

**INCORPORATING SMALL PRODUCERS  
INTO FORMAL RETAIL SUPPLY CHAINS**

**2016**

LSteinfeld/Bentley University

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This report was produced with the support of Wal-Mart Stores, Inc. by Ted London (Vice President, Scaling Impact Initiative at the William Davidson Institute and Faculty member at the University of Michigan's Ross School of Business), Linda Scott (Emeritus DP World Chair for Entrepreneurship and Innovation at the University of Oxford) and Colm Fay (Research Manager at the William Davidson Institute at the University of Michigan), with assistance from Hannah Sherman (Research Assistant at the William Davidson Institute). The data in the report were sourced from publicly available information, information from prior academic research projects undertaken by both the William Davidson Institute at the University of Michigan, and the University of Oxford, as well as from interviews with key stakeholders from the organizations mentioned, along with those from Walmart, and their other partners engaged in these initiatives.

The authors thank Wal-Mart Stores, Inc., and their implementing partners for their contributions to this report. In particular, the authors thank Chief Sustainability Officer for Walmart Kathleen McLaughlin, Senior Manager for Women's Economic Empowerment for Walmart Kara Valikai and Senior Manager for Food Sustainability for Walmart Chris Cochran, for their thoughtful insights and comments on the report.

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## EXECUTIVE SUMMARY

A more complete understanding of the global economy's complex interconnectedness with social and environmental systems has emerged among both corporate leaders and policy makers. The challenges of the near future will demand an integrated response, in which business systems must be engaged to form more sustainable and equitable arrangements for exchange and provision. Major global corporations must take a leadership role by innovating solutions and then sharing the lessons learned.

This paper examines Walmart's efforts to engage small producers in large-scale retail in two arenas: the first, a series of efforts over the past ten years to engage small producers in Walmart's agricultural supply chain; the second endeavored to sell the handicrafts made by women-owned businesses in developing countries through Walmart's online consumer marketing.

Though these efforts met with some success, there were also obstacles found. The problems were often systemic in nature and thus the necessary solutions would demand an ecosystem response involving multiple sectors and, probably, several types of commercial support. Thus, another intention of this report is to draw attention to the need to engage multiple partnerships in a coordinated fashion—and to encourage other private sector entities to join in this important work.

The two initiatives we report here were intended to achieve the overriding socioeconomic objective by engaging with the existing Walmart business infrastructure. However, experience demonstrated that some suppliers have not yet achieved a level of reliable production that makes it possible to engage fruitfully in transactions with a global retailer, while others would be able to do so, if only certain systemic hurdles could be overcome. This report will describe the ecosystem needed, but will also provide guidelines and a checklist that will allow retailers to assess whether a given supplier meets the conditions necessary to do business under existing circumstances.

## Performance Dimensions and Influencing Factors

To understand what influenced the success of the artisan and smallholder farmer sourcing programs, we interviewed key Walmart staff, intermediaries, technical assistance partners, and small producers. To facilitate these interviews, we initially conducted background research on this topic and collected detailed information on the specific programs and the small producers engaged in them.

In our analysis, we focused on identifying and organizing a holistic set of influencing factors that affected the potential for successfully integrating small producers into global supply chains. In total, we found 18 influence factors that were components of four performance dimensions. The four performance dimensions are discussed below and the 18 influencing factors are presented in Figure 1.

**Product:** Attributes or characteristics of products that make them more or less suitable for sourcing from small producers

**Market:** Attributes or characteristics of the market demand for the product that influence the potential for success in sourcing from small producers

**Supplier:** Attributes or characteristics of small producers that make them more or less suitable as suppliers to formal retail

**Ecosystem:** Aspects of the supporting ecosystem that influence the potential for success in sourcing from small producers



Figure 1: Performance Factors

## Assessing Performance

Formal retailers should consider each of these influencing factors when developing their own program to source from small producers. To facilitate this evaluation process, we have created the Sourcing Readiness Checklist. Using this checklist, organizations can consistently assess how each potential sourcing strategy scores across the 18 influencing factors that are associated with the four performance factors.

While the Sourcing Readiness Checklist reviews each of the 18 individual influencing factors, Figure 1 highlights how these factors are components of four performance dimensions. To assess the viability of an opportunity from a particular small producer sourcing strategy, retailers should evaluate the results across the four dimensions in aggregate. To do so, we recommend using the Sourcing Scenario Map, as shown in Figure 2.

A graphic tool, such as the Sourcing Scenario Map, is particularly useful when the objective is to assess a portfolio of attributes or dimensions. In this case, we have identified four dimensions, each of which has four to six influencing factors. The ‘Optimal Sourcing Scenario’, as presented in Figure 2, is when the answer to all 18 influencing factors is ‘yes’. If small producers meet this level, they no longer require the support of programs that specifically target and support the development of small producers.

The Sourcing Readiness Checklist also allows for the definition of a ‘Minimum Sourcing Scenario,’ based on the assumption that any dimension scoring below 50% will result in a problematic situation for executing a formal retail strategy with small producers at that moment in time. The area between the minimum frontier and the optimal frontier could be considered the ‘Supplier Development Space’ where the sourcing scenario is viable, but investment is likely required to create a more sustainable, scalable outcome.

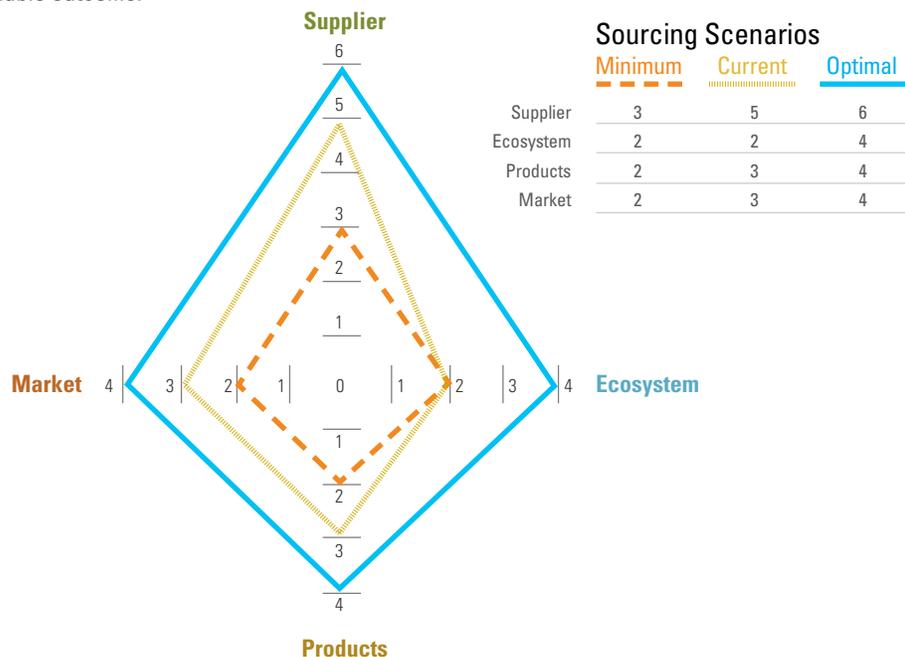


Figure 2: Sourcing Scenario Map

## Taking Action

Very rarely, if ever, will the answer to all 18 factors be yes. The challenge then becomes understanding the viability of the current sourcing opportunity as compared to the Optimal and Minimal Sourcing Scenarios. Again, formal retail can use the Sourcing Readiness Checklist to conduct this analysis, with an example provided in Figure 2.

Retailers can then compare the Current Sourcing Scenario with the minimum and optional scenarios. A comparison to the Minimum Sourcing Strategy offers key insights into whether this proposed strategy is actually viable.

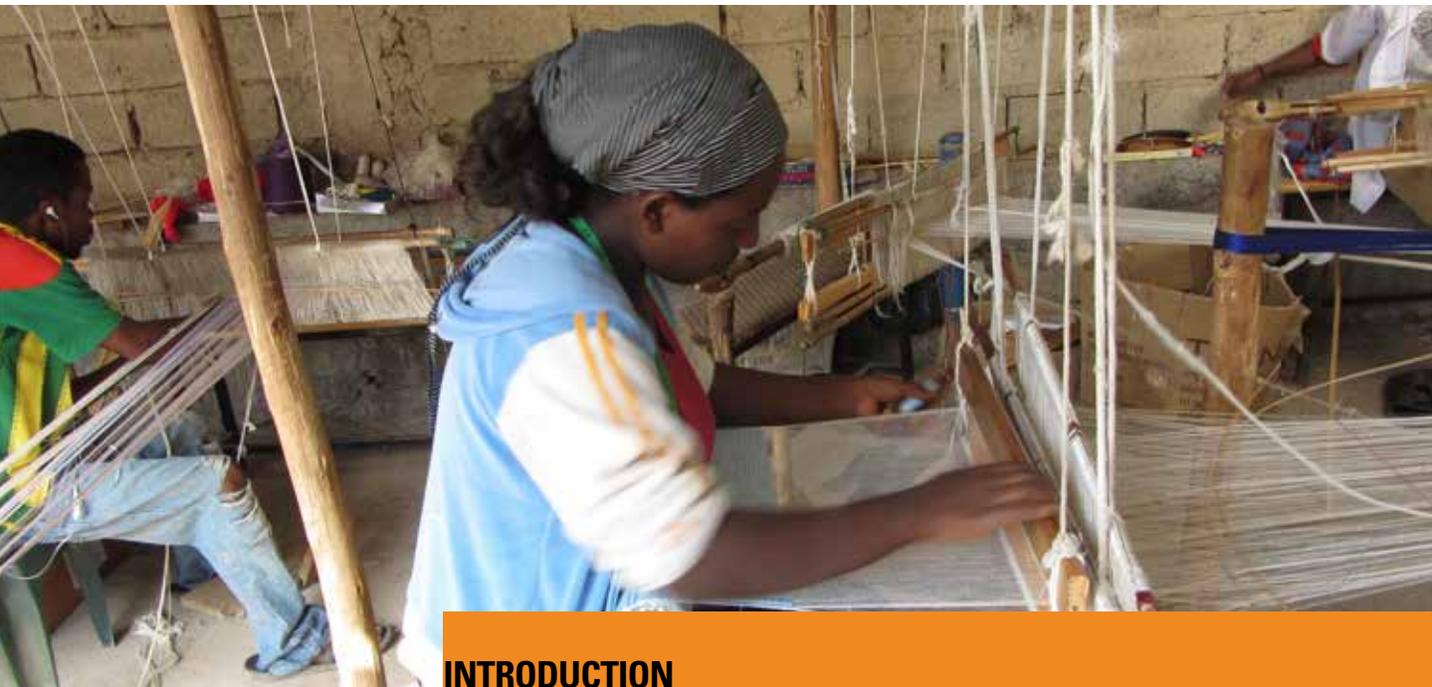
If the answer is yes, the retailer then must decide if it could and should make some investments to move the Current Sourcing Scenario closer to the Optimal Sourcing Scenario. Doing so will enhance the likelihood of success, but of course there is a cost to any investment decision. The source of these investments could be the retailer or a partner organization. These investments can focus on one or more of the following: market information, cash flow and capital, supply management, labor management, storage, logistics, branding, packaging and marketing, export expertise, IT instruction and support, and mentoring and networking.

While we provide a set of recommendations for action, retailers must assess how these investments, or other courses of action, will change the Current Sourcing Scenario and tailor their implementation to the specific context. Indeed, retailers should consider both the implications of their investments and their implementation plans.

Regardless of the retailer, or the sourcing scenario, managers must recognize that integrating small producers is challenging, and generally requires patience and a commitment to remain engaged over the long-term.

While challenging, formal retail can generate substantial benefits from incorporating small producers into their sourcing strategy. This allows these retailers to address changing consumer demands, manage reputational risk, and meet the needs of a rapidly growing global population. Improving productivity and market access opportunities for small producers, particularly smallholder farmers and women-owned artisan enterprises, also offers a powerful pathway to increasing incomes, empowering women, and improving the wellbeing of some of the poorest people on the planet.





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## INTRODUCTION

Over the past ten years, a more complete understanding of the global economy and its complex interconnectedness with social and environmental systems has emerged among both corporate leaders and policy makers, worldwide. The challenges of the near future will demand an integrated response, in which business systems must be consciously engaged and even reinvented in order to form more sustainable and equitable arrangements for exchange and provision. It is essential that major global corporations take a leadership role by innovating solutions and then sharing the lessons learned with the rest of the private sector, as well as with government and civil society.

This study/paper examines Walmart's efforts to engage small producers in large-scale retail in two arenas: the first, a series of efforts over the past ten years to engage small producers in Walmart's agricultural supply chain. Although extremely challenging to execute, in many of these efforts, farmers have become regular suppliers. The second effort, which endeavored to sell the handicrafts made by women-owned businesses in developing countries, ultimately faced more daunting obstacles. These obstacles were often systemic in nature and thus could not be solved by a single retailer. The solutions required would demand an ecosystem response involving multiple sectors and, probably, several types of commercial support for the suppliers. Thus, another intention of this report is to draw attention to the need to engage multiple partnerships in a coordinated fashion—and to encourage other private sector entities to join in this important work.

