

Agricultural Sector Assessment and Agribusiness Development Strategy

Executive Summary

1. The public sector dominates Lesotho's agricultural sector. The public sector provides strategic direction for agriculture; chooses appropriate technologies; provides almost all of the capital used in the sector and assumes most of the risk associated with sector performance. The public sector treats farming per se as one among many "Marginal Livelihood Strategies" available to poor farmers rather than as: "Farming as a Business".
2. To date the participation of the private sector has been only marginal. The private sector provides little market access for farmers; remains inert with respect to technology choices; conforms grudgingly to regulations even when these make little economic sense; and in selective sectors where growth prospects were once attractive remains passive while asset values erode and regulatory institutions diminish in their capacities. The private sector provides little capital, assumes minimal performance risk within the sector and demonstrates little strategic initiative.
3. Within the Lesotho agricultural system, farmers themselves have been subordinated as welfare recipients. Their ranks are dominated by small-scale sharecroppers and small-scale landholders, which are organized only at the household level. Farmers have become passive receivers of technical advice, beneficiaries of public sector subsidized inputs and price takers in local markets, which are particularly volatile because of their small case and isolation from other markets. No effective cooperative or association system operates within the agricultural sector.
4. Moving forward, Lesotho's agricultural economy needs to develop along two tracks in more synchronized ways¹:
5. **Track one** would lift economically disadvantaged farmers who have limited potential for producing sufficient food to feed their own families or, indeed, for improving their livelihoods through agricultural production alone. These marginal farmers must be made ready to respond to opportunities associated with more productive use of the limited endowments available to them. As opportunities emerge in nontraditional crop and animal production and indeed in non-farm activities, e.g. agricultural processing, value adding activities, renting animal traction, sale of organic fertilizer and share cropping of arable land, marginal farmers must be motivated and re-skilled to take advantage of these opportunities.

¹ This two track approach to future agricultural market development has been recommended in many studies. Its failure to date has been in resource allocation, management and implementation. Most recently the PSP review –Food Security in Lesotho: issues and options—S.D. Turner (April 2009), recommends that: "The new national development plan should integrate the enhancement of food security in a convincing and comprehensive set of measures to alleviate poverty, complementing initiatives to stimulate growth and employment. These measures should also incorporate a comprehensive and effectively co-ordinate social protection strategy. Government and civil society have not yet succeeded in formulating such a strategy. It is urgently needed and should be one of the cornerstones of any future national development plan. "

6. **Track two** should complement the first track. This second track will primarily involve commercial farmers – farmers who are able to produce a marketable surplus from their on-farm activities. Importantly, as well, it should work through and with qualified supply chain integrators who are able to access profitable niche markets. Importantly too, it will entail the strengthening of commodity associations and other forms of farm level, commercial organization. In order to grow faster, commercial farmers need to associate with each other in ways, which facilitate functional specialization and the effective leveraging of both economies of scale and specialization. Vertical structures need to be created and strengthened which will link farmers who are producing similar products collectively to markets as well as to private sector market markers (e.g. supply chain integrators), through contract farming and other similar forms of collective commitment.

7. In a nutshell, the strategy put forward in this paper for activating commercial agriculture in Lesotho involves the creation of market linkages between poorer rural areas and better-off urban areas within the country, as well as between the Lesotho agricultural economy more generally and the better-off South African food economy. These linkages may take several forms, including importantly commodity associations of farmers who are prepared to specialize in particular categories of crops or farm product. The intent is that small holder farmers will be able to realize sufficient economies of scale through association formation to justify more focused marketing efforts, more specialized farm input procurement, and farm product quality improvement.

8. Other concrete forms which linkage-strengthening might take involve the development of a corps of community based marketing agents, independent private traders or networks of private traders who specialize in specific product categories and the institutionalization of markets themselves. This later strategy might entail “training and trading up” through several echelons of market hierarchy. For example, “trading up” might entail first instituting infrequent agricultural fairs, then more frequent and even periodic markets and then trading through district wholesale markets which might operate as clearing houses and assembly points for supplying larger scale agro-processors.

9. It has been estimated that only 10% of landowners in Lesotho fall into the category of commercially viable farm producers. However, this 10% if effectively empowered could begin to develop the labor, farm input, quality food output and land markets. This would allow the remaining 90% of rural households to diversify their incomes further and to pursue livelihood strategies, which would be sustainable even in the prevailing depressed agricultural environment.

Recommended Strategy is Congruent with the Budget Message

10. In his most recent budget address, the Minister of Finance demonstrated a keen awareness of the need to respond with a “two track” program to the many challenges facing the nation’s agricultural economy. He noted that:

“Agricultural production has continued to decline over the years. According to the figures compiled by the Central Bank of Lesotho in 2004, output in crop production declined by

1.9%; in 2005 by 1.7%; in 2006 it grew by 1.7% and the preliminary figures for 2007 showed a decline of 8.6%. This means that as a country we are becoming increasingly dependent on imports of cereals, vegetables and fruits and on food donations from the international community. This is happening at a time when the number of landless people is also increasing.”

“This is an unsustainable situation. It must be reversed. The current situation tells us that we need clear programs, which support commercialization and diversification in both crops and livestock sectors and that facilitate the development of agro-industries. The new programs will be financed from the recovery financing that I referred to in my earlier remarks²”.

The strategy suggested in this note fully supports the Minister’s position and provides a way forward with regard to implementing what he has suggested.

Way Forward

11. In order to attract agribusiness investors, GOL needs to do four things:
 - i. **Provide a supportive business environment** which assures contract enforcement; which consolidates arable land into economic lots for farming; and which facilitates the development of supply chain linkages between farm level organizations and niche markets.
 - ii. **Develop market institutions.** This involves not only making improvements in supply chain and market infrastructure but also entails the creation of institutions, which do the work of matching buyers and seller and discovering market clearing prices. It also entails the development of ancillary agricultural business services, such as seed and fertilizer distribution services as well as para-veterinarian and animal medicine services. These support core farming businesses.
 - iii. **Demonstrate the profit making potential of non-traditional value propositions.** Part of this set of initiatives involves the testing of non-traditional agricultural products like mushrooms, organic wool and Chinese vegetables. An even more important part involves the testing of nontraditional business models and in particular supply chain models, which link Basotho farmers and farm-level organizations (e.g. commodity associations) to niche markets. Appendix A elaborates on ways in which demonstration projects can be scaled up. Clearly the future of Lesotho’s agricultural sector lies in discovering and accessing niche markets where farmers can develop competitive advantage through association, experimentation with non-traditional products, and development of niche market targeting supply chains. Unfortunately, these are more difficult to discover and to develop than are commodity markets.
 - iv. **Reform existing regulatory structures,** which limit competition and lock-in

² Budget Speech to the Parliament for the 2009/2010 Fiscal Year by Honourable Timothy T. Thahane, Feb 2009.

traditional business models, modes of competition and inefficient forms of supply chain operation. All of these need to be replaced by more pro-competitive and open forms. In particular, a regulatory reform agenda needs to be developed for dairy and wool and mohair production.

