months before that money comes back on to your bank account. You normally need most cash to pay the producers upon delivery, while you will only receive payments from your clients quite some time later. You will need to bridge the period between expenditures and revenues, for which you require extra working capital. By planning your cash flow on a monthly basis you can determine how much 'foreign' capital you need, and for how long. As money is expensive (interest) the smaller that amount and the shorter you need it for, the better.

Cash flow predictions, like the one provided in Table 6, are also used to request a trade loan from a bank (see chapter 6.5).

A cash flow plan deals with incoming and outgoing payments and not with revenues and costs. For instance depreciation of a car is a cost but not an actual payment. It will therefore not appear on your cash flow planning, but will appear on your profit & loss account. When planning your cash flow always ask yourself if the items you are budgeting lead to an actual change in your cash or bank position in that month.

Figure 14 shows the liquidity situation of an organic vegetable production unit prior to getting external finance. They export during part of the year with weekly shipments. This means that the money comes back fairly regularly and the liquidity requirement is not high. Nevertheless, they need financing for their cash flow for the first 6 months.

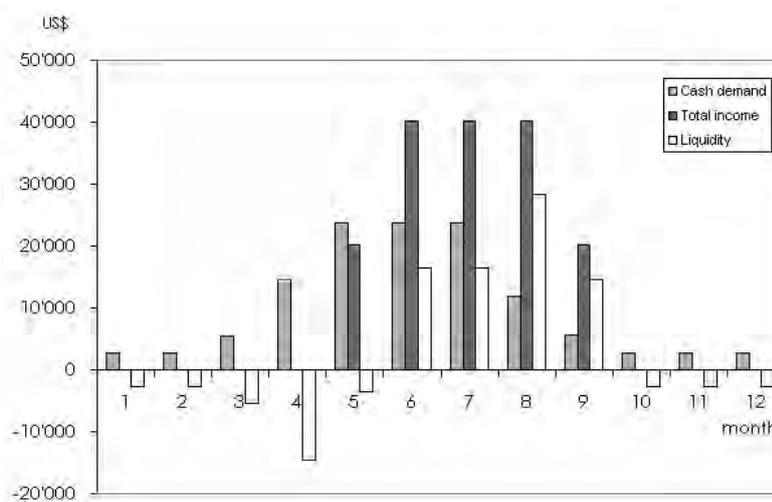


Figure 14: Monthly liquidity of an organic vegetable business (example)

Month	1	2	3	4	5	6	7	8	9	10	11	12
<i>Cash position at the start</i>	40'000	35'700	31'900	26'100	22'100	78'300	13'500	15'200	17'900	11'600	57'600	78'800
Operational cash flow												
<i>Incoming payments from buyer A</i>										300'000	150'000	
<i>Incoming payments from buyer B</i>												20'000
<i>Other income</i>												500
Total in	0	0	0	0	0	0	0	0	0	300'000	150'000	20'500
<i>Purchase of raw material</i>						60'000	160'000	80'000				
<i>Bulking and transport</i>						1'000	3'000	1'000				
<i>Cleaning, processing, packaging</i>							20'000	10'000	2'500			
<i>Office cost</i>	800	300	300	500	300	300	800	300	300	500	300	300
<i>Personnel cost</i>	3'500	3'500	3'500	3'500	3'500	3'500	3'500	3'500	3'500	3'500	3'500	6'500
<i>Certification cost</i>								7'500				
<i>External services</i>			2'000				1'000					2'000
Total out	4'300	3'800	5'800	4'000	3'800	64'800	188'300	102'300	6'300	4'000	3'800	8'800
<i>CP before external finance</i>	35'700	31'900	26'100	22'100	18'300	13'500	-174'800	-87'100	11'600	307'600	203'800	90'500
Financial cash flow												
<i>Loans from bank</i>					60'000		190'000	105'000				
Total in	0	0	0	0	60'000	0	190'000	105'000	0	0	0	0
<i>Repayment of loans and interest</i>										250'000	125'000	
Total out	0	0	0	0	0	0	0	0	0	250'000	125'000	0
Total cash flow												
Total monthly cash flow	-4'300	-3'800	-5'800	-4'000	56'200	-64'800	1'700	2'700	-6'300	46'000	21'200	11'700
<i>Cash position at the end</i>	35'700	31'900	26'100	22'100	78'300	13'500	15'200	17'900	11'600	57'600	78'800	90'500

Table 6: Example of a cash flow calculation

6.5 FINANCING YOUR ORGANIC BUSINESS

There are not many companies that have sufficient working capital on their own to completely finance their business by themselves. Some people say that the success of a good entrepreneur depends on how good a banker s/he is.

A producer organisation or enterprise will need capital generally for the following purposes:

- Investments (buildings, trucks, motor bikes, furniture, computers, processing equipment etc.)
- Working capital (payment of personnel, running cost of the business, inputs)
- Trade finance for buying of harvest
- Capital to overcome start-up losses

There are many different ways to attract or generate capital for these purposes, and most businesses use a mix of them. Possible sources of finance are:

- equity (own capital)
- loans from family and friends
- product provided on credit by the farmers
- advance payment by your client
- loan from a financial institution
- grants

Equity (own capital)

Your own capital is the most dependable source of capital because you have full control over it and there are no costs attached to it. There are different ways of generating equity:

Financial reserves built up through profits from previous seasons. These have to be well guarded until the funds are needed.

Member equity: Most cooperatives ask their members to pay a fee when becoming a member. It can be in the form of product. This fee will be registered in the name of the member depositing it as equity of the cooperative. The membership entitles him/her to a share in the profit of the cooperative, unless the general assembly decides to keep the money in the cooperative. Profit can be paid out based on the value of the share, or based on the volume of product that the member delivered to the cooperative. Proper provisions need to be in place in case a member dies, or wishes to leave. The advantage of member equity is that it creates commitment of the producers towards their cooperative. It will also mean that they will want influence in the decision making in the cooperative.

Share capital: If you are not a cooperative but an enterprise you can look for external investors willing to invest in your company. By issuing shares to them in exchange for their investment you give them part of the ownership in your company. Usually you have to convince them through a business plan. There should be rules on profit sharing among the shareholders, and about the influence that share holders can have in the company strategy or management. Investors can have a positive influence on your company, as they are often seasoned business people. Another example is the main importer of your product. There are even funds stimulating this, like the Private Sector Investment Programme in the Netherlands³⁶. There are also venture capitalists who wish to invest in promising businesses in the so-called emerging markets³⁷, and financing institutions focusing on sustainable investments.

Loans from family or friends

Many entrepreneurs have family abroad, or friends who have done well. For smaller amounts it is quite common to obtain a loan from family or friends, especially one that is paid back fairly quickly, with a profit. These are often informal loans that are not even put on paper. When it concerns larger sums of money, it is very likely that the person will want to have guarantees. They may become a shareholder in the company, so that the loan turns into equity. Whether family or friend, the relationship may come under stress when things do not go as planned, or when the lender wants his/

³⁶ www.evd.nl/business/programmes/programmamaint_psi.asp?land=psi

³⁷ See for example www.bidnetwork.org/page/97620, www.responsability.com

her money back while you still need it. It is up to you how much risk you want to take to sacrifice friendly relations for your business purposes.

Product provided by farmers on credit

The biggest bottleneck in financing is the one of trade finance, needed to buy the product from the farmers, until you get paid by your buyer. In some cases it is a matter of six weeks before the payment comes in, in other cases this takes 3-4 months. Businesses therefore may try to ask the farmers to provide their produce on credit, in exchange for a document stating the quantity delivered. This type of credit system often goes wrong and most farmers prefer to sell cash in hand to the best possible buyer. Asking the farmers to deliver their produce without immediate payment is a situation that you should try to avoid.

Advance payment by clients

Certainly in more advanced relationships the buyer is often willing to pre-finance part of the trade contract. It can be part of the sales agreement and of the price negotiation. For them it is an assurance that they will get the product. They may be able to get trade finance for a much lower interest rate than you would need to pay. The condition for this is that the buyer trusts you. This trust is usually built over the years; it won't happen in the first year. While the buyer may trust you, his/her accountant or bank will still insist on maximum guarantees. This usually starts with an exclusive trade agreement - otherwise you might be buying the product with his/her money and selling it to a competitor.

It might also mean that an external agency must be contracted to monitor how much product is in your warehouse. There may even be a construction with a kind of bonded warehouse. This means that all product that you bring in is registered and additional funds are paid out based on that collateral, and product can only leave the warehouse in a sealed container with the buyer as addressee. The moment that the container leaves, the real payment is effected by your bank. Then the money is really yours.

These contracts are usually made for a specific amount of produce and with a tight time schedule. Once that contract is fulfilled you are free to sell the remainder to any other party. Be aware that such pre-finance might limit you in your freedom to sell to other buyers. It might however be a good solution if banks consider your business as too risky to provide a loan, or if attracting pre-finance from your buyer is a lot cheaper than a bank loan. Always check the different options that are open to you, and compare the pro's and con's of each option.

Loan from a financial institution

Taking a loan from a financial institution has a cost, and bears some risk. You need to pay interest and possibly pledge collateral. If the loan is taken in foreign currency, there also is the risk that the exchange rate changes to your disadvantage. Start-up businesses usually only get part of the required finance; the banks will always ask you to provide a significant part of the total sum required yourself. No one is going to put their money in your business if you do not invest yourself.

One can distinguish two types of loans: trade finance and investment finance.

- **Trade Finance:** A short-term working capital loan (usually 4 to 8 months), mainly used for buying the raw product from the producers. In order to become eligible for

trade finance you usually need a contract or a letter of intent of a buyer of your product. The buyer of the product has to be trustworthy enough for the financial institution as well, as often the loan is repaid through the buyer to the bank.

- **Bank Overdraft Facility:** Once you have built a good relationship with your local bank it might also be possible to negotiate a short-term overdraft facility on your bank account. An overdraft facility is to be used only for short term capital needs.
- **Long term loans:** For long term investments, such as machinery, a building or a truck, or to cover start-up losses, a long term loan is needed since you will need more than one season to recover the costs of the investment. In order to become eligible for a long term loan, a financial institution will look at your business plan, your financial and sales track record, possible collateral, and your equity/debt ratio etc.

For start up producer organisations or enterprises it is difficult to access external loans because of the lack of a long term relationship with a client, the absence of a financial or trade track record, the absence of collateral or other securities and the absence of equity. A guarantor could be the solution in this case. A third party who really believes in the future of your organisation or enterprise and who is financially healthy itself can partially diminish the risk for the lender, by issuing for instance a 50% guarantee to the loan.