## Beyond Philanthropy

The two efforts we report here were both substantively different from most “corporate social responsibility” or philanthropic initiatives, in that the intention was to achieve the overriding socioeconomic objective by engaging with the existing Walmart business infrastructure. Normal business performance metrics were relaxed in order to allow a reasonable learning period, free from profit pressure. However, the ultimate goal was that both groups, smallholders and

artisans, would be brought into the global provisioning system on a permanent basis—and therefore the desired changes would be sustainably achieved.

Efforts to include both smallholders and artisans fell naturally under the guiding principles of Walmart's Global Responsibility mission because the innovations were meant to result in more sustainable business practices, as well as to strengthen local communities. However, each effort had a specific desired outcome, as well as its own theory of change. Improved inclusion of smallholder farmers is believed to effectively reduce poverty in the rural areas of developing countries. There is further good, however, in expanding the world's food supply by reaching out to farmers who are too poor or remote to benefit from, for instance, advances in agricultural technology. Food security is one of the most important challenges facing the future; since Walmart is the world's largest grocer, as well as the leading retailer, improving the stability and quality of food supplies is both good citizenship and good business.

The rising importance of women's economic empowerment among recognized global priorities has been one of the most notable developments of the past decade. Research consistently shows that better including women as economic participants leads to growth for nations, but also improved prospects for households and communities. Women's entrepreneurship has been of particular interest, since formal jobs in developing countries are few. However, persistent barriers to women's equal participation have been identified and one of the most important is their relative lack of access to markets.

The Empowering Women Together program was therefore intended to explore the potential for linking women-owned businesses in developing countries to the largest consumer market in the world, Walmart shoppers. The program was initiated as an online platform through which the women-owned suppliers could sell small volumes of goods to American consumers. Because supplying Walmart stores can put unhealthy financial and operational pressure on small suppliers when done too soon, the intention was to gradually incubate these businesses through the more limited and flexible online route, in the hope that some would eventually grow to be store suppliers. The offering was expected to appeal to Walmart's consumer constituency, based on early market research conducted among both male and female shoppers. Again, therefore, the strategy envisioned positive outcomes for both the global development agenda and for business—and, because of this, it was hoped that EWT would be sustainable going forward.

Two years later, after an intensive effort to develop these ongoing supplier relationships, EWT had not been able to successfully conclude more than two or three transactions with each of the women-owned businesses it engaged with in developing countries. The problems encountered

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<sup>1</sup> Walmart's Global Responsibility activities focus on three key pillars; 1) Opportunity, which aims to increase economic opportunity for the company's associates and other stakeholders, 2) Sustainability, which aims to lower the true cost of its products by prioritizing sustainable business practices, and 3) Community, which aims to strengthen local communities. As part of these activities, the company has made a number of commitments to source from and train two key groups of small producers; women owned businesses, and smallholder farmers.

have already been detailed in a series of case studies developed under an academic research project with the University of Oxford (Scott, Dolan, & Steinfield, 2015) (Scott, Dolan, Steinfield, & Rothman, 2014) (Scott, Steinfield, & Dolan, 2014). The intention of this report is not to revisit those problems, but to propose solutions.

## The Research

Interviews were conducted among key Walmart personnel, intermediaries, and partners. Suppliers and their employees were also interviewed and a number of field visits conducted, including trips to supplier sites in developing countries.

After examining the information thus collected, we concluded that the lessons learned might be best presented as a comparison leading to provisional guidelines. Specifically, given the relative success of the agricultural program for smallholder farmers, it seemed that comparing the factors present in those transactions with the challenges in the EWT system might yield checkpoints for other retailers wishing to engage in similar programs, thus helping them to begin a bit higher on the learning curve. So, later in this report we will suggest guidelines that future programs might use to inform their own selection and management of suppliers in comparable settings. In truth, however, we found it easy to slip into conclusions that would essentially suggest that companies should only do business with suppliers that fit easily into existing, conventional business models and practices: that is, suppliers with generous revolving lines of credit, access to the latest technology, proximity to shipping centers, the means to travel to trade shows, modern factories, and the like. Unfortunately, that kind of thinking will not solve the challenges now facing the international community. Something new is required. Therefore, this report will propose that global leaders undertake to collectively create more supportive ecosystems for small producers, but will also advocate that, in the interim, retailers wishing to engage with small producers adopt a fluid, site-responsive approach, using the tools outlined later in this report.

## Building the Ecosystem that Enables Growth

We suggest that a positive path for developing suppliers, whether in farm or manufacturing, would look something like the S-curve in Figure 1. The distance to Point A represents the early stages of the enterprise (smallholder or artisan), in which basic business capability is still incipient. At this stage, the labor supply is untrained, the production unpredictable, transport still unreliable, and so forth. In these situations, the Walmart experience suggests, attempts to engage with global supply chains will end in frustration and loss for all parties. We believe the best strategy for the period up to Point A is for international agencies and charities, as well as foundations focused on economic development, to cultivate businesses not yet ready for the global market toward a point where they can engage with larger partners.

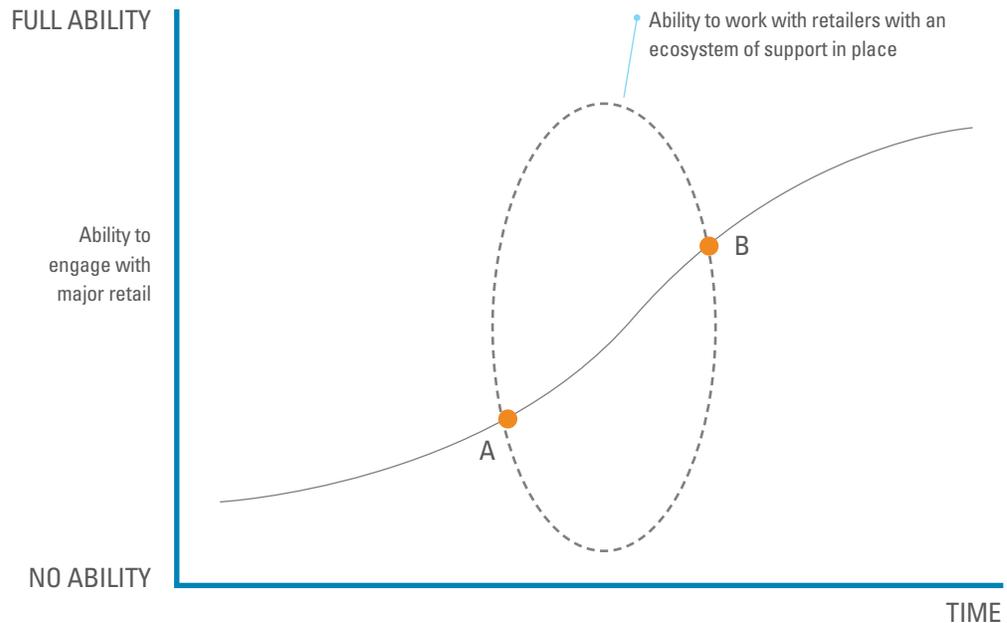


Figure 3: Supplier Development Curve

An example of a public charity working in the way we envision is CARE Bangladesh. The Economic Development Unit in this country works closely with local people, including women, to develop “income-generating activities” into actual businesses by regularizing operations, introducing technologies, enculturating workers, sending owners to trade shows, and the like. It is important, however, that organizations such as CARE be able to see a “payoff” for their efforts, in the form of “graduating” the businesses they cultivate into the global market. Thus, we believe that a formal system to connect businesses that have been vetted through such efforts to global retailers should begin.

Meeting the criteria for “graduation” would bring the supplier to Point A on our S-curve. Based on the initial learning from Walmart’s experience, the criteria for a supplier making artisan craft items might include the following points:

- **The business must be able to show that they have designed at least two products that were successfully sold to global consumers.** The world is glutted with tourist souvenirs. To be viable, the supplier must show the willingness and ability to innovate and to engage with global trends.
- **The business must be able to produce the product consistently and reliably, including meeting exact color and size specifications.** This will mean that it must have a place where production conditions can be controlled and a reliable labor force, no matter how small or whether paid by the piece. It will also mean that it has established internal supplier relations, and that these suppliers themselves are professional and stable enough to

always meet deadlines and quantities.

- **They must have a source of capital other than microfinance.** This could be family money, but it is better if formal capital of some sort, even a small line of credit, is available to smooth production cycles.
- **They must have been in business more than two years.**
- **The business must have consistent communications access (internet access and affordable voice arrangements), as well as English-speaking people who can interface with international suppliers online.**

Once these initial criteria are met, there is potential for a concerted effort among leading corporate players, aided by government and NGOs, to create an enabling eco-system through which the supplier can be gradually lifted to Point B. The curve after Point B represents independent businesses with the capability to grow on their own and even help other businesses to do the same.

Getting to Point B, however, is a challenge that requires a more robust ecosystem to support these producers. There are many promising pieces of this ecosystem under development. While the exact mechanisms that should be adopted depend on the specific context, the research we have done, in this and other projects, indicates several mechanisms that, if jointly developed by a combination of private and public sector institutions, would contribute significantly to the growth of developing-country businesses in this part of the S-curve:

**Modernizing credit systems.** In many developing countries, including several where these programs were trialed, banks loan money only when land title can be pledged as collateral. Since landownership tends to be extremely concentrated—and often is held almost exclusively by males—this credit practice is fundamentally exclusionary. There are other ways in which borrowers can be vetted, covenants designed, and security attained, as witness to the many other modes of lending prevalent in developed nations. We note, for instance, that the Inter-American Development Bank’s effort to test psychometric measures in South America—as a replacement for more exclusionary forms of credit assurance—has been quite successful and could provide a much more inclusionary means for banks to reach the comfort level required to lend. We further note that large funds especially for women have been made available through the International Finance Corporation, after seeding by Goldman Sachs or Coca-Cola. Several companies, agencies, and foundations are now finding that bankers must be trained to be more receptive to lending to women—and training modules are already being piloted. All these innovations suggest to us that there is potential for the partners in this space to turn to the special credit needs of the retail supply chain—and thus facilitate the efforts of global retailers to build more inclusive provisioning methods.

**Transportation.** In both projects, reliable and affordable transportation of goods, from producer to the point of export, as well as from the point of export to the retailer, was a significant problem. The overland methods were unpredictable and expensive, but there was a particular problem shipping the small volumes of manufactured goods in the EWT experiment to the United States for distribution. Because of the quantities and timing involved, suppliers were frequently forced to ship by air, causing an additional cost that had to be absorbed. Yet many organizations in these countries have elaborate logistics systems that move items across land and sea. A conscious collective effort to share small spaces in larger shipments could help make some transactions feasible that otherwise failed.

**Design and market information.** One significant problem among some suppliers in the EWT program was style design. Developing country entrepreneurs and their employees often had no experience with the destination market and thus with the tastes and seasons that would drive consumption. To compensate for this challenge, Walmart's design team and the aggregators worked together to create designs that would appeal to Walmart customers and still stay true to the artisan spirit. To be sure, this lack of connection made it hard for them to comprehend many of the demands typical of global retail: the timetables, the packaging requirements, the information interface, and so on. Such basic forms of interface and information management do need to be taught, and can be learned more easily than the design sensibility can be transmitted. While there are programs that pay for entrepreneurs to go to trade fairs and the like, such efforts are inefficient given the size of the need. A collectively-funded or government-supported program—a kind of Design Corps—would be more affordable, as the cost to do this on a transaction-by-transaction basis is prohibitive.

**Export.** We suspect that learning to work through the export procedure is difficult for all companies wanting to do business internationally. However, the kinds of disadvantaged groups represented in these two efforts are particularly vulnerable to what is already an arcane and often corrupt process. Unscrupulous customs agents can too easily prey on suppliers who may be less worldly, less literate, or less confident than the owners of more mature businesses. Perhaps a special group of advocates, who are knowledgeable about exports and charged with reporting corruption, could be appointed by local governments to assist small suppliers in learning the ropes of export.

**Ethical Sourcing and Quality Control.** The certifications for products involving, for instance, child safety or animal protection or food hygiene, are often completely new and rather mystifying to small producers in developing countries. Expert advice and assistance on these issues, as well as on quality controls of various sorts, could be a huge help to an ecosystem supporting smallholders or artisans. For example, we know that the International Women's Coffee Alliance has had a very positive impact just by teaching female coffee growers how to select quality beans and how to judge the price a coffee will bring by its taste. Another issue, detailed in the Oxford case studies, was the need to enforce international factory standards—from exit lights to time cards—

for artisan enterprises operating under conditions that really were not a match for the criteria. We believe that formulating a joint retail industry set of guidelines for ethical sourcing among small producers in developing countries would help avoid unnecessary work stoppages and failed transactions, yet still be acceptable from a global perspective.

