BRIEF 45: Investment Challenges to Scaling Up 'Inclusive' Businesses.

Scaling up emerging 'inclusive' business models presents many challenges to investors. Experiences over the last year show that transparent transactions along the value chain along with Cash-on-the-Bag (COB) payments to small farmers can be commercially viable. Social impact is demonstrable. Farmers regularly get 20% higher prices for their produce. Value chains operate at 80% efficiency with costs per deal being only 20% of total deal value. However, it is equally clear that such impact will not be enjoyed by large numbers of farmers unless investors come together and address the real world conditions of: very low skills of rural entrepreneurs in money management; in-grained cheating among all value chain players; poor infrastructure, legal systems and policies; and low speed and poor security of financial transactions within and between COMESA countries. The burdens on financing identified here require a close interaction should be established between public and private investors, but who and how should leadership be provided?

Conditions for Commercial Scale up

Experiences over the last year show that transparent transactions along the value chain along with Cash-on-the-Bag (COB) payments to small farmers can be commercially viable. Some ten trader-networks across Kenya, Uganda and Tanzania have proved this. However, this is only true when a range of required conditions are in place and work reliably. Where these conditions were in place, COB has been profitable for all involved. One critical internal condition is the required skills and behaviour of the trader-networks themselves. Critically important external conditions concern transport, infrastructure and money. We examine each of these conditions in more detail:

- Skills and behaviour for trader-networks to operate COB are fundamentally different to what traders have been doing so far in their market operations. Even through they intellectually agree with and appreciate the rules and regulations of transparent transactions, conventional instruction does not work because each situation with each deal is slightly different, and the traders have to react in new ways. It is almost a prerequisite that the traders make mistakes in COB procedures and can then analyse themselves the resulting problems in order for them to grasp and internalize the lessons and change their behaviour to suit the transparency rules with which they agree. This is an iterative process, and it takes time. It also results in some traders dropping out as they discover that this isn't what they want to do.
- Timely deliveries from remote villages to processing plants remain a critical challenge because transport is unreliable. Too often mechanical or operational problems on the way delayed deliveries even to the point of buyers no longer being able to pay on delivery. Given this situation the most profitable type of deal, the regular delivery to factories, could not be realised in spite of several attempts to establish them. Operating their own trucks would require capital and overhead costs beyond their means. Rather it would seem traders should have a running agreement/contract with well-managed transport companies. While scheduled cargo services don't yet exist they would be a solution too.
- Too often bad weather has made it impossible to bulk the produce and keep it safe. Many deals were lost due to these problems. There is not much traders can do with regard to roads. However, establishing collection points that allow bulking of produce before contracting with buyers for deals is within what they can organise. This means putting up structures in the villages that assure safety of the produce while waiting for transport and protection against bad weather.
- Cash is a problem because it is in such short supply. It will invariably be used for whatever has top priority in the fast changes that happen in rural markets.

Recovering cash at short notice when it was used for other purposes has repeatedly become a major issue and has hindered transactions to the point of losing profitability. But what alternatives are there? Normal bank transfers are shown to be too complicated, time-consuming (hours of queuing) and unreliable for time-sensitive trading. There are very good reasons why traders have to work with cash in rural areas. Money transfers through the mobile systems seem to show promise. The main bottleneck for mobile transactions turns out to be the limited liquidity of the cash points in rural towns and villages. There is no easy solution to that.

So, while we know that COB can become a commercial venture, it is still a struggle to ensure the required conditions are in place in the general rural setting. Trader-networks can show commercial viability and competitiveness in the field. Social impact is demonstrable. Farmers regularly get 20% higher prices for their produce. Value chains operate at 80% efficiency with costs per deal being only 20% of total deal value. However, it is equally clear that such impact will not be enjoyed by large numbers of farmers unless investors come together and address the real world conditions described. The challenges to investors we point out here are based on a lot of learning on the ground.