Check with local banks and micro-finance institutions whether they can offer you credit for your organic business on reasonable conditions. If they can not, it is a good idea to also consider international financing institutions specialized in providing trade finance or long-term loans to organic and Fair Trade businesses (see list in Annex A3.4).

Grants

The last possible source of finance is a grant by a third party, such as development organisations or government economic development schemes. A grant could be given in the form of a seed capital grant. A seed capital grant will be integrated in the balance sheet of your organisation as donated equity. The advantage of a seed capital grant is that it improves your equity position through which access to external capital in the future becomes more feasible. There are also schemes that provide grants within a public-private development partnership, or assign a grant for the capacity building of your staff (see chapter 12.3 and Annex A2.2).

The issuing of grants to start up companies is a last resort, because they may distort competition with market actors. Grants do not necessarily stimulate commitment of the grant receiver. In general, it is advisable to use your own funds and being cost efficient by ensuring good financial management. However, especially in a situation where a new business supports smallholders who otherwise have little chance in a market economy, grants can be justified.

6.6 KEEPING THE BUSINESS GOING

Keeping an overview

An organic business rapidly becomes complex and so it is not always easy to keep a good overview. The management needs to know how key business parameters evolve in order to be able to take the right decisions. A reliable accounting system clearly is a must. Regular staff meetings help to keep everyone up to date, and to decide about how to deal with upcoming problems in a team spirit.

Keeping an overview also means knowing where the business actually stands concerning its key figures. It means being able to answer questions like: What acreage is under organic cultivation this year, and what is the expected production? How many farmers have already been inspected by the ICS, and how many were excluded from the project due to non-compliance with the standards? How much produce has already been sold, and how much is still in stock? What volume of seeds is required for the next season, and how much money to purchase the harvest from the farmers?

As your production is spread over hundreds or thousands of farmers, answering these questions usually requires summing up the respective figures of each farm. A database will help you to handle production and ICS figures in an effective and transparent way (see chapter 8.3). Similarly, your processing and sales figures should be entered in some kind of database. An Excel file can do the job until the business reaches a certain size and complexity that a more sophisticated system is required.

The database also helps you to calculate and monitor key indicators of your business such as average yields, the ratio between extension staff and farmers, the realised margin between buying and selling, or the additional income generated at the level of the farmer.

Operational planning

In an organic business, many activities that are interlinked need to be orchestrated over the year. Farmers need to be registered and trained at the beginning of the season, harvest estimates need to be done at certain points of time, internal inspections need to be completed before the harvests start, logistics need to be arranged etc. Operational plans (see example in Annex A4.4) in which the different activities are listed with their respective period of implementation help you not to miss an important activity, and to plan activities that are interdependent. It is also a useful tool for monitoring and steering.

Annual review of plans versus realisation

You may plan your business with utmost care and sincerity, but reality almost always turns out differently. It is therefore important to compare your plan with the actual results at the end of each season, and to analyse the differences. This is true for production and sales figures, but also for the overall budget. Get the real expenditure out of your book-keeping, and adapt the budget for the next season accordingly.

Check real cost prices at the end of the season and see what costs you did not budget correctly. Analyse cost drivers and identify ways to save costs. However, there are also points where it does not pay off to cut costs: quality management and quality certification services, postponing payments or premiums to farmers, payment of field staff etc.

Annual reviews also help you to optimise the performance of your business. It is a good idea to involve your team in this exercise, for example by discussing jointly the strengths and weaknesses observed during the last season. Evaluate how you could possibly become more efficient. Develop strategies on how to earn more, and how to reach the optimum size for your business.

Managing risks

Running an organic business involves certain operational, financial and market risks (Table 7). Doing business means taking risks; knowing and managing risks. Realistic planning is needed, which takes into consideration that effective volumes may turn out to be lower, costs higher and markets less

responsive than one had hoped. Table 7 outlines some ways in which these risks can be mitigated to some extent. A simple rule of thumb says: The higher the risk you take, the higher margin you need to obtain.

Possible risks	Measures to mitigate the risk
Operational risks	
Weather conditions or pests affect crop yields	Provide technical solutions to farmers; calculate with careful scenarios; deal in different crops at a time.
Farmers sell their production to other buyers	Offer farmers an attractive price and pay immediately; build loyalty by involving the farmers in your business. Try to understand how the other buyers are competing with you, and whether it is temporary or permanent.
Theft	Rent a store with a proper door and lock; have it guarded.
Quality deterioration during storage (insect infestation, moulds etc.)	Choose suitable storage facilities, keep the place clean, dry and windows meshed. Monitor pests with traps. Regularly take product samples and check them.
Product getting wet, dirty, or damaged during transportation	Use a reliable transport service. Make sure that the truck is clean, that nothing else is loaded up. Tell them you must be informed immediately in case of an accident or breakdown.
Product getting damaged or lost during export shipment	Make sure that the container is well loaded (take photos). Make sure that the shipment is sufficiently insured by the importer (if FOB conditions) or by yourself (if CIF conditions).
Financial risks	
Payments to farmers disappear on the way	Handle payments via bank accounts; involve farmer organisations in handling the payments to farmers.
Margins are not sufficient to cover operational costs	Increase efficiency, reduce production costs per unit. Calculate with leeway for unforeseen costs and sufficient target margins.
No loans can be obtained to maintain cash flow	Organise trade loans in time; agree with farmers and clients when payments are to be made.
The buyer does not pay, or pays less after having received the product	Know and trust your client (track record); work with FOB, Letters of Credit, CAD with your preferred bank. Send correct samples, have a good agreement on handling discounts.
Market risks	
Demand for the product slows down, no buyer can be found	Check-out market trends before entering into contracts; diversify your business. Look into local-regional markets, look into storing.
Clients do not honour the contracts and do not buy the committed volume	Build strong partnerships; negotiate solid contracts; arrange for alternatives, even with the buyer who did not buy.
Competitors offer the product at lower price or better quality	Continuously work on reducing production costs and improving quality. Be more reliable than the competition. When it is structural, shift focus, diversify.
Sudden increase in local price	Communicate with your buyers in good time. Decide together whether to sit it out or cancel the contract.
Sales prices for the product decrease	Pay farmers in two instalments (see chapter 7.5); the second payment depending on the realised sales price.
Fluctuations in exchange rate	Negotiate sales prices in local currency or in a relatively staple currency (e.g. EUR); sell "back to back" (see next paragraph).

Table 7: Possible risks involved in running an organic business, and measures to mitigate these risks.

Price risk management

Most entrepreneurs have orders or contracts fixed before the season starts. Within the order, the price can either be fixed or kept open. You may want to be sure that you are in the business for a

certain volume, but if you have fixed the price far ahead of the actual buying, both can gain or lose from movements in the market or the exchange rate.

Some entrepreneurs seem to wait for the best possible price; they are in fact speculators. Very seldom do they actually get the best possible price and often they don't stay long in the market. They may not only harm the producers they buy from, but also disturb the wider organic market for the respective product. It is a much better policy to be content with a fair reward for your effort; you won't get this by taking great risks.

Entrepreneurs have to estimate the price they will buy at, and the price they will sell at. Local and world market situations change and exchange rates fluctuate too. This can be positive or negative; it is a risk. The risk is limited if you sell 'back to back'. This means that you only buy for a certain farm gate price when you have a contract in your pocket for a certain sales price. The order is to buy 200 tons, possibly 250, and buyer and seller are in weekly contact, discuss and agree what will be the best time to fulfil the order. You 'lock' the price, the next week you buy.

However, most businesses dealing with non-perishable products do not only sell during the harvesting season. You have to buy produce that you keep in stock for delivery later in the year. You can either go "short" (you have contracts to deliver for more than you possess), or go "long" (you have more in stock than you have sold). It is very dangerous to commit yourself to sell more than you have in stock; you may even lose your buyers. On the other hand, if you want to expand, and you expect more orders to come in you may decide to go long. In both cases you are playing with fire! One major strategy for limiting your risk is to limit the volume by which you are long or short.

6.7 MANAGEMENT STRUCTURES AND CAPACITY

Organic enterprises often start as a very small structure, possibly even as a one-man or one-woman show. Even when hiring staff, many entrepreneurs stick to taking all the decisions themselves. Producer cooperatives on the other side tend to involve a large number of people in decision making. This can block the development of the business. In both cases, the top management needs to be willing to delegate responsibility to 'middle management'. Whether an entrepreneur or a cooperative governing body is able to delegate responsibilities will determine whether the business moves from small to medium size.

Efficient management structures

Management structures need to be designed in such a way that decisions can be taken in an informed and timely way, and at the same time ensure that the people involved in the business feel that their views are taken into consideration. Farmer cooperatives tend to keep a lot of decision power with the general assembly and the board of directors they elect. Decisions sometimes need to be taken in a very short time in order to make use of an opportunity, or to avoid failing to meet a contract. The executive director and the sales manager therefore need to have sufficient mandate to decide on most operational matters. When every decision, every bank draft needs to be signed by a hoard of people, it does not reflect well on your coop.

On the other side the management structure needs to ensure that the executive forces report back to the governing body in a transparent and accountable way. The governing body needs to ensure that the business is managed in line with its core principles, and that there is no fraud or corruption involved.

Professional management

Being professional means being both honest and trustworthy. Commit only to what you can live up to, and stick to your commitments. The market is small; you will be surprised by how much information is exchanged between traders who are in competition with each. When assisting existing businesses in looking for new markets it is not uncommon to hear ‘Oh no, not that one, thanks!’ or similar. It is very difficult to turn such an image around.

Criteria for successful entrepreneurs or managers in organic business:

- Open minded, flexible, determined
- Able to listen, willing to learn
- Good in keeping an overview of the finances
- Good communicators
- Sense the market, react to changing requirements, innovative
- Good business managers, organisers

Your clients expect you to be professional. That means that you have to have, or move towards having, a good administration, a functioning membership or shareholder system, checks and balances in place, accounts annually audited by a reputable organisation, and goods delivered on time at the same quality as the sample.

The professionalism of your business should also be reflected in the way you present yourself: your printed materials and website, your business communication, and the way you interact with clients.

Developing management capacity

Running a business requires a set of skills and abilities that can not easily be developed on your own. An executive director of an organic business needs to have an entrepreneurial mind set and the ability to sell, but at the same time needs to be able to understand the situation of the farmers. He or she needs to be able to handle and understand budgets and business figures, but also to recruit and guide staff, and interact with the outside world.