This agenda is elaborated in Appendix A, which is attached to this note.

Base Line Assessment of Commercial Farming Potential:

12. Agriculture as it is practiced today in Lesotho can most usefully be understood as part of a larger portfolio of livelihood options open to Basotho households. As a consequence, agriculture has moved further and further from a business undertaking and increasingly toward a mode of social security. In the process Basotho farm families have become increasingly passive in coping with their dwindling resource base.³

13. The country has developed few market linkages between producers in rural areas and consumers in urban areas. Market institutional development has not been a priority with the GOL. The result, not surprisingly, has been progressively declining incentives to produce or to take product/ market risks. Where unfilled demand exists in specific local areas, prices fall to levels below the cost of production and local farmers are then unable to realize a profit. Once markets defined by trading among neighbors or relatives are saturated, little opportunity exists to sell more to them and even less incentive exists to sell into more distant areas. As a consequence prices quickly fall below the level of input costs.

14. In addition to the institutional development of trading venues where prices can be discovered and maintained and of market information systems which communicate prices from price discovery points more broadly to production areas, access to larger and more distant markets requires consistent quality and assured quantity control over production.

15. Importantly it also requires agents who are prepared to assume risk – to buy local products, transport and sell them in distant markets and indeed to contract for a specific quality and quantity of supply. These commercial agents, who in their more sophisticated form we will refer to as supply chain integrators, are in extremely short supply in Lesotho.

16. In fact, most agricultural production within Lesotho is consumed within households. Little intra or inter-village exchange actually takes place. Given these extremely narrow market parameters, incentives to produce more than is needed, specialize or to experiment with new products and new production methods, are extremely limited. Over time the result has been a loss of dynamism within the agricultural sector.

17. The way forward is to reverse processes and policies, which restrict the scope of markets and to demonstrate the viability to selling non-traditional products into new and more specialized markets. The Ministry of Agriculture has demonstrated the viability of creating markets for potato seeds, for asparagus and more recently for mushrooms. Private investors have demonstrated the viability of dairy production. More recently Chinese investors have begun to produce ethnic

³ Steven Turner, "A Note on Food Security and Land Tenure," 2004, Southern African Regional Poverty Network.

Chinese vegetables on a commercial scale. The challenge, which has daunted most efforts to date, has been that of scaling to viable sustainable business levels. Much of the discussions, conducted during the author's last mission in Maseru, focused on the threshold and involved finding ways to surmount it. The detailed action plans developed during that mission for four product categories are attached to this note.

Agricultural Sector Assessment and Agribusiness Development Strategy

Overview:

18. The note which follows sets out new thinking and some new directions regarding ways in which the GoL might move along dual tracks to enhance the livelihoods of subsistence and sub-subsistence farmers but would at the same time create wealth for commercial farmers by establishing the value chains with which they could profitably affiliate.

19. It attempts to address the following specific topics, which define the structure of this note:

- Provide an overview of the constraints facing farmers in Lesotho, accompanied by the recognition that many of these will be difficult to overcome in the short term.
- Identify ways to remove obstacles and inefficiencies and to lower economic costs imposed by government policies and actions on the agricultural sector. It also aims to identify ways to mitigate some of the risks that Lesotho farmers face and manage more effectively some of the externalized costs, which current modes of crop and livestock production impose on the general economy.
- Suggest practical ways to engage the private sector to undertake coordinated action, co-investment and collaborations with GoL which can assist the agricultural sector. These can range from assistance to small-scale subsistence producers at one end of the spectrum, to contract farming partnerships with commercial farm producers at the other. Extend these assessments to include NGOs as well.
- Suggest a road map of supportive actions and policies, which would weave together food security concerns on the one hand, and the realization of agribusiness-linked growth on the other.
- Put forward proposals about what to do and policy positions to adopt in order to improve the general business environment. Elements of such a broad strategy designed to improve Lesotho's business environment will of necessity include a land reform process (taking into account the MCC stance), the formation of legal methods for forming public private partnerships, productive and sustainable engagement of qualified strategic partners in the rehabilitation of dormant or underutilized agribusiness assets, ways to activate sustainable sources of competitive advantage and the more strategic application of government regulatory and market management authorities.
- Specify what government should NOT DO based on lessons learnt both in Lesotho and in other developing countries.
- Finally, suggest new directions, which might usefully be considered for inclusion in the national development plan.

Assessment of the Current Context

20. The strategy, which is recommended here for dealing with food security among subsistence farmers, is simply to extend their livelihood options. In Lesotho's rural areas only a limited number of livelihood strategies are currently viable and most of these derive in one way or another from traditional agriculture. Thus, for example, landowners who sharecrop or who rent out their land in return for cash or in-kind payments are able to collect rents. Similarly, owners of animals, which can be used by neighbors to do their ploughing or goods moving, represent an important source of supplemental household income. Local labor markets are thin and for the most part, are related to traditional, agricultural production, which is primarily sheep herding and maize cultivation. Healthy members of poor families offer their labor to other families whose farming activities are commercially viable.

21. The problem with this arrangement is that traditional agricultural production does not generate sufficient value to support other ancillary economic activities; neither does it allow the rural population to save and thus accumulate assets. As long as Lesotho's agricultural food market remains closed and distorted, the prices developed in that market cannot be trusted to allocate land, labor and other resources efficiently. Many current activities do not generate an economic profit despite the contrary appearance. Other more productive uses of limited resources may go untested and untried as long as the local market remains focused on the same crops that South African farmers just across the border produce much more cost effectively.

