

# Informality of actors and its implications for Potato Value Chain upgrading in Uganda

## Executive Statement

*This brief summarizes the findings of the potato value chain study on the following factors; level of informality, size of operation and the length of relationships between the processors, traders and other value chain players<sup>1</sup>. The study reveals that most potato value chain actors operate on a very small scale and are informal- not registered and unlicensed. For instance, 70% of the interviewed agro-input dealers are small scale retailers and about 60% of agro-input dealers are not registered. Also, only 3% of traders are registered and 13% have trade licenses. Whereas 67% of processors have trade licenses, only 13% are registered. These findings suggest that there is a high level of informality in the sector. Business informality is costly to the government and to the public in terms of lost tax revenue and health and safety risk due to non-regulation and non-standardization. In addition, the high level of informality constrain value chain actors from obtaining formal credit and other sources for funding as they are not legal entities. Informality stems from cumbersome procedures and high cost of registering a business<sup>2</sup>. On the other hand, some business owners prefer to operate informally so as to evade taxes. Therefore, to enhance registration, the government should shorten the process and reduce the cost.*

## Introduction

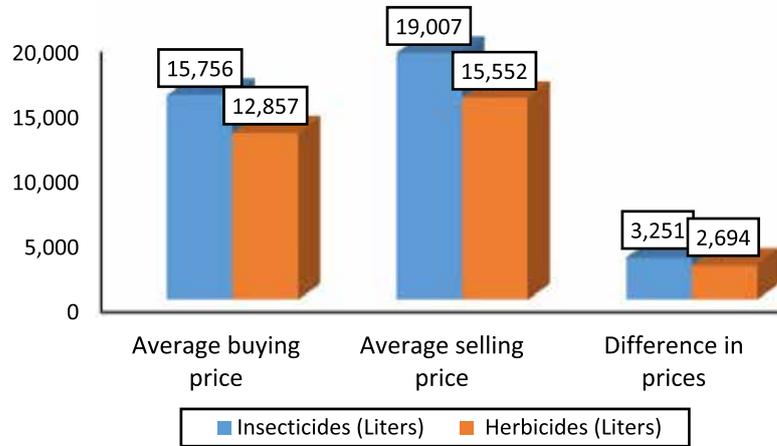
The informal sector is dominant in Uganda. The data from the Uganda National Household Survey (2009) shows that most of these informal businesses are in the agriculture sector<sup>3</sup>. The informal sector is characterized by small scale of operation, use of mainly family labor, and low survival of businesses. Mawejje (2013) suggests that informal sector is aided by a lack of robust enforcement mechanisms, and the desire to avoid paying taxes<sup>4</sup>. Business registration and formalization can be mutually beneficial to business owner, the government and consumers. The informal sector contributes a disproportionately small amount in taxation. Also, the informal sector is likely to produce sub-standard products due to poor regulation. In addition, informality constrains businesses from accessing credit, especially from formal financial institutions. This brief summarizes the findings from the potato value chain study in western Uganda, which explored the extent of informality

among the value chain actors and the extent to which different value chain actors have established demand and supply relationships.

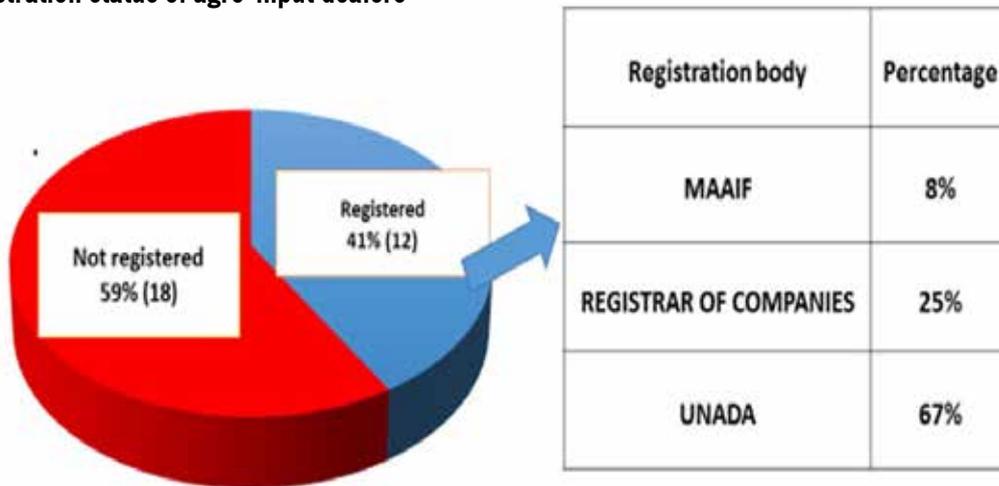
## Formality of agro-input dealers and their scale of operation

Most agro-input dealership operate on a small scale and are highly informal. Nearly 70% of the interviewed agro-input dealers, who are directly serving farmers, operate as small scale retailers and employ an average of 2.3 employees. Small scale operations constrain businesses from exploiting economies of scale partially due to high per unit costs incurred. As such, costs influence prices charged by most small scale agro-dealers. Figure 1 suggest that there are significantly higher margins between the cost of inputs and the selling price. However, high price charged by agro-dealers could also be due to high input demand which surpasses the supply.

