



**BRIEF 44:
Facilitating Value
Chains the
Missing Middle**

A business opportunity exists for those who can provide services that solve the problems of the missing middle in agriculture value chains. Facilitating secure transparent transactions between small farmers and scaled processors with Cash-on-the-Bag payments to farmers (COB) is one such service. Key tasks for this service include: transparency in negotiations, quality checks, cash on the bag payments, checks on delivery, and controlled payment systems. Over the last year twelve trader networks across Kenya, Uganda and Tanzania have conducted some eighty deals benefitting over one thousand small farmers. Farmers get an average of around 15-20% more money into their pockets than if they sell through other existing channels. Value chains efficiency has been brought up to 80% with costs per deal being only 20% of total deal value. Of course there remain huge challenges to take this business opportunity to commercial scale. Lastly, others venturing into this opportunity might learn from the lessons we have had in: organising farmers, independence of service providers, trust and control, farmer cheating, starting out commercial, NGO constraints, public investment clarity, and advisory services roles.

The commercial challenge for agricultural value chains

Nearly five years ago Archer Daniels and Midland, one of the worlds leading agricultural processors, identified the ‘missing middle’ to improving value chains in Africa. ADM challenged the business community to turn what it saw as a vicious cycle of low margin, low value add, weak market orientation, low risk taking, low investment and low productivity into a virtuous cycle that improves margins, creates value add, creates market pull, shares risks, shares investment, and improves productivity. A tall order, but the commercial opportunity is vast. ADM estimates that sub-Saharan Africa could increase GDP by 25% (worth an additional US\$75 billion) if it increased arable land use by 25% and raised yields by 300%. The opportunity for social impact is even greater given that most recent estimates say that 239 million people were undernourished in Sub-Saharan Africa (FAO 2010). A business opportunity exists for those who can deliver a virtuous cycle to value chains in Sub-Saharan Africa.

An inclusive business model for the missing middle

The commercial challenge is not only to provide services that deliver a virtuous cycle but do so in an inclusive manner. That is a commercial service in which small farmers and traders can engage in either as service providers or clients. Facilitating secure transparent transactions between small farmers and scaled processors with Cash-on-the-Bag payments to farmers (COB) is one such

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service. COB services are provided by trader networks with agents who organize deals between sellers (small farmers) and buyers. Small farmers who double as "middlemen" often make the best network agents as they have the contacts, relationships and inclinations to make deals, going the extra mile and taking the extra risks to make them work out. Buyers are ideally not larger traders but end-users like scaled processors who value quality and timely delivery. Reducing the number of players in the value chain, reducing waste along with farmers seizing value add opportunities are the keys to higher value share for farmers.

Farmers and traders have pointed out that COB services is providing them a business model that is diametrically different to what they have been doing so far. So far they are stuck with the model of investing their own money into "buy low and sell high", pushing farm gate prices down as far as they can in order to cover their often stunning transaction risks. But with the COB services their income is the commission, and that is tied to the price farmers get. Their business incentives therefore go towards fighting for high farmer prices and low middle costs. On top of that they get exclusive access to "cash-on-the-bag" financing that allows them to make many more deals than they could do with their own money. The best agents have understood that they earn more money from commissions (linked to farmer incomes) than from margins on deals where they need to risk their own money. The COB business model creates win-win incentives for all value chain players

Key tasks for transparent transactions

Providing a service that facilitates secure and transparent transactions between buyers and sellers requires the following tasks:

- 1) Assist buyers and sellers to negotiate deals by making all the middle costs transparent to both sides, until a deal is agreed by both sides
- 2) Carry out quality checking and packing to the agreed criteria at the designated collection points and organizes shipment to the buyer.

- 3) After farmers produce is accepted at the collection point a "cash-on-the-bag" financing facility provides cash advance payment to farmers if they so wish. It comes with a fee, and some farmers have started to not ask for that advance in order to save on that fee.
- 4) Carry out independent checks when the produce arrives at the buyer and track back any complaints on quality and delays, etc. Agents also ensure correct paper work so that the buyer can then make the payment to controlled payment systems.
- 5) Controlled of payment for all the middle costs (transport, packing materials, taxes, insurances, etc). From the balances the pre-agreed commission (usually around 10%) is then distributed to the agents involved in the deal.
- 6) Controlled payment of remaining money to the sellers. If they already got a cash advance, it is now recovered. If there is a balance, this is a bonus that is then handed out to the sellers, explaining to them exactly all the figures as described above, thereby achieving full transparency. If the balance is negative, the trader network covers that loss.

The COB business experience and achievements

Over the last year twelve trader networks across Kenya, Uganda and Tanzania have conducted some eighty deals providing cash-on-the-bag payment advances to small farmers using secure transparent transactions. Over one thousand small farmers have benefited. The US dollar income to farmers from this trade has been around \$80,000 in Kenya, \$45,000 in Uganda and over \$30,000 in Tanzania. We can show that:

- Farmers get an average of around 15-20% more money into their pockets than if they sell through other existing channels (the range varies from 2% to 80%). That translates into a bonus of \$5,000 going to farmers in each country.

- Value chains efficiency has been brought up to 80% with costs per deal being only 20% of total deal value.

Of course there remain huge challenges to take this business opportunity to commercial scale. So far technical, operational and commercial proofs of concept have been achieved. Growing to commercial scale is the next big challenge. No doubt this will require continuous development of solutions to the serious bottlenecks in the overall marketing environment (logistics, finance, information, money transfers, regulations, rule of law, etc).

Lessons learned on facilitating value chains

So far the effort of building an inclusive business model has been a local process of learning-by-doing. Entrepreneurs have 'invented' the COB business model through sharing experiences in a business-to-business or peer-to-peer learning environment. Some of the lessons that might help others venturing into the commercial challenge of value chain facilitation follow.

- Just organizing farmers for better marketing doesn't work. Nothing works to scale without middlemen. The challenge is not to organize farmers but to give middlemen another business model. While remembering that most middlemen are themselves farmers too, often the most entrepreneurial.
- Marketing services must be independent of both sellers and buyers to be trustworthy to all value chain players and especially those who compete with each other.
- You only trust somebody when you know control measures are in place that will immediately expose cheats. Trust is a result of control, not a replacement of control.
- Poor farmers are often by far the best cheaters and the most difficult to educate not to cheat. It is their mechanism to cope with the current buy-low-sell-high business model.

- A value chain facilitation service that actually organizes deals and financing that puts money into farmers pockets must be commercial from the outset if it is to be sustainable and make long term commercial sense
- Employed NGO staff are ill-equipped to build commercial services in the market place. Their inclinations and behaviour and rules of engagement are often counter to the profit motive. Market players will not trust such staff to continue their services once the project is over.
- Public investment through grants needs to be very carefully designed and calibrated in order not to jeopardize the emergence of commercial behaviour of marketing services. "Competitive neutrality" of grants into commercial ventures is an art difficult to master.
- Rural advisory services have a role to play in showing farmers how to achieve quality in terms of produce, of predictable availability and quantity, suitable storage, and packaging. Poor farmers often also need to learn how to analyse available market intelligence and then calculate their productive investments correctly to achieve a profit. Most cannot yet produce a partial budget of their production operations.

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