BRIEF 42: Learning Where Deals Can Go Wrong

Over the last year twelve trader networks across Kenya, Uganda and Tanzania have conducted some eighty deals providing cash-on-the-bag (COB) payment advances to small farmers using secure transparent transactions. While less than ten percent of the deals failed completely many experienced problems. In this brief we share the hard lessons learned in the words of the network managers. Farmers broke agreements by side selling, they reneged on volumes, and changed prices at pick up. Buyers cheated on deals by not honouring purchase orders, lowering prices at delivery, delaying or not paying. We had cases of fraud and cartels in markets. We had experiences of our own agents swindling the network by cheating on quality, diverting produce, side-using money and even stealing money. For most of these hard lessons ideas for solutions to try out emerged. The brief ends with solutions in: Improved due diligence; Proper documentation; Prompt payments; Alternative sale; Local and Legal redress; Secure payment systems; Contingency for unavoidable risks. All the lessons learned were captured in stories that are referred to here and available online.

Lessons on how farmers break agreements

<u>Farmers side sell:</u> The challenges started when the farmer group started changing the goal posts by coming up with excuses i.e. the group had not met to agree on a common harvest day. Then I found out that they had sold to another buyer who gave them KES 3,300/ on a 140 kg bag, which in actual fact was a lower price per kg than we were offering for 90 kg bag. *(See Story 170[1])*

[1] *All stories can be read or downloaded as PDF files from the website: www.linkinglearners.net following the numbering given here.*

<u>Farmers renege on volumes:</u> When we worked on the harvesting and collection date with the horticulture producers group around ten members promised to harvest on the agreed day only for three members to back off claiming their husbands (who are not the group members) had refused to allow them to sell the potatoes. Eventually we were able to collect five tons) from the seven farmers. Only collecting half the quantity expected increased the costs for transport per bag and meant that the price per bag went down to KES 2,970/ per bag. However the farmers were happy with the system (even at a lower price) and participated in the second delivery of 60 bags to the same buyer. *(See Story 170)*

<u>Farmers change price at last minute:</u> Farmers changed the price at pick up, saying that they had got information that prices had increased elsewhere. They refused to give up the produce, so we were forced to renegotiate because we could not go back empty handed. We ended up paying UGX 30 more per kg. Could we have refused to add on the price the farmers wanted? We could have got the same quality of maize from the middlemen. But the business model to source from farmers ties us, and we wanted to pull off a successful deal with this group and our agent who we had trained. Pulling out and disagreeing would have sent the wrong signal and damaged the relationship established with the farmers. *(See Story 152)*

Lessons on how buyers cheat on deals

<u>Buyer refused to keep to LPO:</u> On reaching the buyer there were many trucks packed at the warehouse waiting to be offloaded. The buyer was reluctant to take our crop. The buyer told us that the market price was now lower by UGX 150/ per kg and offered a new price of UGX 450/ instead of the UGX 600/ that we had agreed upon in the Local Purchase Order he had given us. He gave us a condition to either take that lower price or to sell our maize elsewhere. (*See Story 148)*

Buyer changes price at delivery: I was supposed to deliver twenty tonnes of maize to miller as we had agreed. But on reaching with my truck, the manager refused to pay the UGX 750/ per kg cash, as we had agreed by word of mouth, but instead he insisted to pay the prevailing market price of the day, UGX 570/. I disagreed because this new price meant a total loss to my business. I refused to offload the maize and have put it in a local store until the prices increase. *(See Story 147)*

Buyers delay payment: These cattle deals have been a big stress to me. Our main challenge is the late payment from the buyers. Buyers have twice failed to pay in the time I expected. One gave me a post-dated cheque that failed. Another buyer still refuses to pay for the ten cattle he took to KMC until he is paid by them. When I use COB finance and buyers don't pay in time, I have to pay interest on this financing and then I don't make any money or worse still I am in debt. *(See Story 154)*

Buyers go bankrupt: In September 2011 I was able to sell ten bullocks to a trader who supplied them to a local abattoir as per the local purchase order he had. It is now March 2012 and the trader has not paid me. The reason that the buyer has not paid is that he is in debt. We have heard that a deal he was doing, which involved sourcing cattle on trust from the pastoralists, went wrong when three cattle were stolen. He couldn't then pay the pastoralists, and this became a police matter. He then had to pay a bond to get out of prison. So now he says that he is bankrupt and cannot pay me. *(See Story 165)*

Buyer fraud: I have lived in disbelief for the last five days with regard to a deal of value 11 million UGX. Seven tons of beans were bought, cash-on-the-bag from the farmers in Mityana for 7.6 million UGX. The beans were transported at a cost of 0.8 million UGX and delivered in Kampala. We got a loan of 10 million UGX to finance the deal. With packaging cost and interest to pay on the loan our middle costs were approximately one million UGX. The buyer was a large Ugandan inputs and general supplier. After the delivery of the beans, the buyer tricked us and disappeared. This buyer claimed they did not know the individual we were dealing with even though he was using their compound! *(See Story 129)*

Checking Maize quality at collection point in Kamuli, Uganda

Buyer Cartels at markets: The Busia market is always open for any buyer or seller; however, it has broker tactics of cartels. We brought in a truck that carried twenty tonnes of maize to the market because we could sell the maize at a good market price. However, we were told that we had to sell the maize there through a broker in the Busia Produce Market. The role of the broker is to find the buyer and sell off the commodity and take his or her own commission. The broker sold the maize for KSH 28/ per kg, and then exchanged the money into UGX at a rate of 1 KSH to 26 UGX. This exchange rate was not very good. This meant that we had to lose some money through currency exchange as well as through paying the cartel a commission. *(See Story 152)*