When the business expands, new management capacities are needed. Running a small family business requires different skills and experiences from running a company involving thousands of farmers. Make sure you develop these capacities whilst growing the business, or hire the right staff with the necessary experience, and delegate tasks.

There are various ways to build and improve your management capacities and these of your staff:

- Attend management training
- Get coached by an experienced person
- Make use of business development services
- Exchange with peers in other companies
- Exposure to other businesses, participation in networks
- Self-reflective “learning by doing”

Summary of recommendations

- Even if you do not write a fully-fledged business plan, you need to have fairly clear ideas on the main elements of your business strategy (organisation, scale, markets, costs and revenues, finance etc.).
- If you get assistance in writing a business plan, make sure that you and your team understand and support what is written in it. The process of developing a business plan is usually more important than the document itself.
- Keep the organisational structure of your business slim, simple and efficient. Define clear responsibilities for the main processes, and write them down.
- Start small and focused enough to be able to manage the operation and the financial risk involved, but large enough to reach sizable volumes in a reasonable time span.
- Plan your business in phases; expand and diversify after having reached a first break-even point.
- As a certain degree of specialisation is needed in order to be successful, carefully weigh the advantages and disadvantages of diversifying your business.
- Calculate expected costs and revenues over a period of time in order to assess whether your business can eventually break even.
- Make sure that you do not temporarily run out of money during the course of the year. Plan your cash flow in advance, and organise finance in time, if needed.
- Make sure that you have reliable and up to date figures at hand that provide you an overview of the core aspects of your business.
- At the end of the season or year, check the effective results with the plans. Analyse cost drivers and evaluate how your business can become more efficient.
- Limit your entrepreneurial risk by buying from farmers only at a certain farm-gate price if you have the respective sales contracts for most of this volume.
- Make sure that the people in charge of managing your business have the necessary skills and experience.

7 ORGANISING PRODUCERS FOR THE MARKET

Traditionally, producers are organised in cooperatives or farmer groups in order to negotiate better prices, like having a union. In organic value chains, farmers are organised for extension, certification and marketing. This helps to make the supply chain more efficient, which in the end is better for all parties.

7.1 PRODUCER ORGANISATION VERSUS COMPANY SET-UP

Producers can be organised in different ways in relation to the unit that is marketing their products. They can form a cooperative or a similar type of producer organisation that takes the raw material from the individual members and looks after the marketing. They can also be organised and contracted by a company or trade house which buys and sells the product. Both set-ups have their advantages and disadvantages (Table 8). A third option is that farmers participate as shareholders in a company (see chapter 7.2).

Producer organisation	Company
+ owned by farmers!	- do farmers really benefit?
+ avoiding “middle men“!	- high transaction costs?
+ coherence, loyalty of farmers!	- adherence of farmers?
- im-balanced focus on farmers' interest?	+ business orientation -> competitiveness!
- sufficient management skills?	+ professional management!
- “slow and heavy“?	+ “quick and flexible“!

Table 8: Advantages (+) and disadvantages (-) of a producer organisation versus a company set-up

Producer cooperatives

A producer cooperative is a marketing organisation that is owned by the farmers who are the members of the cooperative (Figure 15).³⁸ The management and staff hired by the cooperative organise production, extension, the internal control system and sales, and possibly also processing



Meeting of coffee producers at Cooperativa Agraria Cafetalera La Florida in Peru (Source: Cooperativa La Florida)

of the product. As the cooperative is the owner of the certificates, it is free to sell to whichever buyer it wants. The advantages of a producer-based set-up are that farmers are involved in decision making (via the general assembly and their representatives in the board of directors) and that the profits of the operation belong to them. Equally, in case of losses farmers risk getting paid less than what had been planned.

³⁸ Examples of organic producer cooperatives are Greenet in Thailand (www.greenet.or.th), El Ceibo in Bolivia (www.elceibo.org) and La Florida in Peru (www.lafloridaperu.com).

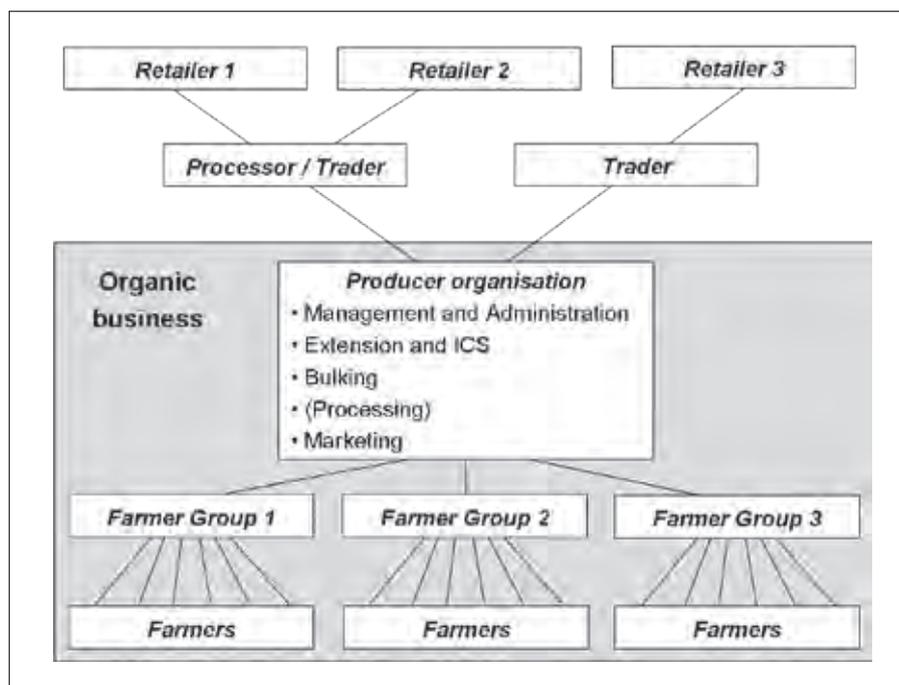


Figure 15: Typical set-up of an organic producer organisation

As it is their own organisation, farmers could be expected to adhere to the rules and to sell their produce to the cooperative only. This is not always the case. Many cooperatives lack management skills and entrepreneurial spirit. Due to the cooperative structure, decision making may be slow. In addition, there is a tendency that imbalanced focus is given to farmers' interests, especially when it comes to pricing, which can put the profitability and competitiveness of the operation at risk. Quality differentiated pricing is not always possible as farmers expect the cooperative to take all produce for the same price. Inefficiently managed cooperatives can be quite expensive intermediaries through which farmers may earn less than when selling to private buyers. There is also a risk that farmers do not really have a say in their cooperative, because board members may not represent their interests. Not all board members always understand how the business works.

Company relating to producers through a contract farming basis

In this set-up of an organic business, the company contracts farmers for the supply of raw material.³⁹ It organises input supply, extension, ICS, first level processing and sales. As the company holds the organic certificate, the farmers can sell their produce as organic to that company only. As the company feels that they take all the risks, they also take the profit. Any commercial enterprise will have a strong risk reduction strategy. What that means for the farmers is that the company will buy the produce for as little premium as they can get away with. They may be willing to share some of the profits after the business is done to build loyalty among the farmers, but this is the exception rather than the rule. As a result, farmers often sell a significant part to other buyers (at least the



Ibero (Uganda) Ltd. manager with field team at their buying store. (Source: AELBI - East Africa)

³⁹ Examples of companies contracting organic producers are bioRe India (www.bioreindia.com), Aratex Organica in Paraguay (www.aratex.com.py), Yiriwa in Mali (www.yiriwa.com) and Ibero (Uganda) Ltd. (www.ibero.co.ug).

low quality part). They may also try to link up with other companies that can offer a better price as they did not have to invest in the development of the farmers.

The advantages of a company set-up are that the entire operation is strongly focused on competitiveness and profitability. The owners therefore have an interest in hiring a professional director and staff, and decisions are usually taken in a quick and flexible way. Of course there are also examples of companies that are not efficient, competitive or profitable. They usually do not stay in business for very long.

Which structure to choose?

Because of the traditional stand off between farmers and buyers, it is necessary to look for new ways of cooperating. Unfortunately, there are still too many mutual apprehensions between entrepreneurs and companies on the one side, and farmer organisations and development agencies on the other side. Many development agencies and farmer organisations have a very exclusive focus on the farmers. Rather than encouraging collaboration with entrepreneurs and companies, they feel that farmer organisations should do everything from production to exporting. That is a very challenging task.

On the other hand, companies tend to focus too much on their own profit rather than on paying farmers a good price. As their main business is to trade, they may not be very familiar with agricultural production. Organising farmers, training and guiding them in organic methods, and building internal control systems which involve farmers is alien to many entrepreneurs.

It is therefore a question as to whether one should engage both in farming and in the export business. These are two very different worlds, and require quite different sets of skills and mind sets. Doing everything at the same time - organising production, getting certified, improving quality, processing, financing, exporting etc. - may just be too much. A reasonable division of tasks could be that the producer organisation is in charge of production, extension, ICS and bulking, and then sells the raw material to a company that covers trade finance, packaging, marketing and export. Certain functions like the provision of inputs, quality management and first-level grading can also be initially covered by the company, and then transferred to the farmer organisation. A crucial question is whether the company or the producer organisation holds the certificate (see chapter 8.1).

Whatever set-up you chose, make sure that:

- the management is professional and experienced
- financial matters are managed in a professional way
- the overall responsibility for the ICS is clearly defined
- skilled staff is in charge of sales and marketing

7.2 INVOLVING FARMERS

Whether you are a company or a cooperative, the farmers are your production base. You need to invest in them, you want them to sell to you, and you depend on them. Consider yourself close to being married with “your” farmers. It is important that there is a strong trust relationship between your business and the associated farmers. In this relationship, both sides have certain rights and duties.

Building ownership and trust

A top-down approach is not likely to work with farmers; a partnership approach has better prospects. If farmers feel that it is also “their” business and that they have a stake in the success (or failure) of the operation, they are more likely to collaborate than if they are mere raw material suppliers. Think about how you can involve farmers in designing the business - for example by regularly consulting with farmer representatives or by involving them in the governing body (for producer cooperatives this is anyway a must). Think about how the management of the business can stay in touch with the farmers, and about how part of the profits can be shared.

Building trust and loyalty with farmers requires:

- timely and transparent information on prices and market developments etc.
- honouring agreements concerning purchases, prices and payments
- transparency; open-book calculation of profits and margins
- tangible impacts and benefits for farmers

Farmers as shareholders?

