ISSD Uganda

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Seed receipt financing

Addressing inherent cash flow challenges in local seed businesses

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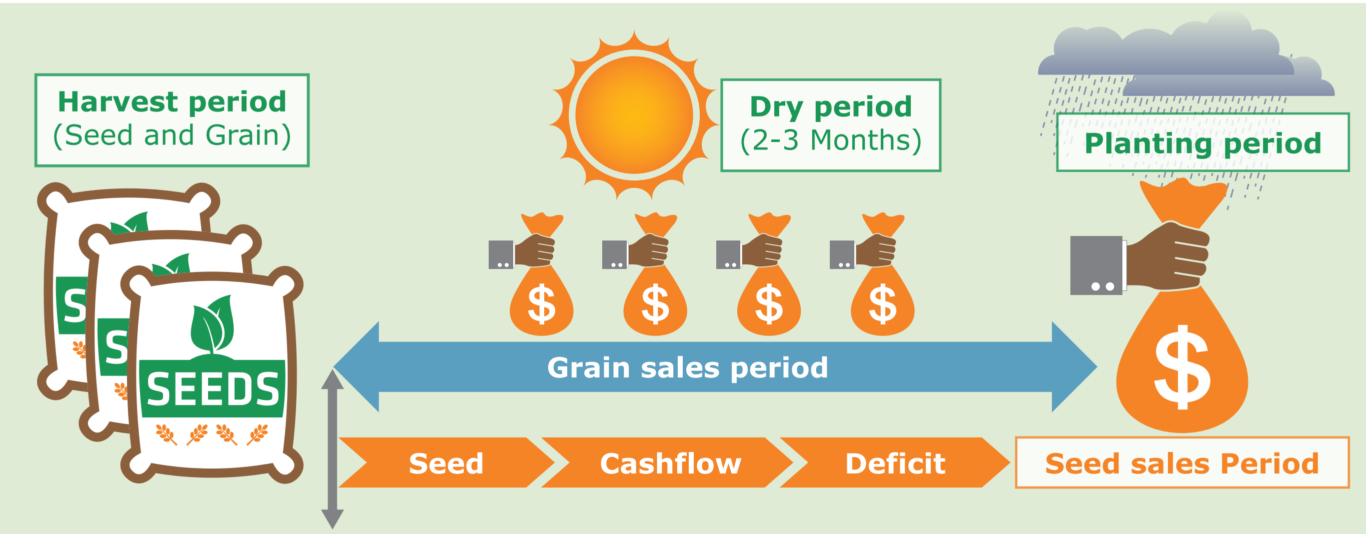

Figure 1: The challenge: seed cash-flow time lags behind as compared to grain

Seed production and marketing by local seed businesses (LSBs) in Uganda is characterised by inherent cash flow problems. This is due to the longer wait until the seed marketing period compared to ordinary grain which can be marketed immediately after harvest. As a result, LSBs are compelled to sell off their valuable seed as grain in desperation. The seed receipt system innovation provides a practical solution by enabling LSBs to receive advances against their stored seed stocks while waiting until it can be sold.

Understanding financial challenges for farmers

Seed production is different from grain production. Seed farmers invest more in their enterprises to acquire expensive foundation seed, to implement other specialised seed activities such as inspections, seed testing, packaging, and to obtain Quality Declared Seed (QDS) labels. This explains the higher production cost compared to grain production. Despite all this, in most cases seed farmers can only market their seed at the start of the planting period which is usually more than two months after harvest. This is because farmers in Uganda, in general, tend to buy seed only at the onset of rains (in March-April for the first season and August-September for the second season).

Having invested more in their enterprises than grain farmers, some seed farmers, particularly women, experience significant cash needs for household requirements such as school fees and food after harvesting the seed, yet they cannot sell their seed at competitive prices. Cash for reinvestment into seed business is also needed after harvest.

Seed producers are thus compelled to sell their valuable seed as grain at prices sometimes half of the expected seed price. This leads to seed sales below the cost of production, thus incurring great losses in income. These losses demotivate farmers and discourage their reinvestments in the business. Of even greater concern is the fact that selling seed as grain leads to the loss of valuable high quality seed meant to enhance productivity.

