

BRIEF 40.
Cash-on-the-Bag
Secure Transactions
on Trial

Transaction Security Services (TSS) with 'Cash-on-the-Bag' payments to smallholders addresses one of the most persistent and prevalent reasons for failure of agricultural supply chains in Africa: the absence of a secure and trustworthy transaction environment. Relations between smallholders and large buyers in Africa are generally characterised by significant distrust between the two parties. Smallholders are reluctant to hand over their produce without full cash payment up front, and large buyers are reluctant to make purchases without first inspecting the merchandise to ensure that quantity and quality correspond to specifications. Transaction risk is defrayed through many layers of middlemen, resulting in higher transaction costs, waste and consequent disadvantageous prices for both producers and eventual large buyers. TSS provides a more effective and efficient way for middlemen to operate. Transparent, commission based middlemen can offer a win-win situation for both parties to the transaction. This is the beauty of secure transaction environments.

TSS an alternative business model for smallholder marketing

TSS with 'Cash-on-the-Bag' changes the business model of smallholder marketing from 'buy-sell' speculation to pre-determined service commission. The problem with the speculation model is that it rewards those who buy at the lowest prices and sell at the highest prices. The business incentive for traders is to get the lowest price possible from farmers. Smallholders are particularly vulnerable to such exploitation when cash is needed urgently or debts must be repaid. In contrast, a business model of commission based on service cost and farmer price rewards those who get the highest price for the producer. Treating transaction services as a 'middle cost' of the market chain, like transport, allows producers and buyers to negotiate prices in a transparent win-win fashion. Cash-on-the-Bag financing gives middlemen using TSS a chance to grow their business through commission as opposed to

high-risk buying and selling. Rather than replacing 'middlemen', TSS gives them an operational environment in which they can do their job much more efficiently.

Private and public investment to test commercial viability

RAVI, on the private side, and IFAD on the public side, are investing in a test of the commercial viability of TSS with Cash-on-the-Bag services to smallholders in Kenya, Uganda and Tanzania.¹

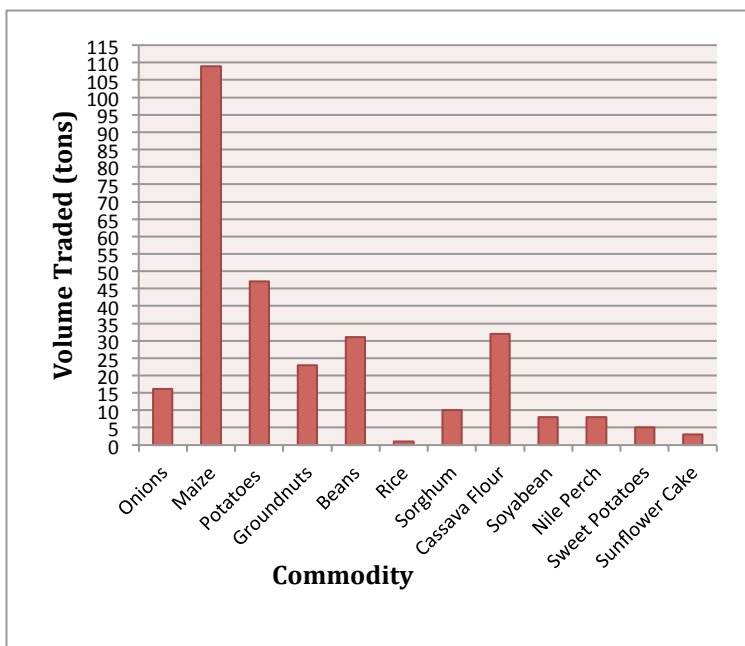
- RAVI finances the TSS operations of twelve licensed local network companies across Kenya, Uganda and Tanzania, engaging some hundred and fifty independent rural entrepreneurs as agents. These networks and their agents ensure due diligence on behalf of the seller by making immediate cash payments for product purchased, and on behalf of the buyer by verifying that the quantity and quality of the merchandise purchased corresponded to specifications.
- Public financing from IFAD goes to Pride Africa for capacity building of the local entrepreneurs involved using their business-to-business learning platform www.linkinglearners.net. Local traders learn how to run the business operations of TSS and handle the Cash-on-the-Bag payments through a revolving fund operated by Pride Africa.