**Safety.** If women are to be properly included, safety precautions must be increased. Too often, street danger must be a major consideration for females choosing to engage in economic systems. Local governments and communities must take responsibility for curbing violence against women if they are to prosper from the growth that comes with better female inclusion.

**Sourcing Materials.** Small suppliers are often unable to get good prices for necessary materials because of the low volumes. They are also at a disadvantage when trying to find novel materials needed to stay up with trends or even basic pigments to create fashionable colors. These small producers are also often at the mercy of raw materials suppliers that do not themselves take deadlines or delivery promises very seriously. A collective effort to make materials acquisition more efficient would contribute mightily to small producer viability.

**Business skills and advice.** Many small producers have limited basic business knowledge or experience. They can benefit from skills training programs, as long as these are suited to the context. Mentoring programs, such as offered by the Cherie Blair Foundation for Women, can help guide decision-making and, importantly, bolster confidence.

These are just a few suggestions for the support that an ecosystem intended to support small producers in developing countries might provide. We would envision a joint effort among both private and public sector institutions that would innovate such a system.

In the absence of the collective system proposed, however, retailers wishing to engage with this important agenda will need to be selective about the suppliers with which they engage. The next section, therefore, will discuss the factors that seemed most determinant of success (defined as the successful retention of the supplier in the program). What will then follow are tools to help select and engage with small producers in developing countries.



Figure 1: Performance Factors

## Performance Dimensions and Influencing Factors

We focused on identifying and organizing a holistic set of influencing factors that affected the potential for successfully integrating small producers into global supply chains. In total, we found 18 influence factors that were components of four performance dimensions. The four performance dimensions are discussed below and the 18 influencing factors are presented in Figure 1.

- Product:** Attributes or characteristics of products that make them more or less suitable for sourcing from small producers
- Market:** Attributes of characteristics of the market demand for the product that influence the potential for success in sourcing from small producers
- Supplier:** Attributes or characteristics of small producers that make them more or less suitable as suppliers to formal retail
- Ecosystem:** Aspects of existing ecosystems that influence the potential for success in sourcing from small producers



Courtesy of Walmart

## INFLUENCING FACTORS

In analyzing our data, we identified the influencing factors within each of the four dimensions that had the most impact on the opportunity to develop an effective sourcing strategy (See Figure 1).

A key consideration for each program seeking to source products from small producers is determining what constitutes ‘success’ in its own context. For programs that view the benefits of this sourcing model as being primarily commercial, success is determined in financial terms first. For programs that see the inclusion of small producers as part of their sustainability or social responsibility strategy, success can mean greater concern for improving the well-being of the producer as compared to economic returns for the company. In this case, the challenges or barriers presented in our findings may be considered as opportunities to achieve deeper and more sustainable impact on the wellbeing of the producer. In both cases, the overall indicator of success is the sustained inclusion of small producers in the supply chain.

In the remainder of this section, we discuss each of the 18 influencing factors in detail. We based this analysis on our examination of Walmart’s initiatives to source from artisans and smallholder farmers over the past decade. In the discussion of each influencing factor, we have sought to include examples from these initiatives to illustrate its impact.

Formal retailers should consider each of these influencing factors when developing their own program to source from local producers. To facilitate this evaluation process, we have created the Sourcing Readiness Checklist. Using this checklist, organizations can consistently assess how each potential sourcing strategy scores across the 18 influencing factors that are associated with the four performance factors (see Appendix 2).

In the material that follows next, we discuss how to understand and evaluate each of influencing factors on Sourcing Readiness Checklist.

While we examine each of these influencing factors individually, the aggregation of these factors provides the final determination of the potential viability of engaging small producers in a specific sourcing scenario.<sup>2</sup>

## Product

### Perishability/Seasonality Characteristics

Our findings indicate that perishable products can be more challenging for small producers to supply. This is particularly the case for smallholder farmers that produced long distances from the point of sale, especially if the supply chain infrastructure involved is inefficient, or does not have the technological requirements to transport goods under the right conditions. Retail seasonality, particularly for artisans, creates challenges in ensuring timely delivery and can require responding to changing expectations over time.

Artisans who are producing fashion or trend-based items may have short lead times in which to respond to these trends. Delays may mean that the product doesn't reach the market until well into the season, or life cycle of a particular trend. This may leave retailers with stock that exceeds demand, potentially resulting in heavily discounting, or discarding the stock when the season is over if the opportunity cost of shelf space or storage is too high.

For example, Walmart ordered a batch of Christmas angels from one of its suppliers in the EWT program based in Kenya. The design of the angels required use of new materials, in particular a glue that evoked an allergic reaction among the workers. It proved difficult to find an equally effective substitute for the glue, which in turn delayed production until the angels could no longer be made and shipped to arrive before Christmas. While Walmart covered the costs involved, the order had to be cancelled. The seasonal delivery requirement left no margin for error (Scott, Steinfield, & Dolan, 2014). In other instances, suppliers found it difficult to source novel materials, including dyes, or to teach workers new techniques, in time to make deadlines. And, other suppliers on which the artisans were reliant also failed to produce needed materials on time, for a variety of reasons.

Smallholder farmers produce products that are generally not subject to quick changes in tastes or trends, and with seasonality that is more predictable. However, retailers will generally only accept perishable products if they are still fresh, and thus they have a short shelf life beyond which they are not fit for sale. This means that smallholder may have to maintain a cold chain from farm to retailer and the length of time it takes for a product to get to the point of sale is particularly important. This is especially problematic for produce that face long supply chains and a short "fresh" life.

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**Implications:** Retailers engaging small producers to provide seasonal items should ensure that those producers add a time cushion to absorb unexpected delays due to unforeseen issues. Where possible, these items should use familiar inputs, and have a predictable production process. Retailers

of fresh products may need to enhance the supply chain infrastructure, such as in transportation, refrigeration, and special handling, to ensure that goods from more remote farmers arrive in stores in peak condition.

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## Premium/Specialty Product

Our findings indicate that specialty products may not realize substantial benefits associated with economies of scale, meaning that small producers can compete more effectively at low volumes. These products may also offer greater margins, providing incentives for small producers to invest the time and financial resources to produce them.

Artisan enterprises produce items with artistic or aesthetic elements that differentiate them from cheaper alternatives. However, while such products may attract a premium because of their unique nature, artisans must ensure that these products also align with current trends in design and function if they are to be successful.

Smallholder farmers may be able to supply higher margin products at price points that are more competitive with larger farmers. In some cases, these smallholders may be a more cost effective option. Niche markets, in which customers are willing to pay a premium, such as organic and fair-trade markets, can offer a particularly attractive option (International Finance Corporation, 2013).

In Central America, Walmart sources chayote, a variety of squash, from smallholder farmers. This vegetable is popular in Central America, but there is little demand outside the region making it unattractive for commercial scale production. Other products, such as cocoa, may be impossible to grow on a commercial scale. Smallholder farmers produce 70% of the world's cocoa in small quantities, since it grows in tropical rainforests zones that are not amenable to commercial scale cultivation (International Cocoa Organization, 1998).

**Implication:** Small producers that are producing undifferentiated products in a competitive environment can face challenges in achieving cost efficiencies. In working with these types of products, retailers may need to make investments in value-chain infrastructure that allows small producers, either individually or in groups or cooperatives, to capture more profit by engaging in value-add processing.

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<sup>2</sup> While each retailer should consider these influencing factors in light of their specific social and commercial objectives, strategies and the sourcing goals, the checklist offers standardized approach to building a more successful program. These findings make the assumption that, all else being equal, retailers will prefer to source from small producers. Further, we assume that retailers will only source from small producers when the product is something that is in demand by the retailer's customers, the product fits within an existing category that the retailer carries or wishes to carry, or sourcing from small producers makes commercial sense or contributes to the retailer's social impact strategy or commitments.

## Inputs and Materials

Our findings indicate that products requiring expensive inputs or materials not always readily available on the local market create challenges for local producers who may not have the working capital or a sufficient network of input suppliers. If the cost of these inputs is highly variable over time, this may present a substantial risk for a small producer.

Artisan enterprises reliant on expensive or hard to find elements of a final product may find themselves constrained in their ability to finance the product development or deliver in a timely fashion.

Smallholder farmers will struggle to absorb higher costs and greater risks if their buyer demands a quality level that requires expensive inputs or large volumes of certain resources such as land or water. For example, fruits and other tree crops can be challenging for smallholder farmers because of the amount of land required to produce at a volume that is cost effective. Smallholder farmers also confront gaps and obstacles in accessing necessary and high quality agricultural inputs. Inputs are often unavailable within reasonable distance, low quality, or both. Smallholder farmers are often reluctant to engage with partners and participate in capacity building initiatives out of fear of financial implications if the new techniques and crops do not perform.

In other cases, crops can require specific inputs, including seeds, fertilizer or pesticides, which are not only expensive, but also can fluctuate in price. For example, in Costa Rica, such inputs are subject to import levies, which can leave locally produced items more expensive to source than imports from neighboring countries that don't have such levies.

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**Implication:** Retailers should recognize the benefits of sourcing products that rely on readily available and inexpensive inputs. Otherwise, retailers should be prepared to support interventions that address cash flow constraints and other issues faced by small producers. This could include providing support for financing, flexible delivery deadlines, or pooled procurement of inputs via farmer groups or co-operatives, or with the support of NGOs and other partner organizations.

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## Processing and Packaging

Small producers are often constrained in their access to capital, particularly women-owned businesses. This makes investment in mechanization less achievable for small producers, and consequently they are unable to capture value that comes from downstream processing. These producers can also face challenges in meeting complicated packaging requirements. Our findings indicate that as a result, small producers are often better able to handle specialized production of products that require skilled labor rather than expensive machinery.

Products that artisans make substantially by hand may require little in the way of special tools or machinery, and often rely on raw materials that are available locally in a readily usable form. For

example, Walmart in India sources seasonal products made from dried flowers from a small producer, Society for Child Development (see case study below). This product relies on simple processes – workers gather flowers by hand, dry them in the sun, and process them by hand to produce colored powders for the Holi festival. With a cost effective supply of both flowers and labor, suppliers can easily scale their business model to meet demand.

Smallholder farmers may have access to a labor pool, through family members of working age, relatives, and local community members that can respond more flexibly and cost effectively to specific production requirements (Costales, et al., 2007). For example, smallholders may be able to engage family members for periods of time that optimally match the effort needed to manage a crop, as opposed to larger farmers that may need to hire employees in larger blocks of time. If the production volumes are low, and as long as farmers comply with applicable laws and retailer's standards, this can make smallholder farmers more efficient on a per unit basis.

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**Implication:** Complicated or technical processes required to transform raw materials, or produce a finished product will often require substantial investment. This is a challenge for most small producers. A potential strategy to mitigate these issues is finding a partner organization that can fulfill these steps, or, if there are many small producers in the same area, to support or invest in co-operatives or other institutions to make these facilities available across a large group of producers.

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## Market

### Quality Standards

Our findings indicate that small producers are generally less able to produce to precise specifications and manage low tolerances for variation. Products that customers require in specific sizes, such as clothing, shoes, and certain vegetables and fruits, are difficult to produce consistently without substantial investment in quality control standards. Smaller producers can more easily produce products that have flexible specifications, or products graded according to these variations.

Artisans produce products that are substantially hand made, and can have variances that may make them unsuitable for formal retail settings. While natural variations can be considered a feature of hand-made products, customers expect consistency or require adherence to specific sizing standards for certain types of products such as clothing or footwear.

For example, Walmart's first order from one of its suppliers in Kenya in March 2012 was for a shipment of horn bangle bracelets painted with animal prints. However, being made from horn, these bracelets were subject to variations in diameter that resulted in bracelets that were too small or too large to be usable as a bracelet, which meant that only a fraction of the delivered units were acceptable for sale (Scott, Steinfield, & Dolan, 2014). Normally this would have resulted in a loss for the producer, however, in this instance, both Walmart and the aggregator company absorbed the losses (Scott, Steinfield, & Dolan, 2014).

Smallholder farmers produce products that have natural variations, however, these are impacted greatly by the conditions under which they are grown. How precisely smallholders control these conditions, is often a matter of investing in the appropriate technology and resources. While a smallholder farmer may be able to invest in hoop houses and irrigation to grow horticultural products, it is more expensive to invest in equivalent production technologies for tree fruits, livestock, etc. and so these products may be more difficult to produce to exact standards.

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**Implications:** Products that fall outside of these specifications can often find alternative markets with different requirements, although these may offer lower prices for lower grade, damaged or non-standard items. However, without these alternative markets, suppliers may experience a level of waste or non-acceptance of product that reduces the financial sustainability of the transaction. Furthermore, small producers should be empowered to perform quality or acceptance tests on site rather than shipping unacceptable products.