On the other hand, financial institutions which are supposed to address these problems, do not provide bridging finance to farmers due to a number of issues notably: high perceived risks for agricultural investments; lack of appropriate financial products; and insufficient or appropriate collateral from farmers.

Towards a new financing strategy for LSBs

In June 2015, ISSD initiated a 'seed receipt system (SRS) financing' pilot, which brought together savings and credit cooperatives (SACCOs) and LSB's for the provision of bridging loans, using seed stocks as collateral for borrowing. The pilot scheme started with two LSBs: 'Omutima Gwa Ruhiira' in Isingiro district in southwestern Uganda and 'Wot Anyim' in Pader district in northern Uganda. For both LSBs, nearby SACCOs were approached to participate in the pilot. Since Omutima Gwa Ruhiira LSB was at a more advanced level of SRS implementation, we will use its experience as a case study in this brief. Below is a detailed description of this LSB.

Box 1: Profile of Omutima Gwa Ruhiira LSB in Isingiro district.

Location: The LSB is in a county called Ruhiira in Isingiro district about 45 minutes' drive from Mbarara town. The road access is good. The office and store (which are in separate buildings) are in the middle of the trading centre. The members hail from surrounding areas.

Membership: The LSB has 68 members of which half are women. The members join as husband and wife.

Management: The LSB is three years old and the chairman is Mr Johnson Tindyeeba. The vice chairman is Julius Tushemeirwe and Apollo Nuwagaba is the LSB secretary.

Committees: Production, finance, quality, committee, construction committee.

Production: Land is a constraint in Isingiro, and it is fragmented in most cases. Members often hire land for seasonal production at a cost of UGX 200,000 per acre. The members produce seed for beans and Irish potatoes. The average field size of each member is four acres of which half an acre is dedicated to seed. The average production is 6 bags of seed per acre. In most places, the predominant crop for both cash and food purposes is matooke *(Musa – Plantain)*. As a result the proportion of income from seed is proportional to the size of the matooke plantation. The consensus is, however, that members get more money from seed than matooke, which is relatively

The SRS strategy involves development of a financing mechanism for seed farmers which enables them to access cash before the seed-selling period, while retaining ownership of their seed stocks in storage (as depicted in Figure 2 below).