**Figure 1: Agro-input buying and selling prices, Ushs**



**Figure 2: Registration status of agro-input dealers**



Source: PASIC Community and Market Survey of potato VC actors (May, 2015)

With regards to the level of informality, 59% of the interviewed agro input dealers were not registered (Figure 2). Unregistered dealers are largely unregulated. Poor regulation poses a threat to the quality of inputs being sold to farmers. Indeed, the presence of poor quality or fake inputs on the market is often cited as a major hindrance to technology adoption in Uganda. Indeed a recent study on the quality of fertilizers in Uganda revealed that the nutrient content in their sample purchased bags is much below the recommended and that the quality of inputs on the market is of low quality than is perceived by farmers<sup>5</sup>.

**Pic 1: The typical agro-input dealer in rural-south western Uganda**



### Formality and scale of operation of traders and processors

Activities related to potato value addition are still in infancy and on a small scale. On average, potato processors had been in operation for 4.5 years, and about 85% of them operate on a small scale. Most of them (87%) are not registered while 33% have no trade licenses, which means that they do not pay income taxes (Table 2). Similarly, traders, operate informally. From table 2, only 3% of traders are registered and 13% have trade licenses. (Table 2). However, traders operate on a medium to large scale because most of them act as agents and distributors to final traders in far towns such as Kampala

**Table 1: Level of informality in potato trading and value addition**

	Traders	Processors
Registered (%)	3	13
% with Trade License	13	67
Average Number of employees	5	3
Years of operation		4.5
<b>Scale of operation</b>		
Small scale (%)	10	84.4
Medium scale (%)	47	15.5
Large scale (%)	43	

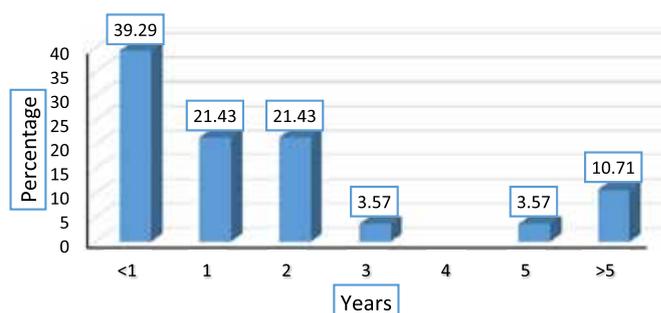
Source: PASIC Community and Market Survey of potato VC actors (May, 2015)

### Length of trading relationships between different value Chain Actors

Given that informal dealings are mostly based on trust, value chain actors tend to develop long term relationships between their potato suppliers and those they sell to. The study, however, reveals that this is not the case for processors. Figure 3

indicates that about 40% of processors have a relationship of less than one year with their ware potato suppliers, and 60% had a relationship of one year and below. This implies that, since they do not have established long term relationships, processors need formal arrangements to facilitate trading between them and other actors, and this can be through registration.

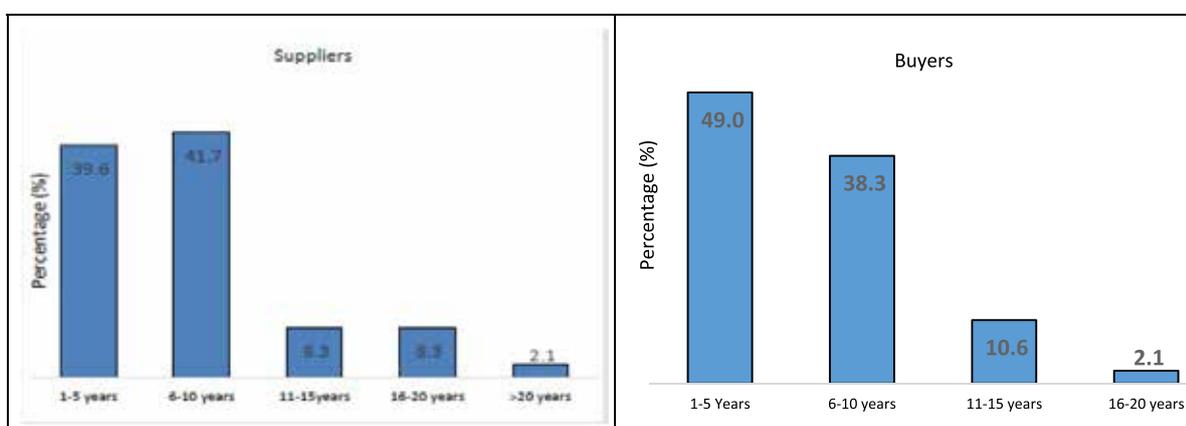
**Fig 3: Length of relationship between processors and the suppliers of ware potato**



Source: Community and Market Survey of potato VC actors (May, 2015)

Traders have a relatively long relationship with their ware potato suppliers and customers compared to processors. About 40% of the surveyed traders reported that they had 1 to 5 years of relationship. About 50% reported the same period of relationship with their traded potato buyers. This might be because trading in potato has a longer history than value addition. It could also mean that there is high competition in trading than in processing which incentivizes traders to develop these strong relationships so as to ensure constant supply of potato and market for traded potato, the kind of competition that is absent at the processing level.

**Figure 4: Length of trading relationship between traders and other actors**



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## Conclusions and Recommendations

The