22. What is clear is that agriculture as it is currently being practiced in Lesotho does not allow for wealth to be accumulated. The savings rate in Lesotho is among the lowest in SSA, at -4.7%. Traditional agricultural practices like those pursued by 95% of the Basotho allow them to realize only low levels of productivity and each year as natural resources are further depleted and new shocks absorbed, productivity levels decline even further. Under current conditions opportunities for non-farm income are extremely limited within Lesotho's rural space. The result for rural families is that capital accumulation falls off from one generation to the next and household poverty levels increase. The savings rate becomes negative when impoverished households are forced to use all (or more than all) of their current income in efforts to stay alive.

23. The result of these circumstances is a "poverty trap" or low level economic equilibrium from which rural households are unable to escape by working harder or by combining subsidized factor inputs for the production of the same types of agricultural product, using the same type of production activities that previous generations have used. Government programs fail to lift them from this poverty trap simply by providing emergency food supplements or extension service or subsidized input assistance, all of which involve more of the same crops, production methods and contained market access.

Overview of Constraints

24. The root causes of Lesotho's rural poverty trap are many and complex. Some of these are related to low initial levels of capitalization, particularly in transport and irrigation infrastructure. A minimum threshold of capital is required before modern production processes can be started up. The Global Competitiveness Report 2008-2009 ranks Lesotho's overall infrastructure as 122nd

among the 134 countries surveyed. It ranks the country's transport infrastructure even lower: 133rd out of 134.⁴

25. Other causes of the poverty trap derive from coordination failures and specifically from the failure of one branch or level of government to synchronize its actions with other branches or with the private sector. When government fails to direct limited public investment toward their most productive use and further when it fails to create incentives for the leveraging of additional private sector co-investment, a poverty trap can result, as the marginal return on investment is progressively diminished.

26. Indeed, the same Global Competitiveness Survey referenced above ranked the social costs associated with various national agricultural policies and found Lesotho's to be the highest in SSA. Lesotho's agricultural policy costs to consumers, producers and other stakeholders ranks 131 out of 134, being exceeded in terms of its negative impact only by Zimbabwe, Ukraine and Venezuela.

27. In Lesotho, crop production is predominantly rain-fed and consists mainly of labor-intensive maize cultivation, with some limited level of hybrid seed use and of tractor service provided by the MOAFS, primarily in low land areas. Although the climatic conditions are more favorable for other field crops (e.g. sorghum and wheat) and although the cost of importing maize from SA is less than the cost of subsidizing the production of maize in Lesotho maize production continues to dominate traditional agriculture, both in the lowlands and mountains. Early-maturing varieties have largely replaced wheat and peas in the mountains. However, maize is not a very suitable food staple for Lesotho. Indigenous sorghum, for example is more nutritious and can be produced more reliably in areas where rainfall is erratic.

28. Yields for maize have been continuously declining over the past decade, at the same time that Lesotho's comparative advantage associated with other cropping systems has continued to increase. Still the agricultural policies which government continues to effect, combined with the risk adverse proclivities of Lesotho farm families who are afflicted with HIV, broken families, lost remittances from SA based family members and shrinking farm sizes have continued to drive the nation's farm system toward dependence on high cost maize production.

29. Several studies have analyzed the economic effects of prevailing government policies and of prevailing cropping preferences. They found without exception that the profitability of sorghum and wheat cultivation was significantly higher than that of maize and less risky as well. In addition, they found that more capital-intensive modes of maize cultivation actually reduced profitability for maize at the same time that it increased break-even yields.

30. The effects of more capital-intensive modes of sorghum and wheat cultivation were quite different. For both of these alternative grains, gross margins increased when resources committed to maize were recommitted to them. Break-even yields also increased. Still break-even points for sorghum and wheat were still only half the break-even production volume associated with maize.

Ways to Remove Prevailing Growth Constraints

31. Prevailing government policies, which involve the subsidized provision of tractor services, seed and fertilizer, actually increase unit costs for small holders who produce maize. Because of

⁴ Global Competitiveness Report 2008-2009, Klaus Schwab, Michael Porter.

the low prevailing market price for maize, productivity increases associated with additional investment cannot compensate fully for the increased capital costs. Prevailing policies which are designed to incentivize maize cultivation actually deliver little or negative value.⁵ According to *Diagnostic Study of Field Crop Production Costs*⁶ “at current yield levels, small holder maize will remain unprofitable with or without subsidy”. Ironically, the primary beneficiaries of the existing set of subsidy and incentive policies are capital intensive, high input intensive farmers – large commercial farmers and not smallholder farmers operating at or below the subsistence level.

32. This same analysis helps to explain why so much arable land remains dormant in Lesotho’s low lands at the same time that the country is importing ever-increasing volumes of maize from South Africa. Landowners who lack working capital often rent their land to producers in return for a share of the crop. The analyses suggests that when sorghum and wheat are grown, share cropping makes good economic sense and investment in technologies, which improve yields are well justified both on the part of the share cropper and the land owner. With maize however, improved technology causes returns to share croppers to become negative.

33. Part of the problem is that no clear alternative crop or cropping system has yet demonstrated its feasibility for smallholder farmers. For a number of reasons other cropping options and other agricultural land use alternatives have failed to reach the “tipping point” of demonstrable commercial viability. Thus the comparative advantage that appears to exist for fruit and vegetable production, dairy, and pork; for the cropping of asparagus, broccoli and other cold temperature green vegetables; for the cultivation of seed potatoes, mushrooms and various Chinese vegetables; have so far failed to achieve commercial lift off. Having said that, it is also true that wool and mohair are produced on a large scale. However, they too would clearly benefit from additional private investment and from additional value chain efficiency improvements.

34. Significantly, no programmatic routes have been found to date within government to scale up successful agribusiness demonstration projects or to engage the private sector in sustained joint commitments to agribusiness development. Such a partnership, where roles are clearly defined, would facilitate risk sharing in order to ensure sustainability and equitable distribution of financial benefits among stakeholders, i.e. small holder farmers, the public sector and the private sector.