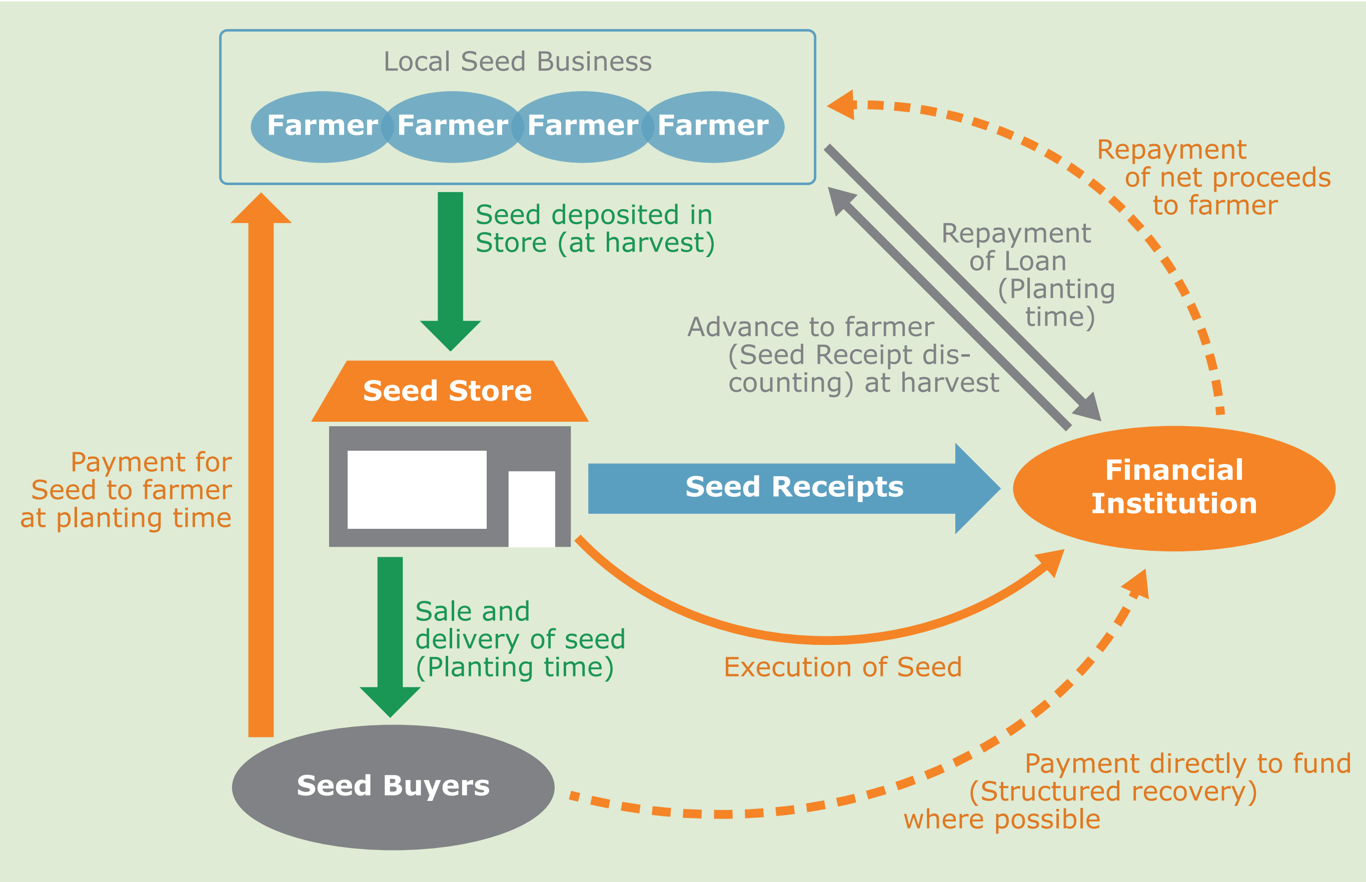

Figure 2: The SRS flow chart

cheap. They are able to produce 6 bags per acre of beans which is their main seed crop.

Buyers and sales: At a yield of 600 kgs and a per kg price of UGX 2,500–3,000. The gross sales per acre for bean seed is UGX 1,500,000. Seed is sold to neighbouring farmers and to larger seed companies like Pearl Seeds and Sidifa. Members prefer to wait until demand is highest and prices are higher before they sell. They have therefore to hold on until the next planting period before they can expect the highest demand and price.

Access to financial services: Most LSB members are also members of Ruhiira SACCO which is in the trading centre. From the SACCO, they are able to get loans and even had a scheme to get solar energy appliances. They get loans from the SACCO with interest charged at 5% per month. They often also borrow as a group and provide their land as security. Individual loans from banks (at 3% per month) are secured by shop inventory and animals.

Warehouse: The warehouse at Omutima Gwa Ruhiira LSB is complete. With a capacity of 60 MT it is suitable for quantities produced by the LSB. It is a standalone warehouse in the centre of the trading centre and is easily accessible. The adjacent land to the warehouse is also owned by the LSB for purposes of expansion. The interior is also complete with pallets.

Well-stacked sacks of bean seeds in the Omutima Gwa Ruhiira LSB store

The SRS allows quality seed to be deposited and seed receipts issued and discounted. Although SACCOs are more expensive and have limited lending funds available, unlike commercial banks, SACCOs are able to accept less stringent collateral management mechanisms than SRS for cost effectiveness. Commercial banks require engagement of an independent collateral management agency to manage seed stocks, a venture deemed too costly for the LSBs; the SACCOs were thus considered the most appropriate mechanism for this SRS financing pilot.