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<sup>3</sup> For example, Walmart expects that all of its suppliers, regardless of size, will comply with Walmart's Standards for Suppliers and all applicable labor laws and regulations, including any applicable labor laws pertaining to permissible age for work.

## Transparency and Traceability Expectations

Our findings indicate that small producers provide the potential for greater transparency into who makes a product, the production process, and conditions under which they make it. However, this is only the case if the relationship between the producer and the retailer is relatively direct. This provides one of the key benefits of a retailer led supply chain that makes limited use of intermediaries (Michelson, 2016).

For artisan products, this transparency is a selling point if customers gain some additional benefit from this knowledge, particularly if it provides a context for the social impact associated with purchasing the product. This was particularly relevant for the EWT platform, which was based on the producer being female and in many cases, working at the base of the pyramid.

Transparency may also be a selling point for goods produced by smallholder farmers for the same reasons. This additional visibility into the production processes and conditions can also enhance a risk management strategy for retailers. They may be better able to demonstrate, for example, compliance with standards for niche markets such as organic or fair trade items.

Buyers of fresh produce for Walmart Chile consider transparency a benefit of working with small producers through the Direct Farm program, because there is greater visibility into the production processes than is possible with larger producers.

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**Implication:** For retailers, transparency is both a product feature, and a risk management strategy. Traceability of the production conditions may be particularly important in product categories that have a reputation for negative social or environmental impacts, such as textiles or palm oil. If relationships with small producers occur via intermediaries, these organizations may not collect data or provide the same level of transparency that is valued by both the retailer and the end customer.

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## Order Size

Products produced in small quantities often require aggregation in order to meet minimum order volumes for retail. This aggregation, while it can often create value for both the retailer and the aggregator, can add complexity to the supply chain and reduce price capture opportunity for the producer. Products produced in volumes suitable for supply directly into formal retail channels with little or no aggregation are more successfully sourced from small producers.

Artisans who produce differentiated products considered unique and valuable may not need to produce substantial volumes. This may be especially true if the aggregator carries these products as a part of a broader portfolio of handcrafted items where a large number of one item is not required or desired.

Walmart intentionally designed the EWT program to sell products via Walmart's online platform walmart.com. This allowed the program to reduce the minimum order size and source small volumes of a wide variety of products, storing them in its warehouse before shipping directly to the customer.

Smallholder farmers face more challenges here. While these farmers may organize themselves around only one or two products, their production level may be insufficient to meet minimum volumes required by a retailer. These are fast moving goods, often sold at lower unit prices as compared to handicrafts, which are generally one-time purchases. As such, aggregation of supply by farmer groups or cooperatives may be required for these products to reach sufficiently large purchasing volumes.

Smallholder farmers often grow low-yield varieties and the majority of these producers have access to only two hectares of land or less (Food and Agriculture Organization of the United Nations, 2015). These conditions create fundamental barriers to accessing formal markets, which require higher quantities of goods than these individuals can provide. In order to address this issue, it can be advantageous for smallholders to aggregate supply through farmers' organizations to meet buyer's quantity requirements. By selling as a group and aggregating their yields, farmers gain access to new markets and the ability to negotiate better prices. New opportunities to sell to larger buyers provide farmers with the potential for stability that comes from longer-term contracts, and presents a pathway to improve socioeconomic growth, and development.

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**Implication:** Retailers may wish to encourage producers to form associations or cooperatives that can aggregate supply to achieve minimum viable order volumes, or encourage the use of aggregators that share their social impact objectives. However, reducing transaction costs to allow for smaller orders may offer an alternative option. Retailers can consider using exclusively online channels, or other ways to reduce inventory or other transaction costs, in order to engage small producers directly with manageable orders.

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## Demand Predictability

Products that have stable demand profiles lend themselves to forward planning and forecasting, which can help to engage small producers more effectively. The ability to plan well ahead of delivery timelines can help mitigate resource constraints, such as the availability of labor or raw materials. Stable demand guarantees a market for the producer's goods (if they meet quality standards) and this may reduce barriers to accessing capital, if the producer can use future orders as collateral.

Artisan enterprises may require some lead time to modify designs, change production processes, and even train more artisans in order to have access to sufficient labor to produce products for formal retail. Having predictability in the demand for the products they produce, therefore, allows

for long-term investment in building the capacity of the enterprise, and the predictable cash flow may make craft production a more valuable and therefore higher priority activity for individual artisans who have competing priorities.

Artisans will likely find it difficult to adjust their production norms to match unfamiliar demand seasonality, and order cycle deadlines. In addition, many artisans who are located in rural communities may face delays in gaining access to raw materials from suppliers and having the ability to transport final products due to a range of factors outside of their control such as limited communications technology, poor transport infrastructure, and disruptive weather. Without stable demand for their products, artisans are unable to rely on predictable cash flow, and have to remain diversified in terms of their economic activities.

Smallholder farmers have a long production cycle, and need to make investments well in advance of receiving revenue for their goods. Stable demand allows for the planning of planting and harvesting cycles, and ensures that long-term contracts support investments in growing the enterprise. Smallholder farmers are often ‘price-takers’, which means that they must accept the price that the market offers. This is partly due to traditional, highly intermediated supply chains in which ‘middle men’ make most of the profit. Due to lack of working capital, and lack of appropriate storage facilities, smallholder farmers are also generally unable to store inventory and sell when prices are high. Having a commitment from a retailer to enter into long-term contracts at guaranteed prices and volumes mitigates some of these risks for smallholder farmers, and reduces the incentive to engage in side-selling – the practice of renegeing on a contract to supply a specific quantity of goods to a specific buyer at an agreed upon price, in order to sell to brokers or other buyers who offer a higher price.

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**Implications:** Products that have stable and predictable demand are easier to plan for, and any delays in the supply chain that come from working with small producers, either through delays in production or logistics, are less impactful than for one-time or variable orders. The predictability of demand also provides the opportunity for small producers to invest in building the capacity of their enterprise, engage in more sustainable practices, and access forms of support that may be more challenging if demand is unpredictable and lumpy.

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## Supplier

### Geographic Location

Proximity can matter. Small suppliers face fewer logistical challenges if they are closer to the store or distribution center that they are supplying. While the logistics and transport costs are also lower for large producers that are closer to stores, these costs typically represent a larger proportion of the total transaction for smaller producers that are supplying in smaller volumes, and so have a disproportionate impact on their ability to compete with other suppliers.

When artisan enterprises are located far from the market they are serving, they face challenges in shipping products to retailers. This can be especially challenging if international shipping is required, which can involve complicated export and customs regulations. Products that are highly seasonal, such as fashion items, may have very strict delivery deadlines, and artisan enterprises can incur additional costs if these deadlines require expedited delivery.

Smallholder farmers are generally located in rural communities that may be far from the retailers they are supplying. Not only does this affect the ability to meet delivery timelines, but it may also have a direct impact on the quality and freshness of the product. The availability of supply chain infrastructure such as refrigerated trucking or shipping mitigates some of this risk. However, this requires an additional cost and is not readily available in all countries. This requirement can also vary by product, with some products being more robust than others once harvested.

For example, when sourcing from smallholder farmers, Walmart Brazil prefers to work with farmers that are located less than 100kms from the store that they are supplying. Beyond this range, the logistics costs increase and the product costs too much to sell in its stores.

In India, Walmart has begun sourcing general merchandise items from local producers, including the Society for Child Development (see case study below). In contrast to the EWT program, these producers only supply products for Walmart in India, rather than for export. While these producers benefit from simpler and less costly logistics, it also allows Walmart to leverage its existing network of suppliers and supporting organizations to assist these small producers. In addition, Walmart can more easily plan production cycles, product design and pricing with producers that are in the local market since they understand seasonality, trends and consumer preferences.

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**Implications:** Retailers that wish to work with small producers that are located far from the point of sale should factor these limitations into both the products they choose to source and the suppliers with which they choose to work. Appropriate supply chain infrastructure, such as the availability and proximity of reliable transport infrastructure, or cold chain and cold storage capacity can address these location challenges. Retailers may need to consider additional investments in this infrastructure in order to work successfully with small producers.

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## Society for Child Development – Case Study



The Society for Child Development is a non-profit founded in Delhi, India in 1992 to provide opportunities for children and young adults with disabilities. Part of the mission of SFCD is to teach entrepreneurial skills to people with disabilities, and it does this through the 'Trash to Cash' initiative. Employees gather flowers that have been discarded in rivers and canals after festivals, and through a process of drying and grinding, turn them into colored powder, that is used during Holi, the Hindu festival of colors. SFCD markets these colors under the brand name 'Avacayam Holi Color' has been supplying to Walmart Cash and Carry's since 2013. Unlike alternative products on the market, Holi Colors is a recycled, organic product that uses no chemicals.



Courtesy of Walmart

Before supplying to Walmart, SFCD produced 300-400 packets per festival season, which it sold at informal retail locations within Delhi. When Walmart approached the organization with a proposal to carry the product in its stores, it envisioned demand initially reaching 10,000 units, with the potential for even greater scale. However, the partnership began by sourcing a small volume and grew well beyond their initial goal of 10,000 units. This allowed SFCD and Walmart to focus on the additional capacities needed in order to qualify as a Walmart supplier. These included conforming with financial, legal and reporting standards, developing the ability to package the product in a way that was suitable for presentation in stores, and developing the logistics capacity required to deliver the product to stores around India. Walmart was able to connect SFCD with some of its other suppliers that were able to provide technical expertise on some of these issues, and with a logistics company that was able to help with distribution to Walmart stores. Walmart itself provided some assistance in helping to understand the cost model for the product, and how to price it for wholesale markets.

With these additional capabilities in place, and a product that met Walmart's needs, SFCD was able to focus on supplying larger volumes. Scaling the business model was dependent on having a readily available and flexible supply of two key inputs, unemployed people with disabilities who could do seasonal work, and flowers. Delhi had too much of both. In a densely populated city the organization had access to a large population of people with disabilities who needed jobs, and whom it could train to do the relatively simple processing steps required to make the colored powders. It also had access to discarded flowers, which the government saw as a nuisance and it supported SFCD's activities as a step towards cleaning up river pollution.

As of 2016, SFCD is supplying 50,000 packages of Holi Colors to 16 Walmart stores around India, which accounts for one third of the organization's production. The organization is preparing to outsource some of the processing steps to organizations working with disabled people in other cities, and is preparing to supply two additional SKUs to Walmart in preparation for Diwali, the Hindu festival of lights.

## Production Capabilities

Our findings indicate that small producers do not always understand or implement established practices for enhancing the quality or quantity of their output, or adding value through processing and packaging. Indeed, small producers often lack the market intelligence required to understand consumer demands, or how to differentiate their products to maximize the market opportunity. Despite the additional investment required, suppliers that have the ability to add value to raw materials through processing and packaging can capture more value, and also may have the opportunity to more easily diversify into new product lines.

Small producers that make craft items using traditional methods, materials, and designs are often not aware of opportunities to enhance efficiency and improve consistency. They produce what they know how to make using a process that may rely on outdated production approaches. These small suppliers typically have very limited access to new low cost technology innovations or new processing tools. They may also be unfamiliar with the packaging and labeling standards that formal retail channels require.

Artisan produced crafts are vehicles of ethnic, political and often gender identity (Grimes & Milgram, 2000, p. 3), and typically use traditional methods, materials and designs. Artisans may be reluctant to modify the style or design of items that have cultural or ethnic significance in ways that impact the item's meaning or function (Grimes & Milgram, 2000, p. 7). As such, these items may not necessarily conform to market trends or fashions in non-local markets. Artisans make what they know how to make, and hope that it sells. They have limited access to new materials, and often find it difficult to adapt to requests for new designs, methods, standardized colors and sizing, or new materials that are required when engaging in formal retail channels. This is particularly challenging with respect to packaging, as few artisans have the capability to package products appropriately for retail sale.

Smallholder farmers are specialists in producing the crops that they are familiar with and that they already grow. New crops may require different inputs and skills, they may have different growing cycles, and they may require new crop rotation strategies as compared to existing crops. Smallholders that can perform even simple processing and packaging may be able to capture additional value, particularly in markets that value convenience, and products that are ready-to-eat.

In Brazil, Walmart's customers value the convenience of packaged products that are ready to eat and have a long shelf life. Smallholder farmers that have the ability to perform these processing and packaging steps are more likely to become successful suppliers.

Walmart Chile is working with local agencies to support a development program for smallholder farmers that includes capacity development on health and safety guidelines, quality assurance and food safety. It is also working with the Ministry of Agriculture to provide technical support to these farmers.