35. Over the last few years, food staple production has been declining and, when faced with sharply rising food prices, the food security of the nation diminished. The Lesotho Disaster Management Authority monitors food staple production closely and reports on it in its annual Food Security and Vulnerability Monitoring Report. The latest of these reports describes a continuous reduction in maize production. See the table below, extracted from the most recent of these reports. It is time to think “outside the box”.

⁵ Diagnostic Study of Field Crop Production Costs, for the Ministry of Agriculture and Food Security, July 2008.

⁶ Ibid p6.

Year	Maize Production (1000 metric tons)
2000/2001	158.3
2001/2002	111.2
2002/2003	85.0
2003/2004	81.0
2004/2005	100.7
2005/2006	86.4
2006/2007	72.6
2007/2008	69.0
2008/2009	Na
2008 compared with average	72%

Dual Track Strategy

36. The strategy recommended in this policy note is a dual track strategy, which takes account of the need to change and the concurrent need to sustain livelihoods.

37. **Track one** would lift economically disadvantaged farmers who have limited potential for producing sufficient food to feed their own families or for improving their livelihoods through agricultural production alone. These marginal farmers must be made ready to respond to opportunities associated with the more productive use of the limited endowments available to them. As opportunities develop in nontraditional crop and animal production and in non-farm activities, e.g. agricultural processing, value adding activities, renting animal traction, sale of organic fertilizer and share cropping of arable land, marginal farmers must be incentivized and skilled to take advantage of these opportunities.

38. Subsistence and sub-subsistence farmers both need to be assisted in discovering paths for diversifying their livelihoods, for improving their nutrition from own grown food and for moving their livelihood sources beyond traditional farming. In the context of a more sustainable agricultural strategy, addressing food insecurity should entail two tactics: i) boosting the income of the poor so that they can afford to buy more food and more nutritious food; and ii) boosting the productivity of the poor so that they do not need to buy as much food.

39. To this end, the government needs to become active in developing local infrastructure with the assistance of community-based enterprises that rely on local labor. In particular, government needs to undertake land and water conservation projects, create market linkages for both agricultural inputs and outputs between urban and rural areas, as well as develop markets for inputs, outputs, land and grazing rights. Once established, market allocations need to be allowed to gradually displace allocations made via government fiat. Market allocation of limited resources will by itself enhance productivity over time as scale, land, grazing rights, seed, etc., are reallocated to more productive uses. With respect to the uplifting of disadvantaged rural families, the way forward is to find market-based solutions, which encourage the development of specialized competencies and the engagement of local government in the business of implementing local solutions to local problems.

40. **Track two** can and should complement the first track. This second track should primarily involve commercial farmers – farmers who are able to produce a marketable surplus from their farm activities. Importantly, it should work through as well as with supply chain integrators who are able to access profitable niche markets.

41. It should also entail the strengthening of commodity associations and other forms of farm level commercial organization. In order to grow faster, commercial farmers need to associate with each other in ways that facilitate functional specialization as well as effective leveraging of both economies of scale and specialization. Vertical structures need to be created and strengthened that can link farmers who are producing similar products collectively to markets as well as to private sector market markers (e.g. supply chain integrators) through contract farming and other similar forms of collective commitment.

Improving the Investment Environment

42. A more fundamental problem that government needs to deal with is the fact that the agribusiness investment environment in Lesotho remains unattractive to the private sector. When asked to compare the business environment in Lesotho with the one with which they are most familiar in SA, three knowledgeable agri-business investors confirmed to the author that the primary constraint to their involvement in Lesotho was the unwillingness of the Government to lease arable land to strong international partners. The lack of infrastructure necessary to support a cold chain between Lesotho and SA was highlighted as another problem.

As one of these investors explained:

- “There is a lot of potential for agriculture in Lesotho but all the players need to get together to discuss the present situation and make it attractive for outside investors. Importantly, all land is owned by the state and should you wish to lease land you need to negotiate separately with farmers who have been allocated land by their chiefs. This process normally has plenty of complications, requires multiple contract negotiations, etc. Moreover, even if one secured leases under the existing land tenure system, they are insufficiently secured to justify private investment”.
- “Recently we wanted to lease some asparagus land and to assist the present asparagus growers. However, we found that land prices were artificially high, at least in part because of prevailing government policies. The lease payment, which these farmers wanted, was the equivalent R2,400 per ha while the going rate is R300 to R400 per ha in South Africa”.
- Still, more and more agricultural land in Lesotho is kept fallow and not cultivated because fewer and fewer people can afford to cultivate it. The result is that agriculture production is going backwards rapidly with serious implications in the future”.

43. When pressed to characterize specific additional aspects of the Lesotho agri-business environment and to compare these with corresponding aspects of the business environment in SA, the three potential investors identified the following as significantly less attractive: i) Difficulty in starting a new business; ii) Difficulty in securing local credit; iii) Difficulty in registering non-farm property rights; iv) Complications associated with trading agricultural products across

borders; v) Difficulty in complying with food safety standards; and vi) Protecting intellectual property rights for branded food products.

44. Other aspects of the Lesotho business environment which potential investors found only slightly less attractive than the ones which prevail in SA include: i) Dealing with construction permits; ii) Protecting investor interests in joint ventures; iii) Enforcing contracts; iv) Firing employees who do not perform; v) Closing a business. Finally, those aspects of the Lesotho environment which the SA investors characterized as equal to that found in SA included the following: i) Employing workers; ii) Paying taxes; iii) Securing satisfaction from government for anti-competitive trade practices. Only with respect to one aspect of the Lesotho business environment did they all agree that a significant advantage did exist and that criteria involved: “Paying workers a fair wage”.

45. Elements of a strategy designed to improve Lesotho’s business environment of necessity must include a land reform process, legal methods for forming public private partnerships, productive and sustainable ways for engaging qualified strategic partners in the rehabilitation of dormant or underutilized agribusiness assets, ways to activate sustainable sources of competitive advantage and the more strategic application of government regulatory and market management authorities.

46. This agenda is a large and complex one and developing it goes well beyond the scope of this strategy paper. However, attached to this paper are a number of appendices, which begin to deal with some of the issues that affect the agribusiness environment in a preliminary way. They are submitted here to begin the process of looking into the country’s agricultural sector from a private sector perspective – to begin the process of thinking outside the box!