If you are a private company, you may consider the option of involving farmers as share holders. The company operates as a privately owned profit-oriented entity, but farmers or farmers’ organisations hold part of the shares. They can participate in decision making in the annual meeting of shareholders and through their representatives in the board of directors, thus ensuring that farmers’ interests are taken into consideration. They participate in profits - and losses - of the company as per the value of their shares. The shares in the company may act as collateral when getting loans, for example for building collection stores. Profits are shared in the form of dividends.

As the farmers are co-owners of the company, they are more likely to be loyal than if compared to a pure contract farming set-up. Despite these advantages, there is also a risk that the participation of farmers in strategic decision making may interfere with the business interests of the company. It is not always easy to find the right balance between paying farmers a high price and being competitive in the market. There are relatively few examples of this type of set-up, in organic⁴⁰ as well as in conventional business⁴¹.

Collaborating with farmers

There are different types of farmers, and you should be careful to associate with the ones who fit with your business. Working with larger and wealthier farmers may make it easier for you to start, as they are more likely to try out new things, and organising them is easier than with smaller and poorer farmers. However, the “early adopters” are usually also the first ones to break off and go their own way. By working with the poorest of the farming community you can make a real impact on their livelihoods, but it can also mean that you are working with the weakest farmers in terms of productivity, which may affect the profitability of your business.

One approach is to work on a community base - a village or existing farmer group - and leave it to the group to decide about whom they include. Clusters of 10-20 farms/families who trust each other

40 Examples of organic farmer co-owned businesses are Zameen (www.zameen.org) and AgroFair (www.agrofair.nl).

41 See Koning, Maurits de et al., 2009. Farmers as Shareholders - A close look at recent experience. www.kitpublishers.nl/smartsite.shtml?&id=33740&ItemID=2764&ch=FAB

seem to work well. However, this can lead to social exclusion of certain marginalised communities. Discuss this issue with the concerned farmers, and find ways together in which the different sections of the farming community can participate. In many cases, traditional leaders (elders) or lead farmers are suitable entry points to win the hearts and minds of entire groups of farmers. On the other hand there is a risk that the leaders become too domineering, or start to pursue their own interests through the organic business.

As some of the farmers who join the initiative may leave after some time, it is advisable to start with a somewhat larger producer base than what is required for the planned production. On the other side, farmer groups usually want to keep all their members in, even the less well performing ones. In order to achieve good product quality and to keep the operation efficient, however, you may need to be able to exclude non-performing farmers. Set clear and transparent conditions at the beginning of the cooperation period, and explain them to the farmers.

Another issue is the spatial distribution of the farmers. If they are spread over too large an area, or located too far away from the processing factory or transport infrastructure, high transaction costs may jeopardise the profitability of your business. Having clusters of farmers in the same location is particularly important for organising extension and internal control in an efficient way. Although connections are getting better (e.g. via cell phone), if the producers are several hours away from the office, you need competent field supervisors who are able to make decisions on their own.

Predators or just ... competitors

There is always a risk that once you have organised and trained the farmers, competitors will come in and take over. You may have invested in a group, provided them with equipment and training, and still the group may break away. It is not very efficient to contract all the farmers in a region, thinking that it will prevent them selling to your competitor. A contract does not say very much if you don't actually buy all their products for a sufficiently high price. In the end, the only way to avoid farmers switching to a competitor is by being a better buyer, and by building loyalty with the farmers, e.g. by making them shareholders of the company. Diversification into more crops might also help, as farmers see the advantage of being able to sell a larger part of their production through you.

7.3 BUILDING UP AN EXTENSION SYSTEM

An organic business needs to have some sort of extension system in place, and it needs to be performing sufficiently well to achieve the desired results. Running an extension system costs money (for salaries, transport, equipment etc.), but also brings benefits. This sub-chapter provides some practical advice on how to develop and manage an effective and efficient extension system.

Roles and functions of the extension system

The extension system ensures that farmers are able to produce in a way that is complying with the organic standards, and at the same time achieve good yields and products of high quality. The extension staff provides the link between the company or cooperative and the individual farmer.

The extension system in an organic farming initiative is usually closely linked to, but not identical with the internal control system (see Figure 16): while the extension staff trains and advises the farmer to produce in the best possible (organic) way, the internal inspector has the responsibility to

control whether the farmer sticks to the organic standards (see chapter 8.2). If staff fulfil both functions, it is advisable that they do the internal inspection of farmer groups in a different location from their work as extension officers.

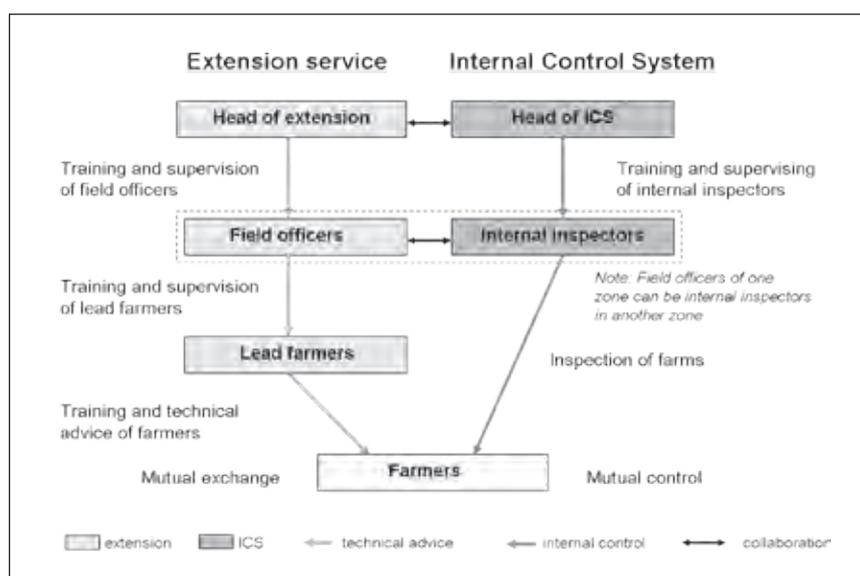


Figure 16: Set-up and roles within the extension and internal control system of an organic business. In practice the roles may be divided during part of the year only.

Many organic projects involve farmers in the extension and internal control system. These are group leaders or farmers who are particularly well versed with organic farming practices, and who are ready to support their fellow farmers by providing advice or assistance in filling in the forms. The service can either be delivered on a voluntary basis or for a small payment. These lead farmers are trained and supervised by the extension staff of the project.

For smooth functioning of the extension and internal control system it is important that each person involved has a clear idea of his or her role. Roles and responsibilities are defined in the job description of each position (see examples in Annex A4.1 and A4.2). They form part of the operating manual or quality management manual.

Extension approaches that work

It is obvious that top-down, class-room type lecturing is not a very suitable approach to building practical know-how among farmers. Nor do farmers read much in the way of manuals or technical leaflets. Training farmers therefore needs to be very practical, involving illustrations, demonstration of the proposed methods, and experimentation. Simple but appropriate extension material, prepared in a language and style understood by the farmers can support this process. Illustrated posters or calendars, for example, are more suitable than plain text.



An extension worker in Tanzania advising farmers on organic peanut cultivation. (Source: AELBI)

Key elements of successful extension

- apply practical, interactive training methods
- use illustrations rather than text
- focus on what problems farmers are actually facing, not on what you want to teach
- facilitate farmer-to-farmer exchange
- "seeing is believing" - organize visits to pilot farms or model farms
- stimulate experimenting with innovative ideas
- get inspiration from suitable guide books and from exchange with other initiatives

The content of training and technical advice should match the needs and interests of the farmers, male and female. It is not of much use to repeat trainings on compost production and the preparation of botanical pesticides if the main challenges for the farmers are related to crop diseases, weed management or irrigation. Try to find out why farmers are not applying the proposed methods, identify the underlying obstacles, and encourage them to develop solutions that can work.

Extension is not limited to training farmers and providing technical advice. Extension also means mobilising resources that are lying with the farmers: their traditional knowledge, their ability to experiment and observe, and their interest to share their know-how and experience with fellow farmers. Farms of successful members that use innovative and good organic agricultural practices may serve as an example for other farmers (pilot farms). Farmers are more liable to try out techniques that they see are working at fellow member's farms, than techniques propagated by the extension officer. Methods like farmer field schools⁴² and participatory technology development⁴³ can easily be adopted for organic extension. It is not the scientist, not the field officer, but the farmer who is the best researcher.

Financing extension

Extension services involve costs, which either are paid by the farmers themselves, by public funds or by the organic business.⁴⁴ It is obviously rather difficult to convince farmers to pay for extension services, even if they will benefit from an organic premium. Most organic businesses therefore will need to cover these costs from their sales margin. In both cases, you want to make sure that the services are cost efficient and useful.

Systems that work with result-based payments pay a part of their staff's salary depending on the achieved output.⁴⁵ This can be linked to an annual assessment of the training and advisory services by the farmers. Being assessed by those who are supposed to benefit from the service can make the extension system more accountable.

42 www.farmerfieldschool.info

43 CIP-UPWARD/IDRC, 2005. Participatory Research and Development for Sustainable Agriculture and Natural Resources Management: A Sourcebook. www.idrc.ca

44 Agridea, 2002. Innovative Approaches to Financing Extension for Agriculture and Natural Resource Management. Conceptual considerations and analysis of experience. www.agridea-international.ch

45 Helvetas, 2005. You Pay for What you Get. From budget financing to result based payments. www.helvetas.org

Outsourcing extension services?

Some organic production initiatives involve official agricultural advisory services which are funded by the government. This can be an efficient and cheap way of organising extension - why should it only be the conventional farmers that benefit from these services? This only works providing that the quality of the extension and the conveyed contents are appropriate. In many cases, the official agricultural extension services are strongly linked to conventional farming practices and inputs.

It is quite a change to switch from promoting 'modern' agrochemicals to nurturing farmer experimentation and using locally available 'dirty' materials like manure. Some agricultural extension officers clearly have difficulty telling another story. In some countries, organic businesses have given up employing former agricultural extension workers and prefer to employ young, untarnished college graduates as field agents instead. Keep in mind that, if you outsource extension and internal control, you have fewer opportunities to take corrective measures than if they are under your direct control.

7.4 STAFF DEVELOPMENT

The most critical factor in any plan is that the right people are in place: the people who will make it happen. You need people who are competent and committed, and who can take and handle responsibilities. This is particularly true for your field staff. An organic business comes with a whole set of extra tasks. It is therefore important to get the right field staff, prepare them well for their tasks, and motivate them to stay with your business.