A secure and sheltered collection point in a rural trading centre, Mt Kenya.

Challenges to Investors

<u>Very low skills of rural entrepreneurs in money management.</u> Few small rural entrepreneurs track their expenses or make projections on future business. Records are rarely kept and no one uses computers and spreadsheets to keep records. Any money in the pocket or bank is treated as a single resource to be used for the next most urgent expense regardless of whether it is personal or business related. Loans taken for business can end up paying for a personal expense like school fees. A further problematic behaviour is with traders who prefer to hold on to a crop out of fear of making a loss and hoping to recover any loss later. Rather they should immediately auction off their problematic crop, cut their losses, and move on to next deals to recover from any loss. The necessity of coaching large numbers of traders on financial management, including attitudes as well as basic tools, places an additional financial burden on scaling up.

<u>In-grained cheating among all value chain players.</u> Any new business offering transparent trading operations goes against the past thirty years of commercial experience. Such businesses not only have to prove themselves but they must also change the 'mind-sets' of farmers, buyers and entrepreneurs. Minds are not going to be changed by sensitization, awareness raising or 'advertising'. The minds of farmers and other value chain players will only be changed by repeated experience of a transparent way of doing business. And that business must bring benefits to all players in the value chain. Providing that experience is expensive as no player in the chain is prepared to discount their hedging against cheating until the business operation is proven to be free of cheating. This implies the development and introduction of intricate and yet easy to establish control mechanisms that ensure transparency and thereby engender trust. The necessity of 'subsidising' the business operation and 'educating' value chain players in the start up phase places an additional financial burden on commercial scale up.

<u>Poor infrastructure, legal systems and policies.</u> It is well know that poor roads disrupt deliveries in heavy rains. Poor roads also inflate transport costs. Transport itself has proven to be grossly unreliable to the extent that regular deliveries cannot yet be promised. This warrants a closer look on what can be done to make transport more reliable. Lack of adequately weather proofed or secure collection points and village warehouses expose small farmers to risks of theft and spoilage. Trade and produce are also put at risk during border crossings because of inadequate infrastructure and lengthy administrative procedures. Legal procedures and costs are such that farmers will side sell against contracts and buyers will default or delay on contracts and Local Purchase Orders. When the police are involved costs can quickly escalate without results. Not only is legal redress unattractive so are debt collection services when the amounts involved are small. A further source of risk arises from government policies and regulations. An export ban imposed without advance warning on the back of food security policies injects uncertainty into what is already a risky business. The good intentions of government regulations backfire when they become opportunities for corruption. The necessity of coordinated action and investment on the side of local and national governments places additional financial burdens on enabling the scale up.

<u>Low speed and poor security of financial transactions within and between COMESA countries.</u> This inefficiency operates at three levels: bank-to-bank transfers, cash transfers and payment systems. Transferring money between banks and even between branches cannot be achieved online at this time. In spite of repeated promises by banks same-day online transfers still are not available. This means that SWIFT transfers are required which take anywhere between seven and fourteen days. Not only are these transfers very slow in relation to the speed at which trade operates but they are also costly. While the use of mobile phones for money transfers is growing, both access and amounts are limited. Cash, with all its risks, will remain the way farmers are paid for their produce.

The necessity of solving liquidity problems for mobile money providers and putting in place tracking systems for cashless payments places additional financial burdens on scale up.

Transport arrives late at the 'open air' pick up point.

We come to the conclusion that scaling up emerging 'inclusive' business models requires considerable preparation. Skill development and taking care of the real world conditions limiting commercial growth presents investors with considerable challenges. It is obvious that purely commercial financing is not feasible. The burdens on financing identified here require a close interaction should be established between public and private investors. Who and how should investors provide for capacity building and R&D and infrastructure and trading operations? Who and how can private and public investors be convened to mutually leverage each other in a clearly defined private-public co-financing venture? Who and how should provide the leadership?

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