Practical Ways to Engage the Private Sector

47. It is the case that the process of commercial experimentation and/or competitive emulation has been extremely slow to develop in Lesotho’s key agribusiness sector. Indeed, no notable successful example of private investment exists to serve as the basis for pointing the way to still greater business model innovation and financial success. As a result private investment has been minimal and linkages between the supply and the demand ends of agribusiness chains remain extremely weak. Among African countries the level of commitment and the effective engagement of private investors in Lesotho agriculture is among the lowest if not the lowest in the continent.

48. The best way to begin this process is to engage the help of neighbors. South Africans are natural investment partners for Lesotho’s agricultural sector. South African commercial farmers possess the requisite technical competencies, as well as deep knowledge of food markets in Southern Africa and the EU, which are essential for commercial success. In spite of Lesotho’s “island” location in the middle of SA and its distinct climate, ecology and food production potential, food imports from SA continue to grow more rapidly than do its exports. SA investments in the sector have primarily involved food retailing and the provision of ancillary agribusiness support services, under low risk service contracts. This, in spite of the fact that successful commercial farmers based in SA are currently seeking alternative locations from which to serve the SA market and production platform where they can invest their “know how” as well as their capital.

49. The first practical step is to open a conversation with South African commercial farmers, food processors and distributors. That conversation should begin by simply letting them know that Lesotho is open for investment, that Lesotho policy makers would like to make the country a more attractive investment platform for them and that in return for their commitment of “know how” and market “know who,” Lesotho policy makers are willing to work with them in finding practical answers to their perceived business environmental problems in Lesotho. Importantly, this conversation needs to be on-going; it needs to take the form of regular meetings with a handful of potential investors, who soon will become a room full and then a convention center full. High level policy makers need to be involved initially in framing the issues and in initial policy discussions. However, initial meetings need to be followed up with technical discussions at working levels with officials who can make good commitments and lay the ground work for concrete public private partnerships.

50. Some of the problems, which South African investors perceive to exist in Lesotho, were discussed above. Finding good farm level partners is another of the challenges which South African investors face, however. Significant weaknesses persist in the way that farm work is organized in Lesotho and the way in which farm level organizations are governed. The lack of a “commercial orientation” among potential partners translates into higher training, transaction execution and quality control costs for private investors. Government can help through selectivity, training and incentive to change this culture. A high-leverage point is the training of first line supervisors who know how to manage and operate commercial farms. Such a training program might be developed jointly with the Government of South Africa and funded through one of the donor organizations.

51. However, changing the culture of farm production goes well beyond the capability of any individual initiative or indeed beyond the opinions of any specific group of investors. Another high leverage point, which has not been fully used to date, involves non-governmental organizations (NGOs). A large number of NGOs and civil society organizations are active in Lesotho’s rural development. However, few of these have had a commercial orientation to date. That could be changed through some explicit direction from the government concerning its priorities.

52. Yet a third high leverage point involves farm level organizations, which are structured along commodity or product lines. A few commodity-based farmers’ organizations exist in Lesotho, which lobby for, and support the producers of specific commodities (e.g. wool and mohair, horticulture, dairy and poultry). The recently established National Lesotho Farmers Union represents an umbrella farmer organization for producers of different commodities. Having said that relatively little institutional support comes from these organizations to encourage farmers to operate their farms as for-profit businesses. Little capacity exists within these organizations to carry out that mandate in any case. Investing in the strengthening of commodity aligned farmer associations and specifically in their young leadership makes a great deal of sense.

53. A fourth leverage point involves “market institutions.” In rural areas of Lesotho informal markets have developed for farm labor, for informally leased farm land (e.g. share cropping is prevalent), for animals and for raw milk. Rural markets for land ownership and for farm inputs, however, remain undeveloped, as do markets for most categories of farm outputs. Price discovery for agricultural inputs and outputs is ineffective and various forms of government intervention distort prevailing prices in any case. A lack of markets for farm production other than modern SA owned supermarkets in Maseru remains a significant deficiency in Lesotho’s farm system. This lack can be explained in part by a long tradition of non-market exchange in Lesotho. However, a

lack of emphasis among Lesotho policy makers, as well as among donors on institutional market development can also be faulted.

54. A practical market development strategy might entail “training and trading up”. Under this strategy extension agents would work with local community leaders through market development projects. These would involve several echelons of a market hierarchy. For example, “trading up” might entail first instituting infrequent agricultural fairs, then more periodic markets and then trading through district wholesale markets which might operate as clearing houses and assembly points for supplying larger scale agro-processors.

55. Several factors, in addition to perceived weaknesses in the general business environment, help to explain a lack of private sector commitment. No sub-sector regulatory framework exists in Lesotho. Such a framework would define generally the rules for setting prices, for establishing food quality standards, for contracting with farm organizations and enforcing those contracts, for resolving disputes and/or for defining the basis for securing certain raw food supplies.

56. Institutions designed to facilitate commodity market development, which have proved successful in developing specific agricultural subsectors in other parts of Africa (e.g. the East African Tea Exchange, the Ugandan Coffee Regulatory Agency, the Malawi Tobacco Regulatory Agency) are missing all together in Lesotho. Clearly an important role exists for government in setting the "rules" under which farm product markets can operate and on which buyers and sellers can depend with some confidence. This kind of institutional invention is particularly effective at the time of start up for new commodity or product markets and allows buyers to avoid the risk and cost of negotiating for farm supply on a case-by-case, producer by producer basis.

57. Over time, legacy market institutions and traditional market "rules" can become competitive liabilities in contemporary business environments where changes are taking place rapidly, for example changes in global market competition, in customer requirements and in technology for carrying out various business processes. However, at the time when an agricultural economy is attempting to introduce new products, market institutions and corresponding market regulatory frameworks can be quite useful.

58. Lesotho’s few legacy market institutional frameworks have failed to adapt to competition and to market change. Direct government intervention is needed from time to time to reboot and reenergize market institutions. However, the political will to intervene in market reregulation and institutional renewal seems to be missing in Lesotho. The two primary examples of slow market adaptation are the Dairy Regulatory Administration and the Wool and Mohair Growers Association.