Recruiting field staff

Your field staff needs to be able to closely interact with the farmers, to understand their problems and assist them in finding solutions. This requires practical people, ideally with an agricultural background. On the other hand your field staff needs to be good at working with figures and forms, understand manuals and writing reports. The ideal extension staff member is also a good facilitator who stimulates farmers to try out new things and who creates opportunities for farmer-to-farmer exchange.

When recruiting field staff try to get candidates who speak the language of the concerned farming communities. Take care not to exclude certain ethnic minorities because your field staff does not speak their language, or does not like to interact with them for social reasons. In order to encourage participation of women in the organic business, strive to have a gender balanced extension team.

The more challenging the project, the larger the distance to cover and the worse the roads are, the better your field staff needs to be; but also the fewer the people to choose from, as most capable people probably take up jobs that are less strenuous and better paid. Don't think that your field staff is cheaper in remote areas - on the contrary: their training and the incentives need to be better.

Training of field staff

It is very rare that you are able to hire field personnel who are already experienced in organic farming. In most cases, you will need to train them. The training should not be limited to your focus crop, but cover the entire farm which needs to be managed in an organic way. There are a couple of training

manuals that you can adapt and use for this purpose.⁴⁶ In addition to technical agronomic know-how, field staff also needs to be trained on extension methods.⁴⁷

HIV/Aids

Don't think that this has nothing to do with your business. Your staff and your farmers could get infected with this disease. No need to say that your staff or your farmers suffering from this disease will seriously hamper the development of the business. It therefore makes perfect business sense to deal with this issue, to make your staff aware of HIV/Aids and to sensitize the farmers before it becomes a real problem for your business. In many countries there are funds and institutions that can help you with training material for awareness creation, and with formulating a workplace policy (see www.ilo.org/aids).

Start with a thorough and systematic training of all new staff, and also ensure that they continuously update their know-how. If you provide experienced staff the opportunity to become experts in a specific field, they are more likely to stay with you. At a certain size, the organisation should have sufficient capacity of its own to train new staff. Do not remain dependent on development agencies or service providers for training.

Motivating your field staff to stay

Besides the producers, your field staff will become one of the most valuable assets of your business. They know the farmers and their problems; they know how the business functions and what needs to be done to make it a success. It therefore can be a disaster for an organic business if field staff members leave. A particularly bad situation is when your staff members leave you in order to start a competing business for themselves.

However, it is also quite natural that people will look for new opportunities. Therefore, it pays off to think early on about how you can provide experienced staff with the opportunities to take up additional responsibilities within the organisation. Exposure visits to other organic businesses or attendance at external training programmes are important incentives for staff to stay.

Ways to motivate your staff to stay

- Pay competitive salaries that match the tasks
- Provide opportunities for training and exposure
- Involve your staff in decision making
- Provide opportunities to grow and develop within the business
- Let your staff participate in the success of the business (via shares, or a bonus system)

⁴⁶ See IFOAM training platform, www.ifoam.org/training

⁴⁷ See www.agridea-international.ch

7.5 HANDLING PRICING, PREMIUMS AND PAYMENTS FOR FARMERS

Whether you are a company or a cooperative, the relationship between you and the farmers associated with your business first of all is a commercial one. It is based on a transfer of goods against payments. The way prices are set and payments are handled will be crucial for the success of this relationship.

Defining the price for the producer

The price that the company or cooperative pays to the individual farmer for the organic raw product should be high enough to cover the production costs the farmer encounters (variable and fixed costs), and to enable the farmer to make a reasonable profit that ensures a decent living. This is the basic idea of the Fair Trade concept, but should also be applied in organics. The price paid to the farmer is one of the main factors in the cost price calculation of the final product (see chapter 6.4). If the price is too high, the final product may not be competitive in the market.

At the time of harvest, you may not yet know the price you will receive from your buyers for the final product. This makes it difficult to define the price that you pay to the farmers. Even if you have a clear idea of your cost price, and have signed contracts with buyers who are ready to pay at least this price, you may not be able to sell the entire production at this price. In addition, costs may turn out higher than expected, and exchange rates may change to your disadvantage. Committing a certain price to the farmers is part of your entrepreneurial risk. You therefore need to be careful with offering farmers a high price at the beginning of the season that can ruin you when frame conditions change - especially if your sales are not yet fully covered by sales contracts.

On the other hand, if the price you offer to farmers is too low, they may leave the programme and sell to someone else. Sometimes, local market prices may temporarily rise to a level beyond the price you offer, so that farmers prefer to sell in the open market. It is therefore important to define a price that is attractive to farmers and that allows some flexibility to increase it in case the market prices rise. Alternatively, be prepared to lose some volume by not following the (temporarily higher) local price.

It is most important that prices are set in a clear and transparent way, and that you communicate this well to the farmers you work with. Nowadays farmers understand that prices fluctuate. Try to find out who else is buying locally, and how to best address local price fluctuations. Explain the buying mechanism to the farmers, including the quality differential (see chapter 9.2).

Side-selling

You can not - and should not try to - force farmers to sell their products to your business or cooperative; but there are ways to motivate them to sell to you instead of selling to other buyers (see box). You can, for example, try to tie farmers to your business by offering good services (pre-financing, immediate payment on delivery, attractive premiums etc.), but farmers may still sell to the buyer who offers the highest price at the time of harvest. It can be difficult to convince the farmers that a long term engagement with a buyer who regularly pays adequate prices including in years of low price-levels, is better than a buyer who pays a high price once but disastrously low ones in the following years. But it is worth trying! If the “capture rate” is low, you have invested in extension and ICS without the likelihood of recovering these costs from your sales margin.

How to motivate farmers to sell to you?

- Offer them contracts with attractive conditions
- Commit to paying a price that is higher than the local market price
- If local prices go up, increase your price offer and communicate this to the farmers in time
- Pay cash against delivery
- Support linkages with micro-credit schemes and encourage saving, so that farmers do not need to sell produce for urgent cash needs
- Make provisions to buy small volumes at village level even before the main purchase activities start

Pricing based on the FLO system

If the produce is certified “Fair Trade” in line with the FLO system, the FLO minimum price and Fair Trade premium need to be taken into consideration. These are defined for specific products and regions.⁴⁸ If market prices are higher than the Fair Trade price, the market price shall be paid (Figure 17). In addition to this price, the producer group receives a Fair Trade premium that shall be used to improve their social, economic and environmental conditions.

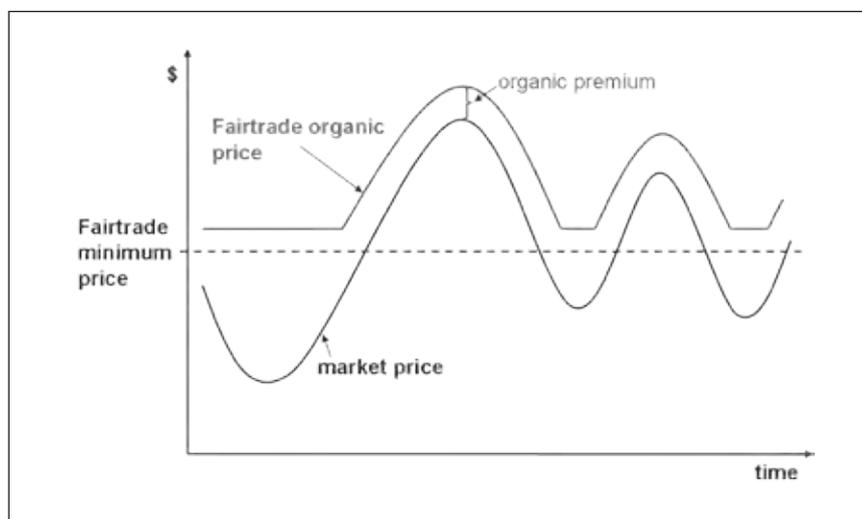


Figure 17: Pricing according to the FLO system

Be careful that you are sufficiently covered by Fair Trade sales contracts, so that you can pay the farmers both the Fair Trade minimum price and the organic premium. In the beginning it is difficult to explain to farmers that for any produce for which you do not get a Fair Trade buyer, you can only pay an organic price. It may also not be accepted in Fair Trade certification for all products and situations.

⁴⁸ See www.fairtrade.net

It is often overlooked but important to note that the FLO minimum price usually defines what the producer organisation needs to get (“ex works producer organisation” or “farm gate producer organisation”), and not the price for the individual farmer. This means that the FLO minimum price includes the costs of all activities necessary to produce the certified organic & Fair Trade product. This includes costs of extension, ICS, certification, bulking and - if done by the producer organisation - cleaning, grading and packaging. The producer organisation can deduct these costs from the Fair Trade minimum price and pay the remainder to the farmer.

Defining and handling premiums for farmers

The premium is what you pay to farmers in addition to the normal market price. There are three types of premiums relevant in this context: the organic premium, the Fair Trade premium and the premium for high product quality.

The premium you pay to the farmer is often similar to the premium you fetch in the market. If you expect an organic premium of 15% on the exports, it is usually safe to pay the farmers 15% on the farm gate price. That is, when you have a sufficiently large operation. If you deal with in-conversion products, it is a good idea to pay farmers a certain (but lower, e.g. 5-10%) premium during the first two years of conversion. This provides farmers with an incentive to engage in and stick to organic production. If you manage to achieve a better product quality through your extension and internal control system, you in turn should be able to get this premium even when selling the in-conversion produce in the conventional market.

If you follow the FLO Fairtrade system, your clients need to pay the Fairtrade premium. The full Fairtrade premium needs to be used for community projects decided by a body representing the producers. If the Fair Trade premium is managed at the level of individual primary cooperatives, the central producer cooperative needs to distribute the Fairtrade premium to the primary cooperatives according to the product volume they produced.

It is a good idea to pay farmers a premium for better product quality. This will motivate them to engage in quality management and deliver products of high quality, which in turn allows you to obtain a better price in the market (see chapter 9.2).

Handling payments to farmers

The exact price you can get in the market, and the volume you can sell as Fair Trade, are not usually known at the time of buying the produce. Therefore it may be a good idea to pay farmers in two instalments:

- 1st payment: the minimum price you offer farmers for their organic produce (needs to be at least as high as local market prices);
- 2nd payment: premiums for organic, Fair Trade and quality, depending on actual sales.



Purchase of organic Fairtrade cotton in a village in Burkina Faso (Source: Helvetas)

Most organic businesses open up buying stations in the villages. You can also delegate the bulking of the crop to a village level farmers organisation. In some set-ups, farmers are required to deliver their production in groups to a larger buying store or warehouse.

