BRIEF 36. Smallholder Market Access Services Fail to Reach Commercial Scale

Many donors expect their NGO delivered, 'subsidised' services to become commercially sustainable. In this way smallholders would continue to enjoy better prices and better access to markets after project support is withdrawn. Of the many 'successful' interventions we have seen in East Africa none we know have reached commercial scale. This includes our own efforts in Kenya, Uganda and Tanzania[1]. This brief highlights some of the 'failed' assumptions we made in our quest for commercialization. It also points out what can be achieved and what still needs to be done for efficient and inclusive market access services to reach commercial scale.

Some Failed Assumptions

Assumption 1. Public projects will stimulate 'local' private enterprise.

Local entrepreneurs are not stimulated to start up a business of their own. Rather they are actually squeezed out by the free or cheap subsidised services of NGOs. Private sector development is further inhibited by civil servants operating private businesses in the same areas they are providing public services.

Assumption 2. The Private sector will take up services after the project is over.

The private sector is unwilling to invest in services based on the experiences of NGO/govt run projects because: a) there is no paying client base; b) the commercial trading record is not there; c) the human and financial assets are not available as all the good people have been reassigned; and d) critical business information and operations, especially surrounding costing and pricing, are lacking.

Assumption 3. Commercial relationships will develop after the project.

Farmers find it hard to understand why they should pay a commission or service fee when they know a donor is paying the NGO. Buyers, either traders or processors, are no different. When programmes finish many are reluctant to start paying the full commercial cost for a service that was once free of charge. The 'aid' mindset nurtured by the project makes it impossible for commercial relationships to develop with potential clients.

Assumption 4. Commercial viability will be reached quickly.

Delivering services with better prices to farmers reduces profit margins. To be competitive buyers must be given a lower price than their local agents can provide them. The reality of low profit margins means that turnover has to be high. Growing a rural business to scales that are commercially viable needs time and long-term credit.

Assumption 5. Rural Entrepreneurs will access local financial services.

Access to micro-credit and business development services is limited because these services are designed in a way that makes them irrelevant for most rural entrepreneurs. Simply, the level of business operation and skills of such entrepreneurs are too low for them to access the services being offered.

[1] *RAVI has provided technical assistance to the IFAD funded First Mile and Rural Knowledge Network projects implemented by Agridea and FAO respectively from 2006 to 2009 and the on-going Market Access Capacity Building project implemented by Traidcraft.*

What Can Be Achieved

Like so many other projects our market access services have yet to reach commercial scale. Indeed, the local networks of rural entrepreneurs we built with NGO's and Farmer Field Schools in Tanzania all gave up after the project ended. We were more successful with Farmer Field Schools in Kenya and Uganda. Here a few remain entrepreneurs within our networks while others have become regular clients of the networks. Our Tanzanian marketing partner providing technical back up declined to continue because they were unwilling to make the jump to commercial operation. We did manage to prove that market access services could be provided on a commercial basis. We did manage to achieve the following:

- Commercially registered 'regional' networks of rural entrepreneurs in Kenya, Uganda and Tanzania. We have two networks in Tanzania and six in both Uganda and Kenya. These networks are comprised of some two hundred farmer/traders or input dealer/shop owners. Two 'national' companies: AgriNet in Uganda and AgriTrade in Kenya, provide support to these networks on a commercial basis.
- Rural entrepreneurs networks capable of managing secure transactions for produce and payments between smallholders and buyers. License agreements provide performance standards and disciplinary mechanisms to minimize the diversion of cash to non-businesses needs. Network members are trained to meet due diligence requirements of investors in terms of keeping trading record, cash ledgers and preparing annual projections of deals.
- Clients' capable of engaging in transparent and efficient trade. Farmers are trained to meet buyers quality and quantity requirements at set collection points organized by the networks opened at set times; not transporting stones, debris and wet crops that factories either reject or clean up saves a lot of money. Such savings make it possible to give better prices to smallholders. Buyers are trained to meet agreed payment schedules with price incentives for paying cash on delivery. Delaying payments because of cash flow problems reduces market efficiency owing to the high cost of commercial credit.
- Commercial operations for secure transactions between smallholders and established buyers, not local middlemen. On these deals our networks have managed to give farmers 10%-15% higher prices and collect commissions of 5%-10%. Although small in terms of turnover each transaction more than covers the costs of its operation. Proof of commercial viability, however, will require much higher levels of turnover.

Network agent advertises a deal on her information board, Uganda

Reaching Commercial Scale

Our demonstration of commercial potential remains at a small scale. While commercial viability can be shown at the level of single network agents, the higher levels of network management require scale to cover their costs. Scaling up to prove commercial viability at the network level will require financing. This is especially important as our business operates on small margins. Our promise to give smallholders better prices and remain competitive for buyers means that margins must be thin. We, therefore, must handle a large number of transactions to be commercially viable. This high turnover must also enable us to absorb the risks of transit losses, theft and defaulting buyers.

Financing is needed not just to increase the number of business transactions, but also to train new network members and new clients. Smallholders require training to become disciplined clients. Buyers require training to become committed to fair and transparent trading.

Our financing proposition to scale up the number of business transactions looks good on paper. A credit facility of US$ 2 million to finance transactions that pay farmers cash-on-the-bag operating initially through six of the best established networks - is projected to make around 2,000 deals with an aggregate value of around US$ 6.5 million in the first full year of operation, increasing to 5,500 with an aggregate value of US$ 17.5 million in the second year. At these projected levels of transactions, the business would record an operating loss of US$ 48,000 in year 1, but achieve a profit of US$ 220,000 in year 2. The profit would cover the overhead cost of operating the business.

On the ground scaling up will require extensive risk mitigation strategies. Finding ways to reduce losses from defaulting buyers may include engaging invoicing or factoring services. On the other hand, scaling up operations presents opportunities to make them more efficient. For example: mobile phone applications to reduce the need for travel and time. Not surprisingly, the projected profits of our start-up networks are not sufficient to cover the costs of all the required R&D. Neither can the profits pay for the extensive capacity building of new clients and new network members needed to reach scale. Scaling up the size of the networks and increasing the client base on both smallholder and buyer side will require considerable long-term investment.

Lack of finance prevents us from reaching commercial scale at the network level. The challenge when accessing finances is not to slip back into 'project' mode. Therefore, on the one hand private capital should be raised to finance increased business transactions, while on the other hand public funds should be restricted to financing the necessary capacity building and R&D. We conclude that for efficient and inclusive market access services to reach commercial scale private and public investors must enter into partnerships: They need to leverage each others finances such that pre-commercial expenses in R&D and capacity building can be met, while at the same time ensuring that the commercial outlook in business operations is not jeopardized.

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