59. The Dairy Regulatory Administration has proved patently ineffective in responding to the market – which it was intended to regulate – to the needs of retail milk buyers, milk processors, informal sector buyer/resellers and farm groups. The Dairy Regulatory Administration was chartered to set prices and fix terms of sale for wholesale and retail milk. However, price levels are reported to have remained unchanged for more than 10 years. In reality, no effective price discovery mechanisms operate in the dairy sector where the market has failed to develop as anticipated and where no new entrants have emerged to challenge the market supremacy of Lesotho Dairy.

60. Similar but less severe lacks of managerial strength and adaptability have adversely affected the Wool and Mohair Growers Association and its affiliated marketing agent and service subsidiary, the Livestock Products Marketing Services (LPMS). These have failed to respond to

the faster payment cycles that independent traders are able to offer and have thus allowed the quality of mohair and wool products to continue to degrade vis a vis SA competition in spite of the fact that they have sufficient financial resources to respond creatively.

61. The lessons to be taken away from this example are larger than those that apply to the two sectors themselves. Both commodity associations have become increasingly dependent on government and have become politicized in the process. Both have become exclusionary organizations, which have turned away potential farmer members who did not fully conform to their membership criteria rather than define a second or third echelon of membership. Both allowed sources of competitive advantage to attenuate when they became overly process oriented and lost sight of what was happening in contested markets, with respect to new technologies and customer preferences for quality. The lesson, which can be taken away for these two examples are that insufficient dialogue with the private sector, uninformed and/or arbitrary decision-making and the transformation of regulatory authorities into inert bureaucracies can severely attenuate original sources of competitive advantage.

62. In other sub-sectors, the institutional starting point is weaker than in either the dairy or the wool/ mohair sectors. In no other subsector has government invested in market institutions or devolved market rule-making authorities to independent associations or to market institutions. In specific high growth potential subsectors, including seed potatoes, pork processing, mushroom cultivation, or organic food production, there is a clear need for grading, standard setting, product classification based on relative market value, as well as ancillary systems for enforcing and applying these standards.

Lessons concerning what NOT TO DO

63. The direct intervention approaches that government has undertaken to date to create new agribusiness sectors *de novo* have proved uniformly unsustainable. These approaches involved investing directly (or more often with donor financial assistance) in agribusiness facilities and other specialized assets required to add value to particular categories of raw food. The assets were then operated through semi autonomous parastatal organizations and in other cases with the assistance of contract management. In Lesotho this approach was applied over the course of 20 years and led to the development of a dairy industry, a meat processing industry, a fruit and vegetable canning industry, a fisheries industry and others as well.

64. This approach failed for a number of reasons including: i) government's failure to shift risk through the transactions, which preceded enterprise start up, from itself to private sector co-investors; ii) government's failure to select qualified strategic co-investors with the requisite competencies, technical "know how" and market "know who" required to create and sustain competitive advantage; iii) failure to deal with farm supply security issues either through some form of contract farming arrangements or through the creation of formal regulatory regimes as discussed above; vi) protection of pioneering enterprises in each sector so that no new market entrants were allowed to enter and consequently innovation, product refinement and new business model testing were suppressed; v) failure to dispose of fixed assets promptly once it was clear they that they were no longer economically sustainable and related failure to offer them to strategic investors possessing the requisite know how and know who to use them productively. Instead, the Government of Lesotho made remedial efforts to effect piecemeal changes in business

processes, product mix, management control, etc., all in an effort to turn around failed going concerns and to rehabilitate their business models.

65. Unfortunately, fixing a broken enterprise is most often more difficult than starting up a new one. The former tactic has the deleterious effect of precluding alternative investment, new start-ups and competing investment and thus retards rather than advances development in specific sectors where comparative advantage once resided. The Minister of Finance acknowledged a need for increased oversight and closer monitoring of state managed enterprises in his Budget Speech:

66. “The mandates and performance of some of our state-owned enterprises need urgent review by professionals. It is important to re-confirm or change their mandates, accountabilities and set high reporting standards for them. I have already mentioned LNDC and BEDCO, but they are not the only ones. The Road Fund, Petroleum Fund, NDSO and others come to mind⁷”.

67. To date, the government has experienced relatively little success in sharing risks with private investment partners or in finding ways to engage investors who possess the requisite “know how” and “know who” to access foreign markets. It is in this “knowledge” dimension of commercial agriculture that the sector remains most deficient.

Starting Again: Private Sector Outreach

68. Industrial organization matters a great deal in the agribusiness sector. The ways in which business processes are integrated into commercial viable structures is as important for enhanced competitiveness as are the technologies which are selected to carry out discrete business process steps. In essence the efficiency, adaptability and agility of the value chain structures, which link on-farm with-off farm activities, determine competitiveness.

69. Government policies can have a significant effect on the structure of agric-industrial organization.⁸ They determine for example, those business processes that government is prepared to undertake with its own resources. Private sector investors will not undertake to perform activities on an expected profit making basis what government is prepared to do for free. If on the other hand government services are inadequate or unreliably provided, private sector investors will be extremely reluctant to replace these services with own provided services.

70. Government policies affect as well the level of risks associated with specific private sector investments. For example, risks associated with investing in a fixed facility, which requires a minimum break even flow of farm products in order to operate profitably, are linked directly to government policies effecting incentives and/or subsidies for the production and market availability of critical inputs. In the agricultural sector more than in any other the effect of government policy on any link in the supply chain tends to have effects on other links as well. These effects are difficult to anticipate and frequently manifest themselves as a simple absence of private investment and/or of interest among private investors in becoming involved in a specific agricultural economy.

71. The kinds of investors who provide capital for agribusiness development also matter a great deal in determining the competitiveness of a national agricultural sector. Not all investors are equally able to add value. The “know how” and “know who” that specific investors bring with

⁷ Budget Speech, Ibid.

⁸ Appendix B contains a critical assessment of prevailing government policies and service delivery systems.

them into Lesotho determines significantly which new markets are opened up for local producers, to which production technologies local producers gain access, and what management methods they employ.