Whatever the construction, it is important that the buying staff is properly instructed, that the weighing scales have been calibrated in the presence of some farmers, and that the approved farmers have received an ID card and a buying record. In most organic businesses, farmers are paid cash in hand upon delivery, which involves certain risks. Make sure that payments are done in a transparent and traceable way, and investigate any allegation of cheating by your buying staff. Where possible, payments into the farmers' bank accounts are even better, as it reduces the risk of carrying money. Obviously, these bank transfers also need to be done promptly.

Summary of recommendations

- Producer cooperatives should be careful with handling business activities that go beyond their management capacity. Companies should ensure that farmer interests are taken care of and that they can participate in decision making.
- In order to build trust and loyalty with your producer base, communicate transparently, honour agreements and ensure that farmers benefit.
- When selecting farmers for participating in your business, ensure that the different groups of the farming community can participate, and that they are geographically not too dispersed.
- Define clear roles within the extension and internal control system and make sure that the services are delivered according to the needs of the farmers.
- Make sure that the right people are in the right positions. Provide suitable incentives so that qualified staff members are motivated to stay with your business.
- Set farm-gate prices in a way that they are high enough to motivate farmers to sell to you, without jeopardising the profitability of your business.
- If you are not sure whether you can sell all your produce with the expected organic and possibly Fair Trade premium, agree with farmers that part of the premium is paid at a (defined) later point of time.

8 CERTIFICATION AND INTERNAL CONTROL SYSTEMS

For organic businesses, achieving and maintaining certification is one of the most difficult aspects to master. It requires a level of organisation, communication and transparency that not everybody can provide. In this chapter you will find practical guidance on how to achieve and maintain certification based on an internal control system (ICS).

8.1 CERTIFICATION OPTIONS

In most of the larger markets for organic products - Europe, North America, Japan, Brazil, South Africa, China, India - labelling agricultural products as “organic” requires certification from an approved certification body (CB). Certification needs to be renewed on an annual basis and needs to also cover all processing and trading steps involved up to the sale of the product.

Organic certification ensures that the product is truly produced in compliance with organic standards. It builds trust between the buyer and the producer, and also protects the genuine producer from unfair competition. The organic integrity of your products is a pre-condition for gaining access to organic markets.

Some buyers offer to pay for the certificate, on the condition that they have the ownership of the certificate. Although this may be tempting as it saves costs, it also leads to a strong dependency on this specific buyer. In most cases organic businesses are better off if they own the certificate themselves, and are flexible in whom they sell to.

What certification do you need?

Think early on about what your target markets are. If you want to sell to the European Union, you will require certification according to the EU organic regulation; if you want to sell to the United States, you need to be NOP-certified, and for Japan JAS-certification is necessary.⁴⁹ For local organic markets, the standards and regulations of the respective country apply - if available. Although the most important official regulations have similar requirements, there are also some aspects which are specific. The NOP regulation, for instance, requires that producers have a production plan, and allows retrospective recognition of conversion.

In addition to the public organic regulations which are mandatory, in some markets voluntary private standards and labels play an important role. Private labels like Soil Association in the UK, Naturland in Germany or the BIO SUISSE bud-label (“Knospe”), for example, may be more popular than the respective official regulations and logos. Supermarkets and brands sometimes have their own company label and standards, which go beyond organic regulations. If you want to be able to cater to different markets and labels, make sure that you meet all the different requirements.⁵⁰



⁴⁹ For the respective links see Annex A5.1.

⁵⁰ For a comprehensive comparison of the requirements of the different standards, see organicrules.org/view/EU

Some buyers may have additional requirements concerning production, social and food safety standards, or they want a combination of organic and other certifications, such as Fair Trade, Rainforest Alliance or Global-GAP (see chapter 2.5 and Annex A5.2).

Organic and other certifications may be a pre-condition to marketing your products, but they are no guarantee for finding a buyer. As certification involves certain costs, make sure you only go for additional certifications when you have buyers.

How to choose the right certification body?

In most situations you can choose between certification bodies. Due to global competition, prices are very competitive, which you can use to bargain for a lower quote. However, cheap certification usually comes with a mediocre service. It is much better for your business if you insist on high quality inspection and certification, even if this is more expensive. Your certifier can help you establish real organic farming, good quality management, traceability and product integrity. Going for the cheapest offer may turn out to be more expensive in the end. There is a risk that farmers won't take the standards very seriously. It may also happen that a certifier who quoted a cheap price for a minimum product may later demand additional inspections or tests for which you need to pay. Make sure that everything is included in the offer - costs for travel, hotel, accommodation, residue analyses, second inspections, transaction certificates etc. Provide clear terms of reference when inviting offers from different certification bodies. Criteria for selection between different offers include:

- recognition of the certification body in the target markets (ask potential buyers)
- range of certifications offered (EU organic, NOP, JAS, GlobalGAP etc.)
- local office; working with experienced local inspectors who speak the language
- service orientation; time required for processing files (track record)
- costs for travel, inspection, certification, transaction certificates

If your attitude is to go for quality instead of the cheapest possible certification, you will attract a better class of buyers who are willing to pay better prices. These are the buyers who want to build partnerships with reliable suppliers; they are not interested in shopping around every year for the cheapest raw material around. Therefore, think carefully how you want to position yourself in the market. Ask other organic businesses in your countries as well as potential buyers about their experience with different certifiers.

If available, choose a local certification body that is approved for certifying according to the standards you require.⁵¹ The European Union maintains a list of recognized CBs⁵². Some countries like Costa Rica and India are recognized by the EU as having standards, certification and accreditation in place that are equivalent to those of the European Union. In these cases, the organic certificates of your local certification body can be used for imports into the EU. There are also international certification bodies that recognise certificates of a local certifier.

⁵¹ A directory of organic certification bodies is available from www.organicstandard.com/directory.html

⁵² ec.europa.eu/agriculture/ofis_public/index.cfm

13 steps to certification

1. Create awareness among producers
2. Decide together to go for O or OFT production
3. Producers commit themselves to follow O or OFT rules
4. Training on production rules
5. Training on producer organisation (in case of OFT)
6. Training on documentation requirements
7. Formalization of ICS, registration
8. Contracting of producers
9. Application for external inspection
10. Internal annual inspection, compilation of findings, corrective action when needed
11. First external inspection
12. Complying with the corrective action requests
13. Second external inspection; certification

If no internationally accredited local certification exists - which is still the case for most developing countries - chose an international certification body that is working with local inspectors. This

reduces travel costs, and makes it more likely that the inspector knows the local context and speaks the language of the farmers.



An internal inspector visiting the cotton field of an organic farmer in Kyrgyzstan (Source: Helvetas)

Certification contracts can be renewed - or cancelled - on an annual basis. Changing the certification body frequently does not reflect well on you. It may raise concerns about your credibility in the same way that changing your auditing company often would. It does not pay to change the certifier after they have detected non-compliances. Be aware that certification bodies are obliged to exchange information about you when you switch certifier.

Managing certification costs

Costs for certification consist of costs for travel and accommodation of the inspector, fees for the inspection (depending on the number of days required), a certification fee (depending on the different standards you want to be certified against, e.g. EU and NOP), as well as the eventual costs of transaction certificates.

Organic standards require that each farm must be inspected at least once per year. However, physical inspection of each smallholder farm by an external agency – whether by a local or an international certifier – would involve considerable costs. To reduce these costs and thus to facilitate certification of smallholders, most certification schemes have provisions for group certification based on an internal control system (ICS, see chapter 8.2).

Although high certification costs are frequently cited as a major obstacle for smallholders to convert to organic farming, they are usually much lower than the costs for the extension and internal control system (salaries, transport, equipment etc.). Both costs can be reduced by setting up efficient systems. The more efficiently the extension system works, and the better the ICS performs, the less staff members are needed and the faster an external certifier can do the inspections. Another way to reduce per-unit certification costs is to include several crops under the same ICS and certificate, so that the additional organic premium can contribute to cover these costs (see box).

Big trees to support organic cotton

In Burkina Faso a cotton project included shea trees and sesame in their organic certification. As these crops are growing on the already certified and monitored area of the operator no conversion period and little additional costs were required. All the required production data could be collected during regular internal inspection visits. The data collected was submitted to the certification agency before external inspection. During the inspection these data were verified and then the crops were included in the certificate. The additional cost of including the crops in the certificate was about 1,000 Euro while the additional turnover now including shea nuts sold as organic, increased by more than 70,000 Euro.

There is no doubt that certification is costly even with an ICS, and even if several crops are covered under the same certificate. On the other hand, it opens up access to interesting markets. To be viable, the additional value generated through certification needs to be bigger than the costs of certification. This requires a certain scale of production: getting 1000 farmers certified under an ICS does not cost much more than getting 100 farmers certified. You will require more staff for extension and ICS if there are more farmers to be covered, but you can gain in efficiency. After 3-4 years, certification costs should not account for more than 2-3% of the export price, while the cost of field staff for extension and ICS may cost 4-6% in an efficient project.

Costs of Fair Trade certification by FLO-Cert depend on the type of organisation, its size (number of members) and the number and volume of certified products.⁵³ FLO International has created a fund from which small farmers' organizations can receive a subsidy of up to 75% for their initial Fair Trade certification.⁵⁴

8.2 DEVELOPING AN INTERNAL CONTROL SYSTEM

In an ICS, a central body (e.g. the cooperative or the processor) ensures and verifies that all individual farmers comply with the respective standards. Each farmer needs to sign a contract with the organisation in which they declare their commitment to following the specific internal regulations of the project (see examples in Annex A5.3 and A5.4). The ICS operator maintains files of all producers and inspects each member at least once a year. Risks which might jeopardise the organic integrity of the product need to be identified at all levels of production, transport, storing, and processing. The internal control procedures need to focus on these specific risks.

⁵³ See www.flo-cert.net/flo-cert/main.php?id=13

⁵⁴ See www.fairtrade.net/producer_certification_fund.html?&L=title%3DOpens

Internal inspectors need to inspect the farms at least once a year. Additional inspections - announced or un-announced - can be conducted. An internal approval committee or an approval officer deals with non-compliances according to set procedures and sanctions, and decides whether a specific farm can be approved for certification.

In this setting, the external certifier inspects the functioning of the ICS based on its documentation and physical re-inspection of a certain percentage of the farms. The re-inspection rate depends on the size of the group and on the performance of the ICS. Overall, the ICS and the external certification need to cover all trade and processing steps implemented by the project (Figure 18).