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**Implication:** Ideally, retailers should purchase products that small producers already have the capability to produce. Requesting suppliers to substantially change the design or production of a product, while also requiring them to transition to greater scale, and take on additional logistics complexity can be a difficult process and may take a number of iterations in order to see success. Retailers may be able to mitigate some of this risk by making up front investments in collaborative design processes and associated sampling or test runs in order to allow producers to adjust to new inputs, production methods, or processing steps. Producers that can capture more of the final value of a product are likely to be more financially sustainable. Retailers should encourage producers to engage in value add processing and be prepared to invest in ways to help them capture as much of this value as possible.

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## Business Capabilities

In order for goods to flow smoothly from initial production to final delivery requires more than just technical skills. Producers must also be able to manage the business side of the enterprise. Working through sometimes long and complex supply chains requires careful planning to ensure the right products are produced at the right quality, at the right price point, and that these products are delivered to the retailer on time. There must also be consistent flow of information. If producers are reluctant or unable to communicate effectively with retailers or intermediaries, there is a greater probability that goods do not meet the expectations. Small producers must also develop the technical capability to engage with the retailer's systems.

Artisan enterprises, particularly those selling products to geographically distant markets, are often responsible for a much wider scope of business operations when engaging with formal retail. Product success in the target market can require design changes that are cognizant of trends and fashions in that market, consumer preferences, packaging norms, etc. These enterprises may also need to manage the exporting of products, including customs and international logistics, all of which may be unfamiliar and not part of their existing operations.

Supplying to formal retail also requires changes in working practices for employees of these enterprises. As Walmart experienced when working with a women's group in Tanzania, people living in base of the pyramid contexts are not necessarily happy to make the transition to a regular work schedule. They are not used to spending all their daytime hours sitting in one place, working on the same thing, and leaving their children in the care of others. These artisans may also need to be enculturated into punctuality and presence at work given that they may not previously have gone to a central place to work, nor did they necessarily want to do so (Scott, Dolan, & Steinfield, 2015).

Smallholder farmers engaging in formal retail channels may also have to engage in a wider scope of business operations, including the monitoring and recording of the use of fertilizers and other chemicals, or achievement of certain standards, such as organic. Depending on the needs of the

retailer, smallholders may also be required to formalize relationships with input suppliers, access additional information on market pricing, engage in non-familiar contracting models such as forward contracts, and engage with logistics partners.

Smallholder producers face significant challenges in entering modern markets, which they need to do in order to engage in supplier relationships with formal retail. Many smallholder farmers have minimal access to education, and lack sufficient knowledge of modern farming techniques, record keeping and tracking farm yields, costs and practices, or proper storage methods. It is critical that partners conduct thorough market research before program design and implementation, and identify information gaps.

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*Implications:* While retailers may find it preferable to work with small producers that already have the business capabilities to engage with formal retail, this may not always be possible. This is particularly challenging if the retailer engages with producers marginalized by lack of education, distance, or gender. In addition to supporting technical capacity building, retailers should ensure that small producers have sufficient support to develop these business capabilities in parallel.

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## Access to Working Capital

Purchasing inputs of the right quantity and quality is one of the key challenges faced by small producers with limited capital resources. Our findings indicate that access to credit is one of the largest barriers faced by small producers engage formal retail channels. Small producers will need to make investments in their product before they receive any returns. However, capital is often the most difficult input to acquire, especially for women. If it can be obtained, there are many factors that make the cost of credit prohibitively high, such as collateral requirements, lack of credit information, sector bias, and perceived risk. Producers that are located in or close to urban areas will typically have more access to lower priced inputs as well as sources of credit, whereas those in more rural areas will have fewer opportunities to address these challenges.

Artisans may face multiple barriers to securing the inputs needed to produce goods to order. In particular, women owned artisan enterprises face additional barriers to obtaining credit barriers to obtaining credit, or obtaining it at competitive rates. There may also be limitations on women's ability to travel safely to different providers of inputs or credit.

One of Walmart's EWT suppliers in Kenya found it particularly difficult to gain access to credit due to collateral requirements. Local banks required property as collateral and women own only 1% of the titled land in the country. Combined with unfavorable credit terms with her local customers, this made management of working capital, and consequently, growing her business, extremely difficult (Scott, Steinfeld, & Dolan, 2014). The combination of collateral requirements for credit and the propensity for custom or law to withhold property ownership from women frequently presents as a barrier to business growth in developing countries.

For the most part, changes to the production process required to incorporate artisans into formal retail requires scaling up to meet volume expectations, which may mean hiring workers on an hourly wage or making a volume order of items. These changes require working capital that artisans find difficult and expensive to access, and so these transactions produce substantial financial risk, even at relatively low volumes.

For smallholder farmers, inputs may be readily available through existing agro-suppliers, access to credit is lacking. Walmart in Costa Rica is seeking to overcome this limitation by collaborating with a development bank to provide better access to sources of credit at competitive rates for smallholder farmers.

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**Implications:** Retailers should be conscious of the cash flow barriers faced by small producers and the particular challenges this creates in fulfilling large orders that require a lot of working capital. Lack of flexibility in the availability of inputs may also introduce additional delays into the supply chain and affect the producer's ability to meet delivery deadlines. Retailers should be prepared to support small producers that face these constraints, for example through intentional efforts to reduce barrier to obtaining credit, or by providing some way for producers to securitize their purchase orders.

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## Resilience

Our findings indicate that suppliers already engaged with other off-takers, or have multiple product lines are more ready to achieve supplier standards and meet delivery deadlines. By diversifying their market opportunities across multiple buyers and products, small producers that can develop this capacity can increasingly become more resourceful and resilient. It is likely that these producers will be better able to plan for resource needs, manage variation in demand, and address cash flow challenges. If producers have relationships with buyers across multiple markets, they may have access to alternative outlets for products unacceptable for quality reasons, or where they miss delivery timelines.

Artisan enterprises that have a diverse portfolio of buyers and products can provide more stable employment to individual artisans since they are not dependent on infrequent large orders from a single source. This may increase the priority of this work for artisans since it provides predictable income.

Smallholder farmers that have a diverse portfolio of buyers and products have the ability to access markets that differ in their quality requirements, which provides opportunities to reduce wastage. For example, fruits that are not suitable for sale as fresh produce because of damage or blemishes may be perfectly acceptable for the production of juices or other products. Diversity of product may also help to smooth revenues if these products have complementary harvest cycles.

In Costa Rica, like many other locations, smallholder farmers that are able to meet Walmart's supplier standards are likely to become more competitive in the retail market as a whole and have greater opportunities to grow their enterprise.

Similarly, farmers that can diversify the range of products they produce are more successful. For example, Walmart Brazil works with a cooperative that supplies fish in whole, portioned, and frozen varieties, which caters to a wide range of customer needs.

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**Implications:** Small producers that are reliant on a single large buyer may struggle to manage cash flow and retain employees when there are gaps between orders. Working with multiple retailers not only reduces risk for the producer, but it may also result in the development of additional capacities that benefit all buyers working with that producer. Small producers that are reliant on a single product may have fewer opportunities to utilize assets to their fullest. Retailers should encourage these producers to identify economies of scope that could enable them to produce additional products, or at different price points, in order to better ensure the sustainability of their relationship.

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## Audit Viable

Producers that supply into formal retail channels may be required to meet minimum standards that the retailer applies to all its partners. These are often in the form of audit requirements. For many small producers, these requirements can be disruptive to existing cultural or contextual norms, such as detailed record keeping, the presence of children in the workplace, family labor, cleanliness standards, or the prevalence of piece-work employment structures.

Artisans who are used to engaging in commercial activities through informal channels may find it difficult to make all the changes necessary to comply with supplier standards. Individual artisans often produce handicrafts in their homes, using methods practiced for generations, with little knowledge of modern certification standards.

Small producers in international markets in the EWT program faced many challenges resulting from differences between the way they had been used to working, and the standards required supplying to Walmart. These enterprises had little prior experience of producing to strict design specifications and timelines, and required substantial support to comply with strict supplier standards.

In particular, suppliers found it challenging to pass Walmart's responsible sourcing audit. Walmart's audit seeks to determine the extent to which its suppliers protect both workers and the environment in certain fundamental areas (e.g., basic sanitation, fire safety and evacuation, pay and working hours, forced and child labor, environmental discharges and permits). Global companies such as Walmart set responsible sourcing standards as fundamental requirements for

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<sup>5</sup> <http://corporate.walmart.com/sourcing-standards-resources>

doing business and typically design these standards to apply universally. How the standards are evaluated and applied would benefit from contextualization for base of the pyramid producers. Making the changes required to meet these criteria can be costly for artisan enterprises or smallholder farmers in developing countries.

For example, women’s handicraft production, exists as an activity that occurs alongside and integrated with daily chores and family care. The women are usually “multitasking” by minding children, cooking dinner, keeping livestock, and beading or braiding at the same time. If a day’s wages on a nearby farm is offered, they may drop their chores and turn the children over to a neighbor, returning the next day. Thus, the income and activities are varied, fluid, and performed in a modular way at various sites. So, to require that the craft activity be moved to a central location and performed exclusively every day for a set number of hours interrupts a way of life and raises questions about the comparative value of the income from crafts versus other activities. As another example, common practices such as sitting on the floor while weaving were precluded by Walmart’s responsible sourcing audit standards. People in the rural areas of the developing world are accustomed to sitting for long periods on the floor—but what they may not be accustomed to doing is sitting in one place for eight hours at a stretch doing the same repetitive task. Some requirements were not applicable for the context, such as requiring exit signs in a small, open air lean-to, or based on incorrect assumptions, such as requiring toilets in a village where there was no plumbing and everyone still practiced open defecation. In a community where everyone has watched their mothers produce the same crafts for generations, the need for children to be kept out of the workspace for safety reasons is considered unusual, and the further requirement that daily alternative care must be arranged seems insensitive.

The cost of complying with these supplier standards was substantial. EWT producers, at a minimum, broke even on the variable costs involved in individual orders, in some cases due to Walmart and the aggregators absorbing losses themselves (Scott, Steinfield, & Dolan, 2014). However, for some of the EWT suppliers the order volumes from Walmart during the lifetime of the EWT program were insufficient to recover all of the fixed costs associated with achieving compliance.

Smallholder farmers that produce non-subsistence items are generally aware of the requirements before engaging with formal retail channels. That said they might still struggle to meet these requirements, especially with greater regulations around the production of food items. The availability of agricultural extension services helps to overcome some of these challenges.

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**Implications:** Supplier audits can often be a substantial barrier for base of the pyramid producers, and retailers should ensure that producers selected for inclusion in sourcing programs can either pass these audits, or that there is a clear pathway to achieving this. The global community of companies, NGOs, multi-laterals, and governments could benefit from aligning on measurement criteria for small producers to meet common standards. New and innovative methods for retailers to reliably monitor the social and environmental practices of base of the pyramid producers could also help alleviate the

challenge. Varying levels of compliance based on the size of the producer may offer a way for retailers to take the initial steps in enabling small producers to meeting the full set of supplier requirements. As we discuss below, social dialogue with small producers on international labor standards is critical, as is building the capabilities of small suppliers to a point where they can engage fully in formal retail channels. Participation requires commitment from the retailer, but can also benefit greatly from an ecosystem of partners that can provide advice, technical expertise, and in some cases, funding support.

## Ecosystem

### Competitive Environment

Small producers often struggle to compete with larger producers that can benefit from economies of scale. These producers can also face competition with imports of similar products from other countries. When these larger domestic or international competitors have a cost advantage in producing those products or benefit from additional incentives or subsidies, small producers may not be price competitive. Additionally, producers in a certain industries and countries may face mandatory requirements and regulations, or be expected to adhere to certain voluntary standards. Complying with these standards is often more difficult for small producers as compared to larger producers, and can result in additional costs related to certification.

Artisan enterprises may be operating in environments that are highly regulated and that require higher standards of production. These enterprises may not have access to the expertise required to address these challenges through improved marketing, packaging, or design that can help distinguish the producers' work. They may also not have access to the market intelligence needed to design products that are sufficiently differentiated.

Smallholder farmers may face similar challenges in terms of the degree to which they are subject to additional overheads due to regulations in the environment in which they operate. Additionally, the products that they produce may be uncompetitive with larger producers or and lack of protection from trade policies may make it impossible for smallholders to compete with cheap imports.

While smallholder farmers often provide greater output efficiency through more economical use of land and labor resources compared to commercial agriculture (Gollin, 2014), large farms do offer several important advantages. Larger operations are better able to access finance and technology, and traditionally have more mechanized and streamlined logistical capabilities. With the shift towards more technologically focused, capital intensive and market driven agriculture, commercial agribusinesses have had greater access and capability to meet these demands. Volatile global commodity prices in response to fluctuating supply and demand and shifts in consumer preferences are barriers for smallholders to establish and maintain global market competitiveness.