Lessons on how agents swindle the network

Agents pressured by relatives to cheat: We delivered nearly twelve tonnes of paddy to a large rice milling company. This consignment came from a farmers' cooperative where our agent was also a member of the coop. The group members carrying out the quality control pressured the agent to accept wet paddy. The millers returned this paddy to us because it had already germinated and so could not be milled. The millers accepted to buy the germinating rice but at around half the price of good quality paddy. We had already paid the farmers COB for more than that price and could not ask farmers for some of that money back. If we had had an independent quality check in the field we would not have had this happen. *(See Story 167)*

Agents substitute fish with sand: Mombasa Millers reported that after they had finished with the sieving process of the omena delivered, that out of the weighbridge weight received of 16.4 tonnes they had only got 9.2 tonnes of fish! Of the produce transported only nine tonnes were fish, the rest was sand. The money disbursed to my agents was paid directly to the suppliers on delivery of good quality fish, but in the days of delay before loading the bags could have been exchanged; good quality fish for sand. Clearly, our agent diverted some of the good fish to another buyer and substituted those bags for sand. Our agent in Busia, has the facts on the funds transferred to the fisher-folk and the quality purchased. So diversion must have occurred while the bags was waiting to be transported *(See Story 159)*

Agent side uses money: We paid 17.7 million UGX cash-on-the-bag to the Kyangwali farmers' group for ten tonnes of upland rice. We milled it and sold it as intended to traders in the Hoima market. However, when our agent received the money, he was tempted to side-use the money for another deal. So he went ahead sourcing for more paddy from the same farmer group. Unfortunately, it started raining and the paddy could not be dried fast enough before milling it. In this situation, our agent sold some of the paddy and deposited 5.8 million UGX into the COB account. From then on he became elusive, he stopped communicating, stopping taking my calls, and deliberately avoided meeting me and discussing what was happening with the remaining money. *(See Story 172)*

Agent runs with money: My agent sourced thirty sheep. On the delivery day I went with him to the buyer where the sheep were slaughtered and we took their weights. The buyer wrote a cheque three days later and gave it to my agent. I gave the agent the bank account details to deposit the cheque. However, he deposited the cheque into his own account and called me to say that he had lost the details of the account I had given him. I immediately told him to contact another network manager near his place, but he did not. I tried to call him but he did not pick my calls up. We tried to trace him but we were not able to find him. We called his father and he said his son had not come home. *(See Story 166)*

Most of the time deals work out well. I have really gained experience through the transaction security system. I registered these deals, sourced the cattle and paid the pastoralists cash-on-the-horn. I negotiated with buyers and built trust with pastoralists. In fact, when there was not enough COB financing to pay for all the bulls I was given one on trust, which I paid for after the deal. Through using my new and growing network of agents, the training we've had and our links to farmer groups, I think that it will be possible to do better business.

Fish are substituted with Sand!

Some solutions to try out

- **Improved due diligence:** There are many buyers out there who are prepared to try all sorts of tricks so that they can foil our deals. Our due diligence must go beyond just asking around to include checks with the district commercial officer and where possible the chamber of commerce. Impulsive decisions to deliver goods to a buyer on whom you have not done proper due diligence, may lead to either delayed payment or total loss.
- **Proper documentation:** Never do business unless the buyer issues his or her own LPO. Otherwise you have no chance to get legal help. You need proper paperwork to use to chase-up buyers. This should include a Local Purchase Order from the buyer, delivery notes, and invoices. LPOs need to show banking details for payments to avoid agents diverting payments into their own accounts.

- **Prompt payments:** One idea to deal with late or slow payments is to have a memorandum of understanding with the buyers which stipulates that they pay 1% per week surcharge to cover the cost of the COB finance until the payment is made. Providing buyers with an incentive to pay promptly is probably a better way to achieve this. Buyers who pay promptly would get a discount on their buying price.
- **Alternative sale option:** Always have a plan B to sell the produce if a buyer plays games at delivery. A quick alternative sale through an auction is a better option than staying with the commodity, unsure if the price will ever increase significantly. Never cling on to the commodity in hope of price rises – rather auction immediately and make your loss there and then and move on to another deal to recoup the loss. You will make greater losses on storage, re-drying, treating for weevils and re-bagging, by keeping the produce.
- **Local and legal redress:** Use local authorities, especially district agricultural and commercial officers, to pressure rogue buyers to pay. Better still is to go to the local community leadership for help. In our case Maasai elders are trying to sort out payment problems and are even trying to raise funds to get the buyer out of debt. If local redress fails and you have all your proper documentation you should seek legal redress. Be prepared to have standby legal advice in case of default on LPOs even though this will increase your cost of doing business.
- **Secure payment systems:** You must never lose sight and control of the money either for paying farmers or being paid by buyers. Agents are easily pressurised by family or circumstance to side-use or steal cash. We are in urgent need of payment systems that are more secure than cash. Mobile-phone payment systems are developing rapidly and we need to explore how we can use them to improve payment security.
- **Contingency for unavoidable risks:** Some risk, such as rain that prevents trucks from reaching collection points, cannot be avoided. We need to recognise these risks and make arrangements to deal with them. One solution would be to establish a contingency fund that could be drawn upon to cover unexpected changes in middle costs (i.e. increased transport costs) or prices resulting from delayed deliveries. Such risks cannot be shared with buyers or sellers so networks need some kind of shared protection from them.

Masaai cattle trekking to collection points.

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