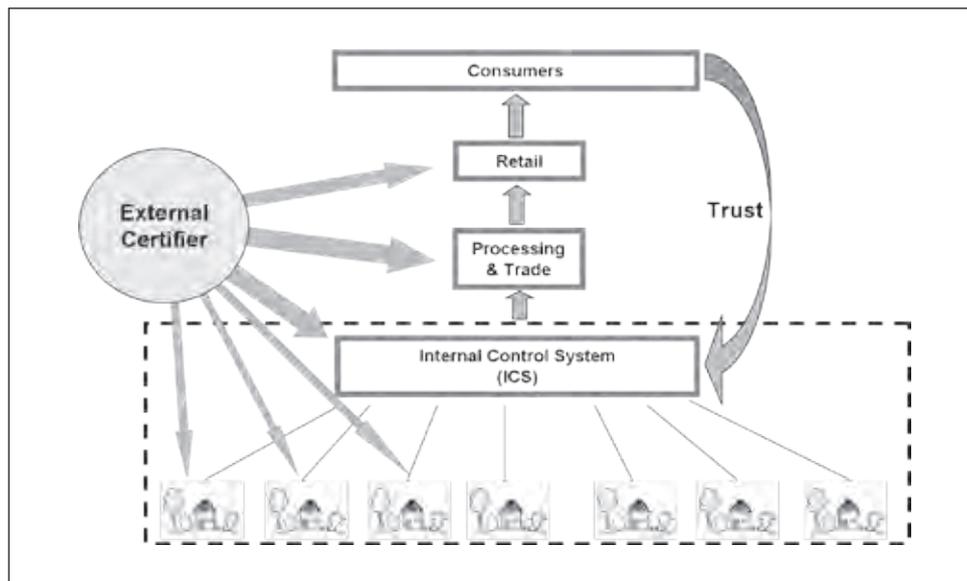


Figure 18: The structure of an internal control system and its relation to the external certifier (adopted from IFOAM).

For a detailed description of group certification and guidelines to develop an ICS, refer to the IFOAM tool 'Smallholder Group Certification'⁵⁵. IFOAM also provides a training curriculum with transparencies to train project staff on ICS. Therefore, the following chapters explain the aspects that need further attention from a business perspective.

Key questions in building up an internal control system

- What structure will the ICS of the project have? How will it be managed?
- Who will develop the documents for the ICS? How?
- How will the project involve the farmers in the ICS?
- Who will decide internally about approval of farms and about sanctions?
- How will inspections be organised (by whom, how often, separation from advice)?
- How will you ensure that internal inspections are effective and reliable?
- What measures will you implement to ensure traceability?

⁵⁵ See shop.ifoam.org/bookstore

Structures and roles in the ICS

The ICS is closely interlinked with the extension system (see chapter 7.3). It is important that you set up a lean and efficient extension and internal control system in which all staff have clearly defined roles (Figure 19). An example on how the roles and responsibilities of each actor can be defined in detail is given in Annex A4.1.

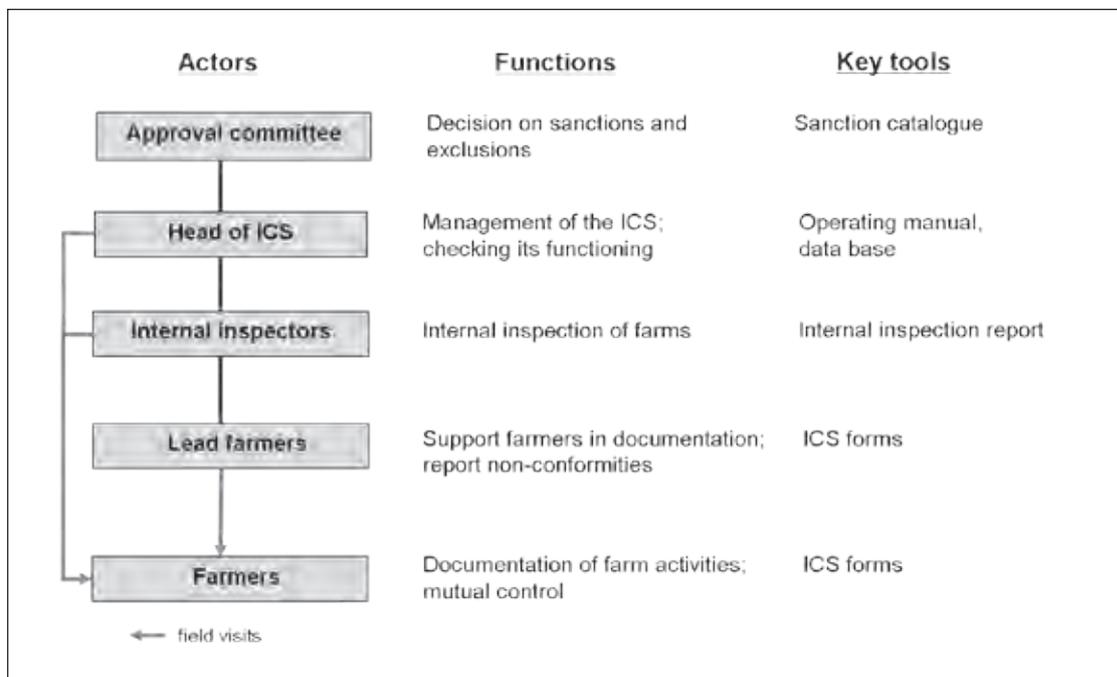


Figure 19: People involved in an ICS, their roles, and the key tools they use

ICS processes and forms

The main processes that are relevant for the ICS are the registration and training of the farmers, the documentation of farm and field data, the internal inspection of the farm including estimation of the expected harvest, and the maintenance of traceability during bulking of the produce. The person responsible for the ICS needs to supervise the work of the internal inspectors and check traceability in processing, storage and sales. Table 9 lists these processes, defines the responsible persons and indicates the required forms.

The procedures and forms are documented in an ICS manual or within the overall operating or quality management manual.⁵⁶ This helps you to develop a clear idea on roles and responsibilities of the involved staff, and to have all relevant documents in one place. It also allows new staff and the certifying body to understand how your system functions. There are various sample ICS documents available.⁵⁷ It is recommended though that you engage an experienced local consultant in the design of your ICS. In most countries fellow organic business people can give you a recommendation. The consultant may also train your staff in implementing the ICS.

⁵⁶ E.g. Operating manual of Mobiom in Mali (available in the tools section on www.organiccotton.org) or ICS manual of ALCODE in Uganda, www.grolink.se/epopa/Publications/ALCODE-ICS-Mar07.pdf

⁵⁷ See the IFOAM Training Kit for ICS for Group Certification, shop.ifoam.org/bookstore

<i>Process</i>	<i>Responsible person</i>	<i>Form / documents</i>
Contracting farmers	Extension officer	Farmer agreement, internal regulations
Training farmers on organics	Extension officer	Farmer diary, internal regulations
Document profile data of farms, draw maps, measure fields	Extension officer	Participatory mapping exercise
Technical advice visits and monitoring of farms	Extension officer	Farmer diary, farmer register
Internal inspection of farm and harvest estimates	Internal inspector	Inspection report: farm
Data processing	Documentation Officer	Database, farmers files complete
Approval decisions for farms	Approval committee	Inspection reports, approved farmers list
Bulking of products from individual farmers	Buying agent w or w/o the extension officer	Farmers' ID, Approved farmers list with harvest estimates
Supervise internal inspection activities	Head of ICS / field supervisor	Completed inspection reports, register of re-inspected farms
Consolidation of records, check traceability in processing, storage and sales	Head of ICS / field supervisor / store manager	Register of product flow in/out

Table 9: Processes of an ICS, responsible people and documents needed

Dealing with non-compliance

Thorough selection and training of the farmers and a well functioning internal control system are crucial to ensure farmers' compliance with organic standards. However, even with the most sophisticated inspection system it is impossible to have 100% control. At least of equal importance is the trust relationship between the farmers and the project. Farmers should understand that if just one of them violates the standards, the certification of the entire project could be at stake. If farmers have a strong feeling of responsibility, mutual social control among the farmers can become an effective way key for guaranteeing the organic integrity of the project.

Still, in every project there will be some farmers who - purposely or by mistake - violate the organic standards. If these violations are not detected and sanctioned by the internal control system, but only come out during the external inspection or when checking for residues on the final product, the project risks losing its organic certification. To reduce this risk, projects might consider creating incentives for farmers themselves to admit to the application of prohibited inputs, for example by giving them the chance to re-join the project after passing through the conversion period again.

If a farmer is found to have violated the standards, the project needs to apply clearly defined sanctions (see the example of a sanction catalogue in Annex A5.5). This may start with refusal of their produce for one year right up to removal of that farmer from the organic group. There is normally an Approval Committee that decides on these issues. It is important to inform and discuss the results with farmer representatives to avoid the same thing happening again.

Ensuring traceability

One of the most critical risks jeopardising the organic product integrity is that produce from farms that are not covered by the ICS enter the organic product flow. When organic products fetch a price which is considerably higher than the conventional market price, some farmers and produce buyers may be especially tempted to deliver product from conventional producers. In order to ensure that this does not happen, it is compulsory to make a harvest estimate of each individual farm.⁵⁸ For this it is important to verify the field size indicated by the farmer (with measuring tape, GPS or Google Earth). When farmers deliver their production to the company or cooperative, the quantity delivered is checked with the estimated harvest volume (Table 10).

Code	Farmer name	Crop surface (ha)	Expected yield (kg/ha)	Expected harvest (kg)	Delivered produce (kg)	Diff. %	Comment
A-123	XXX	0.8	600	480	510	6%	ok
A-234	YYY	0.6	500	300	460	53%	keep aside, check!

Table 10: Approved farmers list with delivered produce vs. harvest estimates

It is equally important to keep track of the volumes of organic products during transporting, processing, storing and selling. Establish a system of weighing and written records and receipts at each level, and cross-check the totals.

Training field staff on the ICS

Once you developed the basic elements of the ICS, your field staff needs to be trained on how to implement the system. The ICS manual (or the respective chapters in the operating or quality management manual) provides the basis for this training. You need to pay particular attention to providing a thorough on-the-job training to the internal inspectors. They not only need to be able to fill in the forms in a way that reflects the reality in the field, but also to focus on the critical control points



Training of field staff in Tanzania
(Source: AELBI)

and to ask the right questions during the inspections. Besides the initial training, all staff require an annual refresher. In most countries the national organic movement can connect you with experienced consultants who can help you in this.