72. Agribusiness investors who can open new routes into new markets are able to transform comparative cost advantage into competitive advantage based on superior market position and greater value offered to consumers for money received. Again, the advantages that companies like Shop Rite, Pick and Pay, Tetra Pak, Parmalat, Barbeque Rib Manufacturers, Intermeat, and the Chinese horticulture producers who have developed in Lesotho have is their ability to open new routes into foreign markets. Their competitive advantage is based on their existing distribution networks, superior order fulfillment capabilities and a demonstrated ability to consistently satisfy the expectations of their targeted customers.⁹

New Directions worth including in the National Development Plan

73. The first step in developing a supply chain partnership with such companies is to formulate a value proposition to offer to them. A value proposition is simply an assessment of net benefits that can be realized by investment partners, and a proposal regarding how these benefits might be shared. This proposition needs to be mutually beneficial to both Lesotho farmers and to private investors. It needs to be based on economic and financial analyses, which demonstrate that the proposition would generate public benefits that exceed the social discount rate relevant to evaluating government investment projects generally. In addition it would assure private parties of a return that exceeds their cost of capital. Assuring a strong strategic match with the existing market needs, distribution network packaging, and quality and volume requirements, or the business strategy of specific investors, represents a second critical step needed to progress the offer of a development partnership to specific investors.

74. This approach is generally consistent and supportive of the strategy that the Minister of Finance advocated in his recent budget speech, where he stated: “First, launch a coordinated, Government-wide program of structural reforms aimed at removing the barriers to ‘Doing Business’ in Lesotho and creating a conducive and competitive investment climate”¹⁰.

The GOL budget for 2009-2010¹¹ set aside M600 in funding for “an economic recovery package, with provisions for special interventions aimed at the following areas of opportunity:¹²

- Rehabilitation of sheep dipping tanks for sheep and sheds for wool shearing;
- Specific interventions that aim at improving the quality of national herd of sheep and marketing of wool;
- Financing of bankable projects for dairy farming;
- Rehabilitation of previous irrigation schemes; and
- Identification of new ones and preparation of investment plans focused on high value cash

⁹ Appendix C explains the difference between *comparative* and *competitive* advantage and its relevance to Lesotho’s agricultural sector.

¹⁰ Budget Speech, Ibid.

¹¹ “The budget will set aside M600 Million, over two years, to support specific investments related to the provision of water, roads, factory shells and communications to the new firms that want to locate in our industrial estates.” Budget Speech, Ibid.

¹² Budget Speech to the Parliament for the 2009/2010 Fiscal Year by Honourable Timothy T. Thahane, Feb 2009.

- crops;
- Preparation of integrated poultry projects that will involve Basotho chicks plant to produce one-day old chicks;
- Groups of growers in the rural areas;
- Lesotho Flour Mill to produce growing mesh; slaughter facilities; cold storage, and distribution centers similar to Egg Circles of yester years, from where all purchases can be made; and
- Rehabilitation of the abattoir and feedlot as a place where animals can be sold, bought, and slaughtered.

75. In order to move forward, the Ministry of Agriculture and Food Security must either train or import technical experts in the above fields. The success of development partnerships undertaken in any of these areas depends on strong market and supply chain linkages. New expertise is required in assessing feasible potential linkages and in forming them where they prove feasible.

76. The training of the Extension Staff and the Extension Staff of farmers as well must radically change. Agriculture is a full time business like any other business. The concepts, values and culture of commercial farming must begin to be disseminated through the Extension Service. Indeed, the primary challenges, which the government is likely to face in advancing its commercialization agenda, are twofold:

- Overcoming a culture and tradition of non-commercial agricultural production. Only a limited tradition of commercial farming exists in Lesotho. Hence, one needs to be fostered from a near zero base. Farmers simply do not know how to undertake farming activities as a business. They cannot play the role of reliable partners for parties seeking reliable suppliers of uniformly high quality farm products or of counter parties to contract farming agreements. The agricultural culture from which most Lesotho farmers come is a traditional one and an integral part of a complex and mutually dependent set of coping strategies; and
- Developing the specialized (niche market targeted) distribution channels required to deliver Lesotho products in South Africa and to overseas buyers. These channels need to be developed almost from a zero base. To this end, supply chain integrators need to be attracted into Lesotho who have the requisite “know how” and “know who” to access and to serve nontraditional markets. Niche markets rather than mainstream markets are the key to future success. Lesotho farmers cannot compete effectively in main stream markets based on cost of production *vis a vis* South African farmers. However, Lesotho farmers have all of the prerequisites for successfully developing niche markets. Building up new value chains to access these niches will require more than investment in fixed assets or supply chain supportive infrastructure. It will require the recruitment and engagement of partners who offer the right set of soft assets required to open new markets, e.g. market credibility, established brands, advanced processing technology, genuine expertise in supply chain management, etc.

77. One such set of potential partners can be found in the ethnic Chinese community, which exists in Maseru. This community is active in raising its own set of distinct vegetables and fruits for its local consumption. However, attractive opportunities exist to partner with Chinese

entrepreneurs – entrepreneurs who produce for the local market (e.g. Lesotho Sun Chinese restaurant and two Chinese food retailers), and to open new distribution channels for selling fresh and table-ready Chinese fruits and vegetables into the large and growing Chinese Diaspora which exists in SSA. During his mission, the author began to explore this set of market development opportunities.

78. To this end, the following steps could be undertaken: i) formulate an open, contestable and competitive tendering process for selecting strategic partners; ii) offer to share gains realized from high productivity performance with strategic investors. In this way begin to shift performance risk from the public to the private sector; iii) provide no subsidy for low productivity performance or for failure to comply fully with the terms of public private partnerships; iv) prefer private sector bidders who afford the opportunity to market high quality, low cost food staples into the South African Market. Shift market risk to private partners as well. To this end, prefer partners who by virtue of previous performance demonstrate an ability to market the food staples actually produced both in Lesotho and in SA.

79. An essential step in scaling up is the development of horticulture associations, which can serve as conduits for distributing information on appropriate technologies; institutions for organizing farmers into larger groups so that they can realize economies in procurement and marketing; agents for assuring quality control, delivery of appropriate quantities to match orders; and effective communication with customers through new market channels. NGOs can be extremely useful in facilitating the training and organizational development efforts, which are required as a foundation for the development of farmer associations. An initial hurdle to be overcome is the absence of stockists and distribution outlets for seeds and fertilizer to assist with the start up of new horticulture undertakings. Opportunities may exist to learn from the “starter pack” experience of Malawi, where small packages of seeds and fertilizers were provided to small-scale farmers in an effort to stimulate demand for non-traditional farm inputs. In order to assure sustainability, a “starter pack” program would ideally involve the GoL engaging the services of private stockists to initially distribute starter packs to qualified farmers. Subsequently, GoL would work with effective stockists to build up a farm input business around seed and fertilizer distribution and petty trading. Qualified farm input stockists would be trained to provide technical support. Financing in the form of trade credits would be secured from suppliers and be partially backed by a credit default fund to support sales of larger scale production packs. Such a program could usefully be launched through a series of farmer learning fairs, where starter packs could be distributed to farm households, and demonstration gardens.