The SRS model is based on the use of seed as collateral for borrowing. Members deposit seed, which is stored by the LSB SRS committee. This ensures that quality is maintained from storage to selling. The LSB presents seed receipts representing stock in the store to the SACCO. The SACCO, in turn, assigns a value to the seed and lends a percentage of the value to the LSB. The loan period is marked for 3-4 months representing the likely time it will take the LSB to sell the seed. Once the seed is sold, the proceeds of the sales are used to retire the loans. The loan may be reduced and paid off at any point within the loan period. The balance of funds from the sale is paid to members. SRS financing relies on the principles of structured commodity financing (SFC) practised by commercial banks (see Box 2 below).

ISSD has identified risk management strategies for SRS financing to identify and manage all underlying transactional risks involved - from seed receipts in the warehouse to loan repayment after seed sales. The SRS risk management matrix (Table 1) attempts to depict underlying risks, their potential effect, and which management strategy LSBs and SACCOs should use.

Box 2: Structured commodity finance (SCF)

SCF is a financing technique utilised by a number of different companies, primarily producers, trading houses and lenders. Commodity producers can benefit from SCF by receiving financing to ensure cash flow is available for maximum output with the intention of repaying the loan once sales begin. SCF provides liquidity management and risk mitigation for the production, purchase and sale of commodities and materials. This is done by isolating assets, which have relatively predictable cash flow attached to them through pricing prediction, from the borrower, and using them to mitigate risk and secure credit from a lender. An enterprise therefore borrows against a commodity's expected worth.

Table 1: SRS risk management matrix

Risks		Potential effect	Management strategy
Internal risks			
1	Poor/wrong quality seed	Value lower than expected	Quality verification/rejection
2	Wrong weight/volumes received/dispatched	Incorrect volumes receipted/valued	Stringent weight verification
3	Diversion of proceeds by farmers	Non-recovery of loan	Collective marketing/structure recovery directly from buyer/ pledging of securities
4	Deterioration of quality in storage	Loss of value/ failure to market	Proper store management and quality control
5	Commingling of seed	Mixing of different seed types/ ownership disputes	Proper packaging, labelling and stacking
6	SRS fraud (forgery)	Loss of funds	Fraud proof system/at least three signatories/audits by finance committee
7	Wrong reference price used	Over-financing causing loss	Use of discounted grain price
8	Management infidelity	Loss of funds	Setting up audit roles for the finance committee
External Risks			
9	Lack of markets	Unsold seed	Pre-determined markets/seed financing at grain prices
10	Fire and burglary	Loss of seed	Insurance/security/firefighting equipment
11	Unscrupulous buyers	Loss of funds	Cash sales/payment before delivery
12	Failure to dispose of as grain when can't be sold as seed	Loss of seed	Avoid seed dressing till market is identified
13	Confiscation of seed by landlord over rent	Loss of seed	Use of own store/execution of a Landlords Waiver and Consent Agreement if rented store

The salient difference with traditional warehouse receipt models used in SCF is that there is no involvement of an independent collateral management agency and the management is fully internal with added responsibilities assigned to LSB committees and members.

SACCOs are provided with appropriate risk management strategies by ISSD as an incentive to participate. So far, two SACCOs are engaged for the SRS. To ensure successful implementation of the financing strategy, various preliminary interventions have to be undertaken at both LSB and SACCO levels.

Table 2: New LSB committee roles

LSB committee	Roles
Seed receipt system	• Development of quality parameters • Receiving seed • Conducting prescribed quality and quantity verification procedures • Documentation and issue of seed receipts • Performing store management duties • Seed quality control and maintenance • Ensuring security
Finance	• Receiving seed receipt from the depositor/holder • Discounting seed receipts • Borrowing from the SACCO on behalf of the LSB • Distributing borrowed funds to depositors • Creating loan accounts for seed receipt holders recorded by date • Recovering sales proceeds and retiring loan accounts with the SACCO accordingly • Presenting fortnightly audited records to the LSB for accountability and transparency
Marketing	• Identifying best markets for seed deposits • Presenting sale details to finance committee • Reconciling sales with seed released for sale by the seed receipt committee

Enhancing LSB governance and institutional preparation

To prepare the LSB institutionally for the SRS, necessary governance structures for financing venture management need to be established. This involves the creation of seed receipt committees and the introduction of new roles for other existing committees (quality control, marketing and finance committees). For *Omutima Gwa Ruhiira* LSB, each committee comprises three members of which at least one has to be female, as stated in the constitution (see committee roles in Table 2 above).