Walmart's experience in Costa Rica is that smallholder farmers are often competing, not only with

larger commercial farmers within the country, but with cheaper imports from abroad. Despite the additional taxes and levies on imported produce, regional commercial treaties mean it can still be cheaper to source certain items, such as potatoes, onions, rice, and beans from abroad.

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*Implications:* Retailers should recognize that small producers struggle to compete in commodity markets that have substantial competition. To benefit from the distinctiveness, transparency and quality that small producers can offer, retailers may need to provide them with support in marketing, product packaging and design. This can be an expensive and frustrating undertaking, and small producers may need to be compensated for this product development process in ways that larger producers do not. Providing small producers with customer insights that enable more targeted design, or building the capacity to access niche markets such as fair trade or organic, may also help them to identify ways to compete more effectively. Providing support for achieving these standards and other regulatory requirements can help retailers identify producers that have specified levels of product quality, business acumen, or labor conditions.

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## Infrastructure

Some products are less robust than others and require special handling (e.g. protective packaging and packing, refrigeration, humidity control). This is especially important for perishable products that are involved in long supply chains such as fruit and vegetables for export markets. The degree to which the supply chain is intermediated also impacts coordination and planning, transparency, and the value captured by small producers (Michelson, 2016).

Artisans often need to engage in formal retail channels through aggregator platforms that can provide insights into the target market or otherwise add value beyond market access. Intermediaries that facilitate greater understanding of design trends and the requirements for working with formal retail channels can address some of the key constraints faced by artisan enterprises. Artisans may also form artisan cooperatives to perform some of this function themselves, however, aggregators have the additional benefit of providing a curated portfolio of products that would be difficult for retailers to assemble alone.

The aggregators for the EWT program were required to play a hands-on role with participating suppliers. This included product design, financing, and logistics support. In some cases, aggregators needed to locate sources of raw materials and take on the responsibility of delivering these raw materials in order to ensure on time delivery. The aggregators also incurred significantly higher transaction costs than expected due to the cost of interfacing with Walmart's information systems, the additional support provided to suppliers, multiple design and sampling iterations, and in some instances absorbing losses associated with unacceptable units instead of passing them on to the supplier (Scott, Steinfield, & Dolan, 2014).

Smallholder farmers that face gaps in the local infrastructure may face substantial challenges in

providing their products directly to retailers. Farmers, for example, may be responsible for key logistical steps such as transporting the produce to a central collection center or to the store itself. While an intermediary will capture some of the value, they can be a source of aggregation and may even collect produce at the farm gate. Smallholders who are used to engaging in highly intermediated markets may be required to take on substantial additional risk by transitioning to retail-led models. Prices agreed with a retailer may be below spot prices available from intermediaries.

In South Africa, Walmart invested in the development of a pack house that was managed by a farmer group, and facilitated the processing and packaging of fresh produce. This allowed farmers to supply directly to Walmart's stores, and to capture more of the value of their products.

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**Implications:** Retailers must recognize the challenges and potential trade-offs that small producers face when operating in an environment with limited infrastructure. In these situations, the intermediaries' role is more extensive, and they can provide additional benefits to producers in addition to market access, such as marketing, packaging, and logistics support. These benefits, however, also come with a cost, as the producer must share some of the value they create with these intermediaries. Understanding and potentially intervening in this relationship between aggregators and small producers is an important consideration for retailers. Through volume or price guarantees, or by supporting new intermediaries, retailers can encourage aggregators to be sensitive to the particular needs of small producers, and can help build capacity of producer organizations as well as aggregate supply.

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## Service Providers

Access to finance is potentially the most critical input for small producers seeking to work with retailers. Availability of working and investment capital allows small producers to transition to scale. Small producers also rely on other service providers or suppliers –organizations that have transactional relationships with the producer to supply the necessary inputs into the production process. These inputs may include raw materials, access to mobile technology, access to the internet and other information platforms, and affordable access to energy and natural resources.

Artisan enterprises may face substantial hurdles to access raw materials in the quantities needed, or to support complex logistics requirements. As a result, they can often be highly dependent on a network of service providers that facilitate the operations of the enterprise.

As in the case of Society for Child Development in India, external organizations may be responsible for production as well. SFCDD has outsourced the production of clay pots for one of its products to a local supplier because it lacks the capabilities internally to produce these components. Many artisans also subcontract production of items that they may not have the capability or capacity to produce entirely on their own.

Artisans producing crafts are largely women, who often face an additional set of challenges related

to gender bias (The Alliance for Artisan Enterprise, 2015). These biases can be both cultural and institutional, such as experiencing more limited access to capital, being offered worse credit terms than men, the inability to own land title, and generally being taken advantage of in their business dealings on a more frequent and systematic basis than men. These limitations may make engaging with formal retail more attractive to women-owned artisan enterprises, since it may be an opportunity to address or circumnavigate some of these imbalances, but these barriers may also make it more difficult for artisans to deliver on the commitments they make.

Smallholder farmers may have access to ample quantities of essential inputs such as land and water; however, lack of capital limits their productivity. Smallholders need access to working capital in order to manage long production cycles, as well as access to investment capital in order to invest in the technology and infrastructure required to scale their productivity, such as harvesting machinery or irrigation. Smallholders are also dependent on a network of agro-dealers to supply inputs such as fertilizers, and seeds. In some cases, smallholders may also rely on providers of irrigation systems, and may subcontract some activities, especially those that require specialized machinery.

As with artisans, women farmers face an additional set of barriers to owning and growing their business. Capital is often less available to women farmers, and women are, in many cases, encumbered by patriarchal systems of land tenure that severely limit or prohibit their ability to inherit or own land.

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*Implications:* Retailers often need to support small producers by facilitating access to sources of capital and other services through provision of guaranteed contracts or other forms of collateral. Retailers should also seek to strengthen the broader ecosystem and support the creation of alternative financing options for small producers by working with financing partners, such as local banks, foundations, and development organizations. In situations where service providers are scarce, encouraging farmers to form associations or co-operatives may reduce some of these dependencies.

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## Partner Organizations

A key factor influencing the success of initiatives that engage small producers is the presence of a network of partner organizations, such as local and international NGOs, social enterprises, government agencies, multi-lateral institutions, associations, etc., that can help build capacity of the enterprise. As distinct from Service Providers who have transactional relationships with small producers, this support can include financial capital, knowledge capital and strategic support, human resources, and social capital. Partners can also facilitate the operations of the organization through the provision of market intelligence, or market access. Additionally, partners may also be able to influence the market environment for small producers, increasing its support for these types of organizations, or investing in the value chain infrastructure required for small producers to effectively and efficiently compete in the market.

Artisan enterprises may benefit greatly from the presence of supporting organizations that can provide linkages to markets, and provide market intelligence on consumer preferences, design and fashion trends. These enterprises can also benefit from assistance in building business and financial management capacity, as well as technical expertise in preparing products for retail through packaging and labeling.

Smallholder farmers may benefit from continuing technical assistance as farming practices evolve, support in building business skills and better access to inputs that can increase their productivity. Smallholders may also benefit from partnerships with organizations that can link them to market opportunities, and organize farmers for more efficient supply into formal channels. These organizations may also be able to support farmers' negotiations with buyers to ensure they are getting a fair price for their products.

Walmart's Direct Farm program engages with supporting organizations to provide both technical and financial support to smallholder farmers. Walmart has worked with funding agencies such as the United States Agency for International Development (USAID) and the Bill and Melinda Gates Foundation, and technical assistance providers such as TechnoServe and FINTRAC to support farmer training and capacity building programs in a variety of countries including Mexico, South Africa and Guatemala (London & Fay, 2015). In countries such as Costa Rica, Chile, and Brazil, smallholder farmers that Walmart works with via its Direct Farm program are often part of local government programs, which also aim to increase the capacity of poor smallholder farmers to enable them to engage more effectively with formal retail.

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**Implications:** Retailers may find it easier to work with small producers that have access to a robust landscape of potential partners, whether public, or private sector. The presence of such organizations may help to mitigate some of the other challenges that retailers and small producers face in working together, and provides opportunities for third-party funding and capacity building that may be necessary in order to develop sustainable and scalable sourcing relationships over the long-term.

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Courtesy of Walmart

## IMPLICATIONS FOR FORMAL RETAIL

While the preceding section and the associated Sourcing Readiness Checklist (Appendix 2) review each of the 18 individual influencing factors, Figure 1 highlights how these factors are components of four performance dimensions. To assess the viability of an opportunity from a particular small producer sourcing strategy, retailers should evaluate the results across the four dimensions in aggregate. To do so, we recommend using the Sourcing Scenario Map, as shown in Figure 2.

A graphic tool, such as the Sourcing Scenario Map, is particularly useful when the objective is to assess a portfolio of attributes or dimensions. In this case, we have identified four dimensions, each of which has four to six influencing factors. The ‘Optimal Sourcing Scenario’, as presented in Figure 2, is when the answer to all 18 influencing factors is ‘yes’. If this optimal situation is present, small producers are ready to transition to a program that does not specifically target and support the integration of small producers into the formal retailers’ sourcing strategy.

The Sourcing Readiness Checklist also allows for the definition of a ‘Minimum Sourcing Scenario’. While approximate in nature, our research and findings suggest that any dimension scoring below 50% will result in a problematic situation for executing a formal retail strategy with small producers at that moment in time. The ‘Minimum Sourcing Scenario’ also illustrated in Figure 2 represents this assessment. The area between the minimum frontier and the optimal frontier could be considered the ‘Supplier Development Space’ where the sourcing scenario is viable, but investment is likely required to create a more sustainable, scalable outcome.

Very rarely, if ever, will the answer to all 18 factors be yes. The challenge then becomes understanding the viability of the current sourcing opportunity as compared to the Optimal and Minimal Sourcing Scenarios. Again, we can use the Sourcing Readiness Checklist to conduct this analysis. For example, let’s assume that after conducting an analysis, the retailer found that the Product, and Market for a specific sourcing scenario each scored a three, Ecosystem scored a two, and Supplier scored a four. The ‘Current Sourcing Scenario’ in Figure 2 represents this assessment.

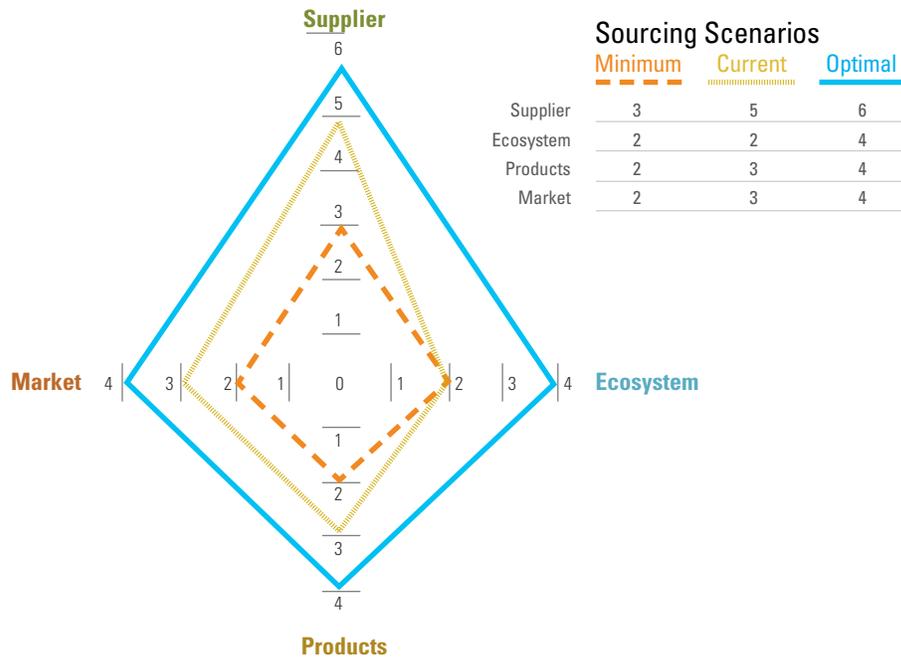


Figure 3: Sourcing Scenario Map

After assessing a specific sourcing scenario, the retailer must then address two questions. The first is if the current situation meets the minimum criteria to engage small producers using this sourcing strategy.

In deciding whether or not to proceed, our analysis, albeit still relatively rough, suggests that if any of the four dimensions fall below the Minimum Sourcing Scenario frontier, the sourcing scenario is unlikely to be amenable to formal retail.

If the answer is no, then the retailer must then decide to delay implementation until the situation changes.

While potentially disappointing to the parties involved, key stakeholders should also realize that launching a strategy that ultimately fails could have substantial negative repercussions from all the key stakeholders, including the small producers. While there are no guarantees of success, identifying opportunities that present a greater likelihood of success is a valuable undertaking.

If the answer is yes, the retailer then must decide if it could and should make some investments to move the Current Sourcing Scenario closer to the Optimal Sourcing Scenario. Doing so will enhance the likelihood of success, but of course there is a cost to any investment decision. The source of these investments could be the retailer or a partner organization.