80. Arrangements need to be worked through which might allow tenant/workers to accumulate equity, as well as profit from a nuclear farm operation. First, however, nuclear farm operators need to be qualified in terms of their prior experience and their capacity to make good contractual commitments. Each operator needs to pass a rigorous due diligence review and then provide security commitments against the obligations that they would be taking up. Operators would provide four sets of critical support services to small holder farmers located on the periphery of nuclear farms. These include: i) provide expert technical assistance in selecting appropriate and economically beneficial crops, seeds and cropping systems, including appropriate methods of conservation agriculture; ii) guarantee trade credits from local stockists or provide vouchers for seeds, fertilizer and appropriate harvesting equipment; iii) provide marketing services and access to food product markets through forward delivery contracts and/or own assumption to price and delivery risk; iv) guarantee the repayment of any public sector resources advanced under the project against collateral interest in assets pledged by strategic investors. This way would ensure

that government at least breaks-even. Importantly, contract farming guidelines need to be set, which would ensure that they are the primary beneficiaries of a nuclear farm concept. Nuclear farm organizers would be selected through an open, contestable, and transparent process.

81. The MOAFS should organize a nationwide matching grants program and corresponding set of tendering processes. These would provide resources to Community Counsels to work with private sector co-investors and launch public private sector partnerships whose objectives would be to develop new local agribusinesses, open and manage new distribution channels, and market nontraditional categories of agricultural product sourced locally. Potential local investors would develop business plans and submit these for review by CCs. Each CC would then champion and sponsor the best of its business proposals to the MOAFS for final consideration and award. During the course of the business project the MOAFS would review, evaluate performance and determine which business models represented best practice and were worth transferring to other CCs for appropriate local redesign and re-launch. Criteria for making competitive matching grant awards would include: i) commitments made by local CCs to make their local agribusiness environment more supportive and investor friendly; ii) the transfer of commercial risk from the public sector to the private sector; iii) the creation of local employment; and iv) the development of collateral private enterprises.

82. During his last mission to Lesotho, the author developed four niche market development plans and discussed these with the PS's of Finance, Commerce and Agriculture. The Appendices, attached to this note, contain summaries of these plans.

CONCLUSIONS AND RECOMMENDATIONS

83. An action plan is attached below as Appendix A. It recommends specific steps for moving the reform agenda described in this paper forward. The discussion in this note section references that plan which elaborates and expounds on the action agenda recommended in the note. Additional key points, which are worth taking away from this discussion, include the following:

84. Lesotho cannot develop a vibrant agribusiness sector unless it first leverages private sector resources. It follows that the first mission critical step then is to engage the private sector meaningfully. The GOL needs to open a dialogue with potential investors in its agricultural sector and make them understand that Lesotho is open to agricultural business. In this context, open discussions need to be held with key opinion leaders in the private sector. In addition, potential South African farmer investors and Chinese investors need to be invited to join an ongoing forum whose intent is to move the boundary line of risk taking and initiative, which currently divides public and private sector roles.

85. The second mission critical step is the testing of a new development paradigm for the sector – one that involves the engagement of private sector competencies in the development of supply chains. Ways need to be tested and most effective modes identified for aligning development resources vertically (e.g. between farm and market) rather than horizontally (e.g. distribution and subsidy of maize seed). Therefore value propositions and subsequently more elaborate product specific business plans need to be developed for transforming comparative advantage into sustainable competitive advantage. The transformation of non-market ready subsectors into market ready subsectors typically entails investment in three categories of

underinvested assets: i) public goods; ii) community goods; and iii) private goods¹³. Business plans for each product need to justify investment returns to each of these asset categories.

86. The third mission critical step is to target and then develop niche markets. Niche markets are ones in which Basotho farmers can compete effectively based on superior product quality, distinct capabilities to certify food origins, content, etc, superior service and/or other advantages other than lowest production cost. Niche markets are smaller than commodity markets and customers in niche markets value specific aspects of the food they consume differently than do consumers in commodity markets. The small scale potato seed market that the Ministry of Agriculture has developed is one example of a niche market. Discovering the differences which consumers value and investing in these differences is the key. Once niche markets are discovered, scaling up to explore their full potential requires targeted access strategies, which in turn imply the engagement of uniquely positioned strategic partners. This is what the Ministry of Agriculture has failed to do in the potato seed niche. The processing, packing, order filling and branding processes between farm level organizations and niche markets typically need to be developed from both ends of the supply chain in a highly synchronized way. Niche market gatekeepers require as a minimum predictable and uniformly high quality product flow. The best way to target niche markets is to learn from what works and what doesn't by testing small scale commercial experiments, by refining these and then scaling them up.

87. During his last mission to Lesotho, the author developed four niche market development plans and discussed these with the PS's of Finance, Commerce and Agriculture. Appendix A contains summaries of these plans.

¹³ Public goods investments need to be made in co-operation and coordination with private investors because of the deep complementarity that exists between private and public investments in places like Lesotho. Community goods are like public goods in that they generate large positive externalities for members of a trade or for dispersed communities of farmers producing the same farm product. These assets are underinvested, however, because benefits associated with them cannot be fully captured and internalized within existing agro-industrial organizations. A new form of organization is required to sustain investment in these assets. Similarly private assets may also be underinvested if markets have failed to develop for specialized services, specialized agro processes, specialized inputs, specialized means and modes of finance, specialized types of risk management, etc. In order to facilitate investment in specialized private assets, it may be necessary to demonstrate new modes and means of competition – competition based on better packaging, temperature controlled delivery, organic farming and processing, etc. Transforming price-based competition (using lowest cost production methods) into competition based on product and service differentiation requires some demonstration projects and strengthened relationships with food chain partners at the demand end of the chain, e.g. the South African end.