Addressing logistics

In preparation for SRS financing, there are a number of logistical issues that must be addressed. The SRS requires the use of an appropriate store with good structural integrity and adequate security for collateralised seed in stock, at least two high security padlocks per warehouse (each key kept by a separate LSB member).

For proper documentation and record keeping, various types of printed documents must be used for all seed parameters and movements. These include: weight notes, seed receipts, dispatch notes and payment vouchers.

To ensure proper storage, as well as avoid commingling of seed of different varieties and ownership, proper packaging and labelling of the seed receipted is needed which requires basic packaging equipment and materials for each warehouse. Other basic equipment required includes a weighing scale and moisture metre.

Finally, training of the warehouse committee entrusted with essential warehouse management responsibilities, including: receiving seed, proper storage and stock management, issuance of documentation fumigation, and security.

Amadrima LSB store

Developing procedures and correct documentation

Developing the procedures involves establishing effective working processes, including incorporating control mechanisms within the context of LSB's business environment. Key to this is allocating new roles to committees and members. It also means developing internal procedures which are practical and conscious of possible risks with adequate preparation for default scenarios and fail safes (e.g. dispute resolution strategies). These procedures are included in the terms of reference for LSB committees.

Warehouse receipt finance documentation involves the development of documentation for every step of the process while being mindful of document security and legality. These documents relate to receipt, storage, insurance, discounting, accounting and redemption, and safety protocols. Principal documents include: procedures and guidelines for seed receipt financing; warehouse and financial documentation (weight notes, seed receipts and loan ledgers); terms of reference for LSB committees (SRS, finance and audit); and training modules and materials.

Photos above and on the right: A SRS training session

Financial institutions intervention

A progressive approach is necessary to make seed receipt financing a viable financing opportunity for SACCOs. There is a need to convince SACCO management and board members to adopt the products. The participating SACCO loans officers are also trained in procedures and risk management strategies. Where necessary, the provision of risk management incentives, in the form of guarantee/on-lending funds, can be an incentive for the adoption of products by the SACCOs. Where necessary, this is achievable by the assignment of funds to a fixed deposit account in SACCOs - to act as guarantee and on-lending (third party) funds. Also, with SACCO interest rates known to be exorbitant, there is need to negotiate lower interest rates especially where they are beneficiaries of guarantee/on-lending funds. A lending rate of 2% per month was successfully negotiated with Ruhiira SACCO while their normal rate was 4%.

Challenges faced in SRS financing

Despite the justified objective of the SRS financing mechanism, there are many inherent challenges in the implementation of this approach.

First, there is the difficulty of convincing LSBs to take loans as a solution. This is attributed to reluctance to borrow and perceived high cost of financial products. This is overcome by explaining risk management strategies to LSBs and the fact that actual costs of semi-seasonal loans still allows for profit after paying interest.

Convincing and engaging SACCOs requires substantial effort, especially as they do not have experience with the product and perceive risks to be high. In addition, both the SACCO board and management must be convinced. The board requires a special Annual General Meeting (AGM) to adopt the product and approve any reduction in interest rates. Organising special AGMs at short notice is difficult and can cause delays in this time-sensitive financing schedule.

Most LSBs are young in existence, thus lack the necessary infrastructure and equipment for a viable SRS. Basic warehouse management requirements (appropriate storage space, quality assurance, packaging and security) must be fulfilled before considering seed receipt financing. This may require internal and external resource mobilisation to address these pre-requisites.

High interest rates can discourage farmers from adopting financing models if these interest rates will eventually lead to significant loss or lower profits. It is therefore crucial that financial mechanism sponsors educate famers about practical options of lowering borrowing costs e.g. negotiating lower interest rates, lowering loan amounts, and shortening loan periods by prompt sale of seed.