In the following section, we offer some recommendations that formal retail could implement in efforts to move the Current Sourcing Scenario closer to the Optimal Sourcing Scenario.

<sup>5</sup> There may well be some opportunity for philanthropic programs or government programs that could change the current situation in a positive way. Until completed, however, this particular sourcing strategy is not a viable approach for the retailer.



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## TAKING ACTION

At or beyond the Minimum Sourcing Scenario, a small producer becomes viable as a potential supplier for the formal retail sector. The next question is what interventions a retailer, and others in the ecosystem, could consider implementing to help move the Current Sourcing Scenario closer to Optimal Sourcing Scenario.

Below we list ten opportunities that resulted from the analysis of our field work and data collection.

**Market information:** In order to continually develop a stream of new products, the producer will need a sense of trends in the market. Retailers can provide this in the form of advance notice of any changes in demand for the product, through training consultants, as well as opportunities to meet or interact with end buyers in the value chain. Innovations that bring the market closer to the producer through technology, trunk shows, or other channels, will enhance the ability of small producers to identify and respond to changing trends. Retailers that seek to enhance relationships with small producers should investigate strategies and innovations for closing this market information gap. This may be most efficiently achieved collectively through retailer consortiums, or by programs that have the support of government or other third-parties.

**Cash flow and capital:** The problem of capital availability, especially for women, is often a major opportunity for intervention. However, it is also the case that poor cash flow management can be a factor in perceived capital needs. Providing and setting up cash management systems can have an important impact. Artisans and smallholder farmers should consider joining or forming institutions such as cooperatives, which are more bankable than individuals.

<sup>6</sup> Sales events that give vendors the opportunity to show merchandise directly to retail buyers.

**Supply management:** Selling to formal retail brings at least two new pressures in the area of supply management. One is getting sufficient volume and appropriate discounts for traditional inputs (Note: this is a situation where women may be especially disadvantaged, as suppliers are likely to offer less accommodation to females). The other is getting access to novel inputs. Especially for artisans, the need to innovate with new kinds of fabrics, beads, and dyes is a big challenge because new materials needed often might not be available locally. Even beyond the need to find new materials and negotiate volumes and prices, smallholder producers often benefited from assistance in planning for and managing shortages and delays in their basic supplies. The potential role of institutions such as retailer consortiums, and international and local NGOs in facilitating strategies such as pooling the procurement of supplies, may be worthy of further study.

**Labor management:** The change and growth required to serve the formal retail sector can require substantial changes in hiring patterns. Small producers may need more part time labor at specific times of the year. In other cases, particularly for artisans, the producer may have to shift part-time piecework to full time employment. This may also be a requirement in a formal retail audit. Thus, these producers would benefit from training in managing such a labor force transition.

**Storage:** Safe space to store large quantities of either supplies or finished goods is in short supply for many producers. Accommodating this challenge through shared space such as a central fulfillment center could help in solving this problem, and would additionally provide protection from spoilage or theft.

**Logistics:** For smallholder producers, challenges in bagging, tagging, packing, shipping, etc. were substantial. Producers that did best had a network contact who pointed them to a third party supplier to support these activities. In many cases, the producer accomplished much of this by relying on the aggregator. However, they still had major problems with things like product transport and could often use help in both planning and executing such transfers.

**Branding, packaging, and marketing:** Many small producers, especially artisan enterprises, may need to develop a brand, a distinctive look, and attractive retail packaging. Supporting these activities through technical assistance can have a significant impact on a producer's ability to compete in the market. Corporate low bono programs can also be a rich source of expertise that can provide technical and strategic advice and coaching to small producer enterprises.

**Export expertise:** The process of importing supplies and exporting-finished products can be daunting. Women are again particularly disadvantaged here because customs agents are more likely to take advantage based on gender. Having an advisor or representative to help teach procedures and reduce vulnerability to corruption can be extremely helpful.

**IT instruction and support:** Even if the producer has been using phones, internet or computers, the unreliability of systems and potential breakdown of equipment is a problem, especially as expertise is not always locally available. Having service providers available to help would reduce delays and mistakes that could jeopardize incomes. International and local NGOs and country governments can play an important role in developing the skills and capacity of small producers through training and instruction programs that focus on the use of these technologies and information systems. These organizations could also investigate the development of communications hubs that provide technology access and advice, which would be particularly helpful for women entrepreneurs who may not feel safe using existing facilities.

**Mentoring and networking:** While local producers are often accomplished and confident men and women, one-on-one mentoring specifically for business guidance can often be of great help. This is best if it is industry or challenge-specific and not just general mentoring. This may also be an opportunity for low bono style engagement by corporates. These interactions could consist of both in-person and longer term virtual mentorship using technology such as email, video-conferencing, etc. For example, the Cherie Blair Foundation's 'Mentoring Women in Business' program uses technology to match women entrepreneurs in developing countries with mentors around the world. There may also be benefits in connecting inexperienced producers with those who have some experience in working with formal retail. Creating such a network can be a powerful way to solve many practical problems. Women, in particular, have even less access to professional networks. Organizations like Vital Voices ([vitalvoices.org](http://vitalvoices.org)) that promote professional women networks can create vital linkages for women entrepreneurs.

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<sup>7</sup> Low bono refers to the practice of corporations providing 'enrichment' projects for its employees that allow them to contribute to social causes by providing their skills and expertise to companies in developing countries. The company may be charged a reduced rate for these services, or they may be provided entirely free of charge, and the employee typically takes a pay cut in order to participate. These projects may be done remotely, or they may involve a sabbatical period working directly with the client companies.



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## CONCLUSION

In this report, we have identified four performance dimensions and 18 influencing factors that affect the potential for formal retail organizations to source from small producers in developing countries. In doing so, we developed a Sourcing Readiness Checklist that retailers can use to determine if their proposed sourcing strategy is likely to be viable. Retailers should consider these questions through the lens of their strategy, and the specific sourcing scenario.

In order to guide retailers through this assessment, we recommend plotting the results from this Checklist onto a Sourcing Scenario Map. Retailers can then compare the Current Sourcing Scenario with the minimum and optional frontiers. A comparison to the Minimum Sourcing Strategy offers key insights into whether this proposed strategy is actually viable. Comparing to the Optimal Sourcing Scenario yields the Supplier Development Space, which provides insights into opportunities for investment to create a more sustainable, scalable outcome.

We then offer some specific actionable recommendations that formal retailers can implement to address the Supplier Development Space opportunity. While we provide a set of recommendations for action, retailers must assess how these investments, or other courses of action, will change the Current Sourcing Scenario and tailor their implementation to the specific context. Indeed, retailers should consider both the implications of their investments and their implementation plans.

Regardless of the retailer, or the sourcing scenario, managers must recognize that integrating small producers is challenging, and generally requires patience and a commitment to remain engaged over the long-term.

While challenging, formal retail can generate substantial benefits from incorporating small producers into their sourcing strategy. This allows them to address changing consumer demands, manage reputational risk, and meet the needs of a rapidly growing global population. Improving productivity and market access opportunities for small producers, particularly smallholder farmers and women-owned artisan enterprises, also offers a powerful pathway to increasing incomes, empowering women, and improving the wellbeing of some of the poorest people on the planet.

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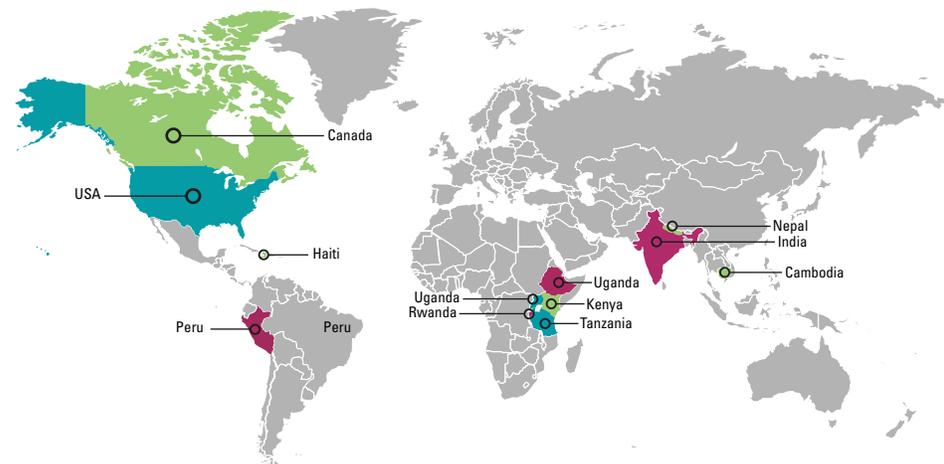
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## EXHIBIT 1: Small Producer Sourcing Initiatives at Walmart

### Empowering Women Together (EWT): Business Model

**Customers:** Customers were visitors to Walmart’s online e-commerce site, Walmart.com, who were interested in purchasing products that contributed to women’s empowerment, but still were within the price range that customers expect from Walmart.

**Suppliers:** Suppliers were women-owned businesses and women-empowering cooperatives from Africa, Asia, and North and Latin America, which supplied products ranging from food to general merchandise to fashion products using traditional materials, designs, and processes. See Figure 1 for the geographic scope of the EWT supplier portfolio.



Empowering Women Together Countries (Scott, Dolan, & Steinfield, Women’s Empowerment through Access to Markets: Maasai Women Development Organisation (MWEDO), Arusha, Tanzania, 2015)

**Value Proposition:** Walmart designed the EWT model to provide high-quality products that supported women in small businesses, particularly those at the base of the global economic pyramid, to Walmart customers at an attractive price point. The model offered access to a new market for women, with the potential to overcome barriers they faced in growing their enterprises. Finally, the model contributed to Walmart’s commitments on sourcing from women owned businesses.

**Partners:** Walmart engaged the assistance of two intermediary organizations, or aggregators, to provide support to small producers around the world. These intermediaries helped to design products, facilitate communication with suppliers, aggregate supply, build capacity of the supplier, monitor production, and assist with the logistics, in some cases paying the cost of shipping goods to the US. While Walmart covered the cost of audits to determine a producer’s compliance with supplier

<sup>8</sup> In some cases, the supplier themselves incurred the shipping expenses directly.

standards, the cost of any changes required to meet these standards were the responsibility of the producer themselves. The aggregators provided short term financing in some instances to ensure that producers were able to begin supplying to Walmart. In some cases, these aggregators also absorbed losses associated with rejected or unsold items rather than passing these losses on to the producer (Scott, Steinfield, & Dolan, 2014).

**Activities:** Walmart worked with suppliers and intermediaries to help design a product that could sell on Walmart.com. Suppliers provided sample products and Walmart placed orders with the aggregators with agreed prices, quantities, and delivery timeframes. The aggregators then placed orders with the suppliers. Once delivered, the products were packaged and labeled by the aggregator and shipped to Walmart. The products were stored in a warehouse in San Bruno, CA and from there, shipped direct to the customer who had ordered the product online. In some instances, particularly for seasonal campaigns, Walmart displayed products in a limited number of stores in order to create greater awareness of the products and the program.

**Logistics:** Suppliers were responsible for shipping products to the aggregator in the US, and the aggregator incurred the relevant shipping and customs expenses, which were included in the initial costing of the products. The aggregator was responsible for collecting shipments from customs in the US, packaging, labeling, and shipping products onwards to Walmart's warehouse in San Bruno, CA.

## Direct Farm: Business Model

**Customers:** Customers are typically higher-income consumers in low and middle income countries that are shopping in stores branded as either Walmart or a local brand owned by Walmart.

**Suppliers:** Suppliers are small and medium farmers that are often located in close proximity to stores or distribution centers. These farmers vary in size and capacity, and in some cases aggregate themselves into groups such as co-operatives.

**Value Proposition:** By sourcing directly from farmers or the local aggregators, Walmart is able to collaboratively plan production. This allows Walmart to benefit from predictable supply and pricing over the long-term, rather than being subject to fluctuations in availability and price on the spot market. Walmart also gains visibility into how these products are grown, and can therefore provide additional assurances to its customers, as to their quality and origin.

However, there are a number of differences in how Walmart implements the program across different countries depending on the market environment and Walmart's particular needs in that market. We describe the three main variations below.

### *Business Driven, Available to Farmers of All Sizes*

In this model, Direct Farm describes an approach to sourcing directly from farmers regardless of their size. Small and medium farmers, however, may receive additional support that the large-scale farmers do not get. The size of the farmer is typically defined in terms of revenue or weight of produce supplied to Walmart.

### *Business Driven, Exclusively Small and Medium Farmers*

In this model, Walmart designed Direct Farm exclusively for small and medium farmers, and the program provides additional resources and benefits for those farmers that qualify. Once a farmer becomes a medium-sized farmer, they transition out of the Direct Farm program. Walmart typically determines this by the revenue generated by the farmer, or the volume they supply.

