PROCEEDINGS

Fireside Chat on Connecting Africa's SMEs to Wider Markets

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Executive Summary

Kenya's food market accounts for 45 percent of consumer spending because the market is fragmented and inefficient. Indeed, about 30 percent of stock is lost in the process of multiple trades between farmers and the final vendors. However, the company, Twiga foods (Twiga), loses only about 3-4 percent in the course of its trading activities. How does it do it? Twiga's mobile-based ordering platform enables about 1,500 vendors a day to buy stock using their phones and then delivering the stock directly to them. Farmers gain certainty that their produce will be sold, while vendors can access a better-quality stock at lower prices. This predictability facilitates the financing of farmers and vendors, and opens a new set of possibilities for Kenya's agricultural sector.

Twiga's activities also enable it to predict future prices. This allows for the creation of a new type of commodity market, which in turn will enable a secondary level of investment to be introduced into the system. Four years ago, as a start-up, Twiga struggled to access capital. No local bank would lend to it, and it was forced to turn to European banks because the local market is not equipped to deal with venture capital-backed start-up products, which typically need several years to become profitable. This limits Africa's ability to build its own multibillion dollar start-up market, and it is a regional disadvantage when compared with the rest of the world.

Kenya's Food Market Is Fragmented and Inefficient

- In Kenya, food accounts for 45 percent of consumer spending because the food market is fragmented and inefficient. For example, in Nairobi, with a population of about 4 million people, there are 130,000 basic goods vendors. Food vendors represent 96 percent of food in fast-moving consumer goods (FMCG) product sales in Kenya.
- The process that vendors use to buy produce is inefficient. Small shop owners obtain their agricultural produce from large informal markets. They must go to the markets at 4 a.m. to purchase their stock and then bring the stock to their outlets to be sold during the day.
- About 70 percent of Kenyans work in agriculture, but only 2 percent of the credit goes into agriculture. This credit gets passed several times between farmers and markets, and this causes high default rates, thereby contributing to inflation.
- Kenya's agricultural economy is based and built on the back of small farmers. One of the reasons for this phenomenon is that the buyer's side is fragmented, making it hard for large suppliers to access it.

Twiga's Proposition

- Twiga's solution is to provide vendors with a mobile-based ordering platform that enables them to buy stock using their phone and deliver stock directly to them. This eliminates the need for them to undertake an early morning trip to the market. Twiga also collects information about vendors' purchasing power and then transmits it to farmers around the country to guarantee markets for those farmers.
- In the four years since its inception, Twiga has evolved into a commodities market that uses its mobile platform to offer financial services, logistical fulfillment service, warehousing, and cold storage and distribution, thereby connecting different sides of a marketplace. Twiga can also predict future prices, which essentially creates a commodity market. This enables a secondary level of investment to enter into the system.
- The advantage that Twiga brings to farmers is that they can now access a steady market with predictable demand. As such, it eliminates the biggest problem of uncertainty that farmers face. The advantage for vendors is that they can access a better-quality stock at lower prices.
- About 30 percent of stock is usually lost between farms and markets through the multiple trades that occur before the produce gets to a "Mama Mboga's" (small-scale vendor) stand. Twiga loses only about 3-4 percent in the process because of its cold storage and logistical investments. This means that Twiga can pay the farmer more, while selling to the vendor for less.
- The largest driver of post-harvest losses in Kenya is the lack of communications. In Meru, for example, farmers pile tons of produce on the side of the road each day, not knowing how many tons worth of haulage capacity will arrive that day, resulting in a mismatch. The ability to control timing provides a lot more certainty in the network, which helps to enable financing for farmers. Twiga sells to about 1,500 vendors a day, who collectively try to set prices. That pricing data is then pushed back to farmers and provides them with predictability about their incomes. Furthermore, if farmers have knowledge about what they can sell, they are more likely to invest in production.

Blockchain and Informality

- A recently launched project with IBM uses blockchain to provide financing for retail vendors. The results showed that vendors ordered about 30 percent more stock when financing was provided alongside delivery. Blockchain provides certainty to farmers and vendors. Specifically, it eliminates the issue of informal payments by having thousands of third parties verify and store their transactions on an indelible public ledger that cannot be modified. Certainty in turn drives investment in production, as farmers are more willing to invest if they reliable information about what they can sell. It is likely that there will be more blockchain applications in future, leading to the de-risking of the informal credit sector.
- Informality is a requirement for working in Africa, and the actors in the sector are rational businessmen. Banks are also increasingly interested in the informal sector. However, if banks lack reliable and affordable information, they will require collateral that most people lack. The challenge then is making transactions verifiable, especially within the agriculture sector.
- The system could work more efficiently in a better policy environment. For instance, agricultural contracts should be enforceable. Alternatively, smart contracts could be implemented by geo-tracking the commodities.
- On the consumer side, informality is here to stay. Most consumers do not have more than a week's worth of cash to spend. Most cannot put groceries in their car and drive home. They are very much local shoppers. Also, most do not have refrigerators, so they need to shop on a daily basis, or at least every other day. Furthermore, with rapid urbanization occurring across the continent, by 2025 the majority of the population will be urban. These consumers are the future face of the retail market. Laborers are typically paid in cash because they do not have bank accounts. They also do not want to pay the transactions fees of M-PESA, a mobile phone-based money transfer service. Obtaining data on agricultural production remains a major challenge. Specific technology is needed to address this problem, and M-PESA cannot provide the solution. However, new start-ups are arising to tackle this issue.

Looking Ahead: The Triumph of Retail Over Big Grocery Stores

- A whole new set of possibilities has opened as the fragmentation problem has been addressed, allowing improved access to markets, commodities and finance.
- The policy agendas of most Sub-Saharan African nations include an objective of building commodities markets based on the traditional model of people going to a centralized floor and trading tickets. However, this does not work well in the food marketplace because the buyers are not large. Rather, such a marketplace can be built through the use of mobile phones, offering all the benefits of the traditional commodities markets. For farmers, it means that they do not have to short sell their produce. Furthermore, if farmers have a secured market and a history of payments to a certified buyer or marketplace, such as Twiga, they can bring this transaction history to a bank and obtain discount financing. As a result, their products would not have to be sold at 20 to 30 percent discount to a broker.
- East Africa’s two largest grocery stores are currently in some form of receivership. This is related to the misdiagnosis of what the African middle class means. Even in more established markets like South Africa, the informal sector is gaining more market share against formal retailers. The only place that formal groceries have an advantage is in imported products, where they can negotiate the importation terms.

- The small-scale retail sector is experiencing a renaissance. For instance, in the United Kingdom, there is a big trend back toward front grocery/convenience shops. Twiga's data shows that the average Kenyan household spends about 80 percent of its income on the same 65 products. Therefore, it will be hard for big grocery stores to make the margin they need on the lower velocity products to substantiate such infrastructure.

Lack of Local Financing for Venture Capital-Backed Start-Ups in Africa

- As a start-up, Twiga struggled to access capital for the first few years. No local bank would lend to it, and it had to turn to European banks for financing. The local market was not equipped to deal with venture capital-backed, start-up products, which need several years to become profitable. This is still the case, and it limits Africa's ability to build its own multibillion dollar start-up sector. As such, the region is at a disadvantage with the rest of the world. Many entrepreneurs are ready to change this world. Those working in venture capital and high finance should turn their attention to this issue.