Achievements so far

Because the SRS pilot started in May 2015, *Omutima Gwa Ruhiira* LSB is yet to evaluate the SRS scheme. Still, many notable achievements are already apparent.

The LSB has fully accepted the SRS, complying with all necessary requirements and procedures. The relevant LSB providing seed as part of the financing mechanism and over five metric tonnes (MT) was deposited in *Omutima Gwa Ruhiira* LSB store using prescribed quality and packaging parameters for the season 2015A crop.

The Ruhiira SACCO easily adopted the products and agreed to lower interest rates in a bid to launch and market the new product. The SACCO also adopted recommended risk management strategies including prudent discounting rates, regulate monitoring and verification of stocks.

Farmers have received advances against the five MT seed deposit at *Omutima Gwa Ruhiira* LSB and loan recovery has started as sales happen.

Of the 68 members, 24 warehouse receipts were issued, against which lending was provided for 15, while nine opted not to borrow. Since group membership is both husband and wife this means that about 30 members borrowed under the scheme. Farmers still profited after borrowing. This is shown by the example of Prossy Ahumuza (see Box 2).

Prossy produced 733 kg of bean seed (Table 3). She has the choice of selling it immediately as grain at the price of UGX 2,000 per kg, where she will get an immediate UGX 1,466,000 or she can take a loan against a seed receipt with an initial disbursement of UGX 1,099,500. Her interest per kg is UGX 90 for the three months before the LSB sells the seed at a better price of UGX 3,000 per kg. After three months, Prossy will receive a further UGX 1,033,530. She thereby avoids losing UGX 667,030 (equivalent to 46% of the grain value) by using the SRS.

Box 2: Testimony - Brian 38 and Prossy Ahumuza 35

Brian and Prosy Ahumuza are married. Brian is 38 years old while Prossy is 35. Together they have six children of school age. They are both Omutima Gwa Ruhiira members as a couple and have been members for five seasons. Brian, however, is not a member of Ruhiira SACCO but is a member of another community-based organisation called the Millennium Village project.

Together they cultivate three acres of seed of which two acres are beans and one acre is potato. During the 2015A season, Brian produced 600 kg of beans while his wife harvested 733kg. They delivered their beans separately to the LSB seed store, and they received separate seed receipts. They borrowed against these on 25th August 2015.

They left some money with the LSB to buy foundation seed. With the balance, the couple added money to their joint business, partly paid school fees and bought goats. Three of these goats were female and have already produced six kids. Brian can now sell these and use the proceeds to pay off the remainder of the fees.

Compared with Brain's normal borrowing, SRS is cheaper with an interest rate of 2% rather than 2.5% per month. The disbursements were also timely and there were no hidden charges or fees. Brian also says he did not have to join Ruhiira SACCO in order to access the finance under the SRS.

Brian says that the SRS has helped him to better plan his businesses and affairs.

Table 3: Prossy Ahumuza comparison with and without SRS

		With loan	Without loan
With loan	**Unit**	**Value**	**Value**
Quantity	kg	733	733
Bean (Grain) price/kg	UGX	2,000	2,000
Bean (Grain) value	UGX	1,466,000	1,466,000
Seed price	UGX	3,000	
Loan Details			
Loan disbursement (75%)	UGX	1,099,500	-
Duration	Months	3	
Rate	per month	2%	-
Total interest paid	UGX	65,970	-
Seed sales	UGX	2,199,000	1,466,000
Net income (less) interest	UGX	2,133,030	1,466,000
Balance to member after sale	UGX	**1,033,530**	-
Difference in net income	UGX	**667,030**	
Percentage difference	UGX		**-46%**

Given the necessary arrangements and groundwork, SRS is an appropriate and sustainable solution to address LSB cash-flow challenges. It also provides new viable financing opportunities to financial institutions and can be duplicated to other LSBs of different entrepreneurship levels across the country.

Reference

• ISSD Uganda. 2015. Seed Receipt Innovation Report, October.

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