Too often, ICS activities start late in the year, and inspections and farm visits are done in a hurry. Too many farms are then inspected in one day, or forms are even filled in without visiting the farms and fields. Allowing this to happen is short sighted, as it jeopardises your certification,

⁵⁸ For a procedure how harvest estimates and traceability checks can be done in cotton production, see www.organiccotton.org ->

and is also not really of assistance to the farmers. On the other hand, there also is a danger that the staff are too slow, wanting to do a 'too good' job. This means that it will take them too much time, which causes high costs. On the other hand they may create a write up that is how it should be, rather than how it is on the ground, in order to please the management and the certifier. Good training and supervision of the field staff needs to address these aspects in an appropriate way. You need to have a really good field supervisor.

8.3 TRACEABILITY AND DATA MANAGEMENT

Managing a business that involves several hundreds or thousands of individual farmers who need to be monitored also means handling a large amount of data. For each farm, you need to collect and update various types of data: information about the farms (details of the farmer, landholdings etc.), their production (field size under each crop you are dealing with, estimated and real harvests), the inputs you provided, the inspections, the payments etc. In addition to the field level data, you need to handle data at central level, like staff data, client data, and data concerning stocks, processing and sales (Figure 20).

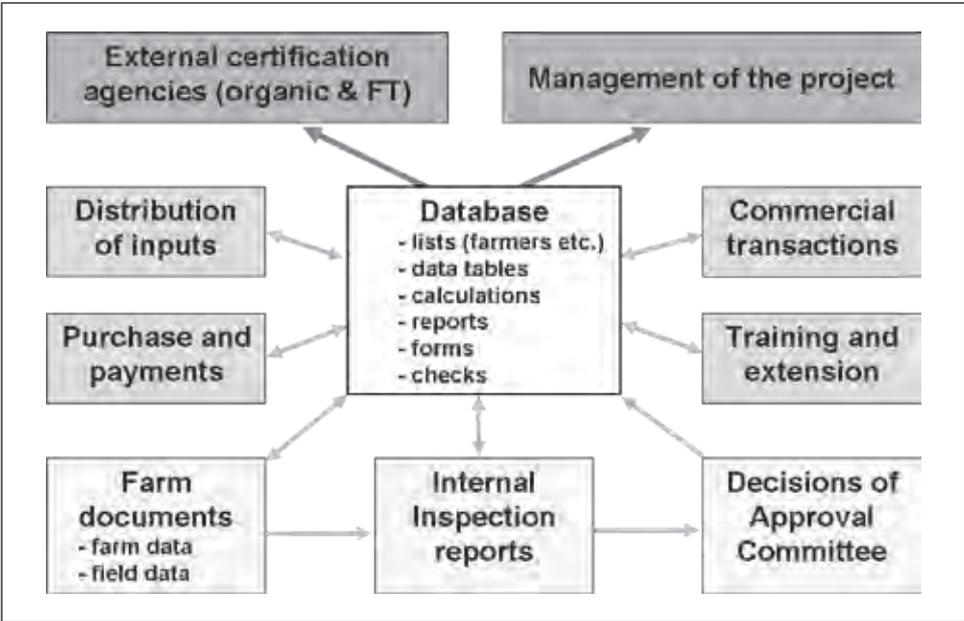


Figure 20: Functions of a central database in an organic business; arrows indicating flow of information

Having these data available is not only a necessity for certification - it is also crucial for managing your business. You need to be able to plan the extension and ICS operations, the purchase of inputs and the transport and processing of the produce. Based on these data you will manage your cash flow, and you will know how much production you can offer and when it is available in the market. It may start with a bundle of hand-written tables, some excel sheets or perhaps a real database system.

A database has the following functions:

- Keeping an updated list of approved farmers to hand at any time
- Collecting and centralising field data (e.g. production details of each farm)
- Calculating totals and averages (e.g. total expected harvest or average yield)
- Keeping track of extension and ICS activities (e.g. participation in trainings, completed/pending inspections etc.)
- Feeding processed information back to the field (e.g. lists of approved farmers)
- Handling personal data (addresses of producers, staff, clients etc.)

Developing a database for your business

Before you start developing a database, think carefully about which data you really need to manage at central level. It is easy to prepare a database with all kinds of fields for data entry, but collecting and updating this data is time consuming and costly. Therefore, you should restrict the data to the absolute minimum. You may, for example, be tempted to collect the numbers of farm animals of all farmers in your database, in order to get an idea of how much manure is available. Keeping these data up to date, however, is a Herculean task. You might be better off with collecting this information in a survey on just a representative sample of farms.

The simplest form of a computer-supported database is an excel sheet in which all essential data of each farmer are entered into a table (see Table 11).

<i>Farmer Code</i>	<i>Farmer Name</i>	<i>Year of joining</i>	<i>Village</i>	<i>Total land (ha)</i>	<i>Surface crop A (ha)</i>	<i>Last date of training</i>	<i>Inspection date</i>	<i>Status</i>

Table 11: Extract of a producer database

The disadvantage of Excel is that the data records are difficult to handle when the business grows and farmers produce several crops. A database system like Access allows storage of data in a way that you can easily:

- enter data via simple forms
- interlink different levels of data
- access extracts of data for specific years, crops, regions etc.
- create summary reports
- export specific data in a simple format (e.g. as form or excel file)

As this is a specialist area, consult with other organic projects on which system they use and whose services they use to set up and maintain the system, including training your staff to use it properly.

Managing data

The most sophisticated database is of no use if the data contained are incomplete, incorrect or not up to date. Managing the database therefore involves checks and cross checks. The person responsible for data management should periodically check whether the data of the current year are entered completely. Furthermore, s/he should check whether the entered data are realistic, e.g. by simple sorting and cross-calculations. Ideally, this also involves spot-checks on randomly selected farms.

Collecting data is equally of not much use if the results are not available at the right time at the level where they are needed. The decisions of the approval committee and the harvest estimates, for example, need to be available in the villages when the product is collected from the farmers - otherwise they are of no use. It is therefore important that you think about how to transfer data from the field to the centre, and back.

Make sure that the right persons have access to the database. As the database may contain some sensitive producer data, take appropriate measures to ensure confidentiality.

8.4 MAINTAINING CERTIFICATION

Being certified is not a one-time thing, but an ongoing process. While achieving the first certification is a big effort, the challenge of maintaining certification should not be ignored. Losing your organic certification is the worst thing that can happen to you, as you can not sell your production with an organic premium, but still have to bear all the additional costs (including those for certification!).

As the farmers are expected to comply with the standards throughout the year, the surveillance by the ICS should also be active throughout the year. It is not enough for someone to fill in the forms and do a skimpy internal inspection shortly before the external inspector arrives. The ICS needs to start its operations before the season starts (registering and training new farmers on ICS, updating farmer files etc.) and needs to continuously monitor the ongoing activities up to the time of harvest. Some CBs insist that you employ field staff on fixed contracts to be sure that they are active the whole year round. The person who is responsible for the ICS makes an annual plan of activities. The internal inspection usually takes three of the twelve months of the year and is finished one month before the harvest starts (see example of an annual operational plan in Annex A4.4).

Checking the system

It is not sufficient to set up an ICS and to hire and train field staff. You also need to make sure that they really do their jobs, and that the collected information is correct. Collecting reliable information in the field is a tiresome process, and field staff may be tempted to fill in approximate figures, possibly even without visiting the farms. To prevent this, a system of cross-checks through the person responsible for the ICS should be introduced. S/he should re-visit a randomly selected sample of 2-5% of the farms at certain critical moments during the season (e.g. after farmer registration is completed, before harvests start), and cross-check the registered information. Regular supervision of field staff also helps identify bottlenecks and shortcomings, and thus contributes to continuous improvement of the effectiveness and efficiency of the system. In the end this helps in saving time and money.

ICS and quality management

Having a system in place which is in continuous contact with the farmers can be turned into THE big competitive advantage of an organic business. The ICS allows inclusion of quality management aspects without much additional effort. You can integrate measures that improve product quality during production, harvesting and post-harvest handling in the internal regulations, and verify their implementation through the internal inspections (i.e. include them in the inspection report). The most important quality management measures are usually to keep the product free of contamination and to sort out produce of lower quality (see chapter 9.2).

Managing growth

It is particularly challenging to maintain quality of the ICS in situations of fast growth of the business. Including large numbers of new farmers requires hiring new field staff, which in turn need to be trained and supervised by the Field Supervisor. Although growth is necessary in order to reach economies of scale (see chapter 6.4), it increases the burden for the initial team - and costs additional money. In the end, growth which is too fast may jeopardize certification, as quality of the internal control measures go down. To avoid this, make sure that your staff is well prepared to manage the growth, and keep the speed of it within reasonable limits.

Revising the ICS system

It is advisable to revise the ICS including the manual after the annual external inspection and before the start of the new season. External inspections usually result in some corrective action requests or conditions and recommendations from the certifier. These need to be incorporated in the ICS for the next season. It is a good idea to combine this external review with an internal review, in which the concerned ICS staff are involved. A simple method of doing this is to conduct an analysis of strengths, weaknesses, opportunities and threats (SWOT-Analysis). During a meeting, ask the ICS team to list the strengths and weaknesses they observed in the ICS during the previous season. Ask them which opportunities they see to improve the effectiveness and efficiency of the ICS, and which threats they see for its functioning in the next season. Based on this analysis, you can then define appropriate methods to improve the system.

Take care that all staff (including the buying agents) are aware of the changes you decide. If necessary, conduct refresher trainings with the staff. Also make sure that the farmers are properly informed on changes they need to be aware of.

Be careful with introducing new forms whenever a new aspect is taken into consideration. It might take a bit more time to think how the aspect can be integrated in the present set of forms and processes, but this pays off as you gain efficiency. Many ICS tend to get big and heavy over the course of the years, making it difficult to handle the data. It therefore is advisable to conduct a larger review of the ICS forms and processes every five years. Keeping it lean and simple is the most important principle in managing an ICS. Otherwise there is a risk that the ICS becomes inefficient - and too costly!

Summary of recommendations

- Think early on about what your target markets are in order to decide what certification you need
- Insist on quality certification services rather than going for the cheapest option
- In order to reduce certification costs, try to increase the efficiency of your ICS and cover several commercial crops under one certificate
- Set up lean extension and ICS structures and clearly define roles and responsibilities for all involved
- Define clear processes and practical forms; make sure that they are applied
- Set clear internal standards, and define and apply effective sanctions in case of non-conformity
- Use harvest estimates and receipts to check traceability of the organic produce
- Train ICS staff "on the job" and ensure timely implementation of internal controls
- Keep all production and ICS data up to date in a well managed database
- Ensure close monitoring of the ICS and revise it periodically, without making it too heavy
- Exchange experiences and tools with fellow organic projects in the region