IFAD SAYS: "The project offers IFAD a clear and tangible exit strategy, being long-term financing by social investors once financial viability at a required scale is demonstrated. The proposed marketing service is innovative; improving the security of supply chain transactions is essential for smallholders to shift from predominantly self-sufficient agriculture to generating increased revenues through farming as a business."

For more information contact:

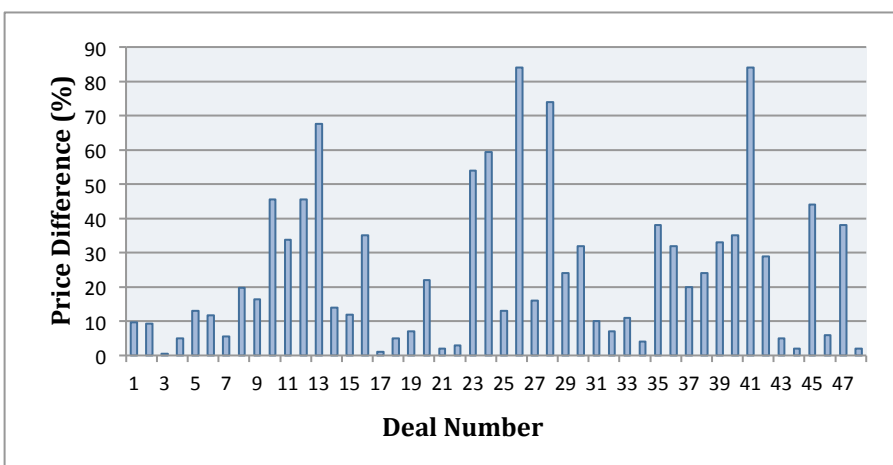
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¹ RAVI has been financing TSS Cash-on-the-Bag transactions since June 2010. In July 2011 Pride Africa made its US\$100,000 revolving fund from IFAD available to the networks.



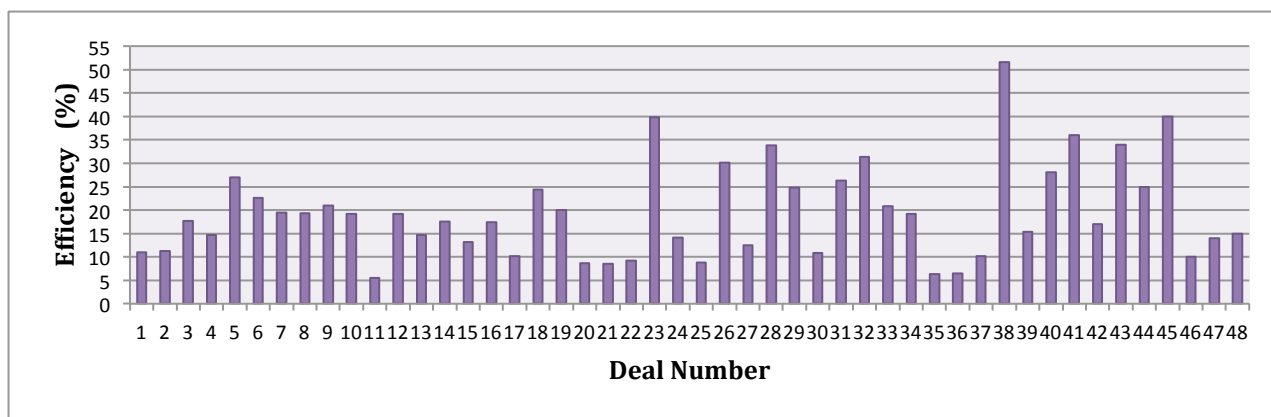
Trials on commercial viability

Early results show that Cash-on-the-Bag financing provided within secure transaction operations by licensed local networks eliminated most of the problems between seller and buyer. Since June last year forty-eight deals have been transacted worth over US\$ 160,000 in total value. To date, these deals have used a total of US\$ 61,400 to finance the Cash-on-the-Bag payments to smallholders. The range and volumes of commodities traded in tons is shown in the graph. The current, cumulative volume of trade stands at 400 tons. This does not include trade in animals and timber. Experiences, although still very limited, suggest that the TSS business model can:

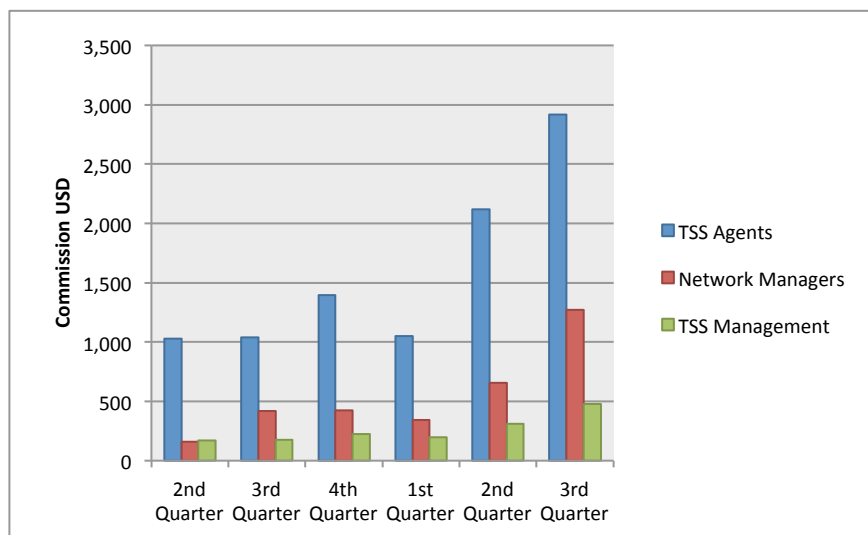


1) Deliver higher prices to smallholders. On average, across all the deals shown in the graph farmers have got 20% higher prices. In the worst cases farmers got 1% while in the best case they got over 80%. In US dollar terms that is an extra US\$ 21,678 on a total farmer income of US\$ 141,139. So far 1,227 farmers have benefitted from the service.

2) Reduce inefficiencies in the supply chain operations. TSS deals reduce the cost of marketing down to 19% of the total value of the deal on average. In most cases the costs of marketing through TSS ranges from 10% to 30% of the total deal value as shown in the graph below.



3) Provide income streams to networks, agents and for the TSS management operation. Since the second quarter of 2010 when the trial started TSS agent commissions remained flat until the second and third quarters of 2011 when they rose to levels that meet agent income expectations. Of the twelve network managers involved commissions while rising are below breakeven points. This is also the case for those who manage the TSS operation.



Lessons learned so far

We have learned of many risks and identified threats to commercial viability of TSS. Risks that can be avoided still occur.

The risk of late or reduced payment remains unacceptably high. Local Purchase Orders or LPO's issued by buyers are of little value when a buyer decides not to pay on time or change the price at delivery. Taking a buyer to court is unrealistic and damages relationships.

The risk of farmers not bringing promised produce qualities and quantities to collection point remains unacceptably high. Poor discipline among farmers as individuals and groups leads to longer collection periods and missed transport all of which undermine buyer confidence and drive up transaction costs.

The risks of side selling, theft and spoilage because of poorly built collection centres and lack of well-managed local village level warehouses. Secure collection points where farmers feel confident to deposit their produce in safe-keeping are the start of secure transaction environments.

The risks of trucks being seized by cartels in main markets preventing direct trade with local market vendors. The cartel 'surcharge' of 20% to 30% drives up middle costs and eats into both farmer and vendor prices. Cartels intimidate vendors to buy only from them. In places market authorities benefit from and thus sustain this activity.

Threats to the demonstration of financial viability are the higher costs associated with introducing a new and very different service to both farmers and buyers.

- Smallholders and buyers are very suspicious of new market agents and operations. Such suspicion can only be overcome by repeated successful trading experiences. New business operations must bear the costs of building a reputation through subsidised services.
- The operational costs of introducing agents, farmers and buyers to TSS deals can exceed commissions because too much costly travel by the manager is needed to build confidence in agents, buyers and farmers.

A further threat to commercial viability comes from poor banking services. For example transfers between branches, even within the same bank, can take up to a week within the same country. The promise of same day transfer rarely actually happens. If a transfer mistake has to be cleared up this can take several weeks, with no refund by the bank in the meantime. Such uncertainty is unsuitable for agricultural trade and explains why so few payments are presently made through normal banking mechanisms. The arrival of financial services through mobile phones has started to break this up. We are sure that money transfers over handheld devices will be the future for trade in rural areas. We intend to experiment with this as speed and reliability of payments to farmers is at the core of Transaction Security.