### *Impact Driven, Exclusively Small and Medium Farmers*

In this model, there is greater emphasis on the social impact achieved by supporting small and medium farmers. Rather than starting with a business imperative to solve a sourcing challenge, these models focus on addressing a social responsibility challenge. In some cases, this is an initiative based on commitments to social goals, or may be part of complying with mandatory provisions of the local market environment.

**Activities:** Walmart buyers work directly with farmers or farmer co-operatives to plan growing cycles and agree on price and volumes contracts.

**Logistics:** Farmers often deliver product to Distribution Centers, either individually or as part of a co-operative or farmer group. In some instances, farmers may deliver produce directly to the store. Generally, farmers are located within 100 Km of a distribution center, as transporting produce over any greater distances is challenging without investment in improved technology such as refrigerated trucks.

**Partner:** Walmart works with a variety of partners in different countries to support smallholder farmers. These partners may include technical experts that provide agronomic advice, capacity building organizations that provide enterprise support and funding organizations such as bilateral or multilateral donors and foundations that fund investments in farmer development.

## EXHIBIT 2: Sourcing Readiness Checklist

### PRODUCT

#### Perishability/Seasonality Characteristics

**Does the product have an extended useful life that is not substantially constrained by perishability or seasonality?**

##### Artisan

Is the product designed to be independent of short-term fashions or trends? Can the product remain at a constant price over the long term without being discounted?

##### Smallholder

Does the product have a long shelf life? Can it be stored easily without degradation?

**YES:** Non-perishable items may have greater tolerance for delays in the supply chain. It may also be possible to source these items from producers that are further removed from the point of sale.

**NO:** Provide producers with sufficient notice to plan production cycles to ensure predictable delivery at the optimal time to capture sales. Invest in building the supply chain infrastructure to meet timeliness and quality goals.

#### Premium/Specialty Product

**Is this a premium or specialty product with a high margin?**

##### Artisan

Is the product differentiated from mass produced alternatives in terms of aesthetics, artistic content? Are consumers willing to pay a premium for this?

##### Smallholder

Is the product naturally higher margin (for example berry fruit)? Does the product meet niche market requirements that attract higher margins such as fair trade or organic?

**YES:** Focus on planning production cycles, improving product handling and logistics to maximize yield, identify opportunities for market diversification if the producer has excess production.

**NO:** Investigate opportunities to support the sustainability of the enterprise, potentially via investments in value-add processing infrastructure, product diversification, etc.

#### Inputs and Materials

**Does the product require easily accessible and low cost inputs?**

##### Artisan

Are the raw materials required for production readily available in a usable form?

##### Smallholder

Are input prices stable? Does the crop make efficient use of natural resources such as land and water?

**YES:** Small producers will likely be able to produce the product without significant exposure to risk. However, scaling up production may still require acquiring inputs in greater quantities than the producer is used to, which may require support.

**NO:** Small producers may be taking on substantial risk in order to secure inputs. Retailers should consider supporting risk mitigation strategies such as trade financing, crop insurance, etc. Retailers should consider gradually scaling order sizes to allow the producer to identify new sources of supply of inputs and develop new supplier relationships.

## PRODUCT

### Processing and Packaging

#### Can the product be sold with little or no additional processing or packaging?

#### Artisan

Is the product produced by hand without specialized machinery or tools? Are inputs available in a usable form with little or no processing required?

#### Smallholder

Can the crop be planted, grown and harvested by hand or without the use of complex machinery? Can the product be sold without packaging or processing?

**YES:** Small producers may still require assistance in scaling up production of labor intensive products, particularly when it comes to costing labor and incorporating this into price negotiations. An independent partner with both business and technical expertise may be helpful in these situations.

**NO:** Retailers should encourage the formation of co-operatives or associations that can provide facilities for a large number of farmers to make use of mechanization where needed. Retailers may need to partner with organizations that can provide both the financing and technical expertise to do this effectively.

## MARKETS

### Quality Standards

#### Is there flexibility in the acceptable quality standards?

#### Artisan

Can the supplier control the quality of production enough to match standard sizes and colors? Does the supplier have sufficient access to markets for materials and willingness to learn new craft skills?

#### Smallholder

Can the product be graded according to quality? Are there viable markets for different quality levels?

**YES:** Small producers may still require assistance in finding alternative markets for products that don't meet quality standards and to perform quality checks prior to shipping.

**NO:** Retailers may need to be flexible initially to allow for the steep learning curve involved in producing items to exacting specifications. Provision of templates that can aid production or allow individual artisans to quality check their work may be helpful both in engendering individual ownership of quality and identifying products that don't meet this standard prior to shipping. Financial incentives (i.e. discounting or non-acceptance of product) may be necessary to encourage behavior change on the part of small producers to meet exacting requirements.

## MARKETS

### Transparency and Traceability Expectations

**Is product traceability required for regulatory reasons, or is transparency into the supply chain something that adds value for the customer?**

#### Artisan

Does the customer gain additional benefit from knowledge of how the product was made, where, and by whom?

#### Smallholder

Is the product required to be traceable back to an individual farm for health and safety reasons? Are the conditions under which a product is produced of interest and value to the customer?

**YES:** Support small producers in developing the ability to capture and report information about the product and its production process. Ensure that aggregators, if they are involved in the supply chain, provide this same level of data to the retailer and customer.

**NO:** Retailers should voluntarily monitor the production process in order to proactively manage any reputational risks.

### Order Size

**Can the product be produced in quantities greater than a retailer's minimum order size?**

#### Artisan

Can the product be sourced directly from a single supplier in sufficient quantities with low transaction cost?

#### Smallholder

Can the product be grown in quantities sufficient to supply a single store or meet other minimum viable quantities? Does the product have a high turnover rate and consistent demand, which would require small quantities and frequent buying cycles?

**YES:** Direct relationships with producers can be considered, however, aggregation may offer additional economies of scope and other benefits to a retailer.

**NO:** Retailers should encourage the formation of associations or cooperatives to facilitate the aggregation of products into quantities that meet minimum volumes. Aggregators may be an alternative means to secure this volume, with the potential added benefit of providing a broad portfolio of products. Reducing transaction costs by using online channels or other methods to reduce minimum order size may also be effective strategies.

### Demand Predictability

**Is demand for the product predictable over time?**

#### Artisan

Can production cycles be planned in advance to ensure availability of raw materials and labor? Over time, does predictable demand raise the priority of craft work?

#### Smallholder

Can predictable demand contribute to planning of production with the retailer to guarantee price and volume commitments? Can this offset the risk of side selling?

**YES:** Retailers should work with small producers to plan production to ensure availability of inputs, and to allow for consistent levels of supply across multiple suppliers if necessary.

**NO:** Retailers may need to support small producers with investments in facilitating greater access to capital, such as reducing payment terms, or investments in more efficient supply chain infrastructure.

## SUPPLIERS

### Geographic Location

#### Is the supplier located close to the point of sale?

#### Artisan

Can the product be sourced locally, with minimal logistics costs? Can the product be delivered direct to stores or distribution centers? Is the supplier familiar with the market being served in terms of preferences, trends, etc.?

#### Smallholder

Can the product be delivered to stores immediately after harvesting? Is the appropriate supply chain infrastructure in place in terms of transport, refrigeration, etc.?

**YES:** Suppliers may be more suitable for sourcing products that are particularly time sensitive such as fresh fruits, and may be more capable of meeting short lead times.

**NO:** Retailers should aim to place orders in sufficient time to allow for any potential delays in the supply chain. Retailers may also explore the opportunities to make investments in improved supply chain infrastructure that can overcome location constraints.

### Production Capabilities

#### Does the supplier have the capabilities to implement best practices for production, processing and packaging?

#### Artisan

Does the enterprise have the ability to use updated design and production techniques? Are they familiar with retail packaging and labeling requirements?

#### Smallholder

Does the smallholder have the technical knowledge to produce new crops? Can they engage in simple preparation and packaging?

**YES:** Producers may be able to respond quite quickly to new design or product requirements and packaging needs. However, they may still require support to scale up these practices predictably.

**NO:** Invest in sampling or test runs before attempting scale to ensure the producer becomes familiar with managing new inputs, new suppliers, new production processes and handling the final product.

### Business Capabilities

#### Does the supplier have the ability to manage business activities as the enterprise grows?

#### Artisan

Is the enterprise used to engaging in export and logistics? Do they have the ability to gather market intelligence, design products that meet customer preferences?

#### Smallholder

Do farmers already have the capabilities to monitor and record compliance with environmental best practices? Do they have access to information about market prices?

**YES:** Small producers that are able to perform the full scope of business operations may still require support to scale these up.

**NO:** Retailers should invest in building the business capacity of the producer as well as the technical capacity, and should seek partners that can provide the financial support this requires.

## SUPPLIERS

### Access to Working Capital

**Does the supplier have access to sufficient working capital?**

#### Artisan

Does the supplier have access to the collateral required to access commercial lending? If the enterprise is women-owned, do women have equal access to capital in this context?

#### Smallholder

Is banking infrastructure available in rural locations where smallholders are located? Are there supporting organizations such as co-operatives that can assist with access to finance?

**YES:** Retailers may be able to support the further growth and sustainability of small producers through improved credit terms.

**NO:** Retailers may need to support small producers with investments in facilitating greater access to capital, such as reducing payment terms, or work with partners to improve the enabling environment for small producers.

### Resilience

**Does the supplier have experience with diverse markets, buyers and products?**

#### Artisan

Does the enterprise supply multiple buyers and can it provide ongoing and substantial employment to artisans to ensure craft work is prioritized?

#### Smallholder

Can the smallholder access a variety of markets for products that may differ in quality or grade?

**YES:** Focus on enabling small producers to maximize economies of scale and scope to increase their sustainability.

**NO:** Encourage small producers to seek out additional markets, and invest in exploring new and complementary product lines.

### Audit Viable

**Is the supplier capable of passing required audits?**

#### Artisan

Do production conditions meet minimum standards for suppliers? Are there contextual limitations that should be taken into account?

#### Smallholder

Do smallholders meet existing mandatory regulations with respect to the production of food items?

**YES:** Focus on helping producers to scale their operations and improve the sustainability of their enterprises.

**NO:** Retailers should ensure that audit requirements are appropriate for the context and may need to consider tiered or progressive audits to allow small producers to meet these standards over time.

## ECOSYSTEM

### Competitive Environment

**Are there a relatively limited number of competitive product suppliers in the market?**

#### Artisan

Are there opportunities for artisan enterprises to capture niche markets or compete with existing players?

#### Smallholder

Are smallholders protected from cheaper imports? Can they compete in niche markets like organic or Fair Trade?

**YES:** Focus on building the skills of the producer and capacity to scale in other areas such as business operations, logistics, etc.

**NO:** Retailers should ensure the value that small producers add can be captured by supporting voluntary certifications for niche markets.

### Infrastructure

**Does the level of supply chain infrastructure support direct engagement with small producers?**

#### Artisan

Are artisan groups or co-operatives in place to aggregate supply? Is it cost effective to transport goods to the point of sale?

#### Smallholder

Are there pack houses and storage facilities that are accessible to smallholder farmers? Is the appropriate transportation and technology available to ensure products arrive in peak condition? Are there farmer groups or co-operatives in place?

**YES:** Retailers will likely be able to transition to more direct relationships with producers. These relationships may still require some time to develop and to ensure that they support the growth of smallholder farmers as well as providing viable sourcing solutions.

**NO:** Retailers may need to work with partners to build the supply chain infrastructure to allow more direct engagement with small producers, and to allow them to capture more value within the value chain.

### Service Providers

**Are capital providers and other suppliers of services accessible to small producers?**

#### Artisan

Is there a robust landscape of service providers that can provide inputs such as capital? Are there aggregators that can facilitate market access? Are there outsourcing partners that can add value to products?

#### Smallholder

Is there a robust network of input suppliers for seeds, fertilizers, etc? Does banking infrastructure extend into rural areas in order to serve smallholder farmers?

**YES:** Support small producers with forward contracts or other mechanisms to facilitate cost effective access to capital and other services.

**NO:** Retailers may need to reduce payment terms to ease capital constraints on small producers. Retailers should also work with partners to improve the enabling environment for small producers.

## ECOSYSTEM

### Partner Organizations

**Does the ecosystem contain a sufficient number of non-profits, cooperatives and government agencies that offer low- or no-cost support to small producers?**

#### Artisan

Are there supporting organizations that help build capacity of artisan enterprises and promote trade in new markets?

#### Smallholder

Are sources of technical capacity building, agricultural extension services and other support accessible to smallholder farmers?

**YES:** Retailers should seek partners in the public and private spheres to assist in building the capacity of small producers and increasing the impact of retailers' programs.

**NO:** Retailers should explore ways to grow the partner ecosystem in order to create an environment that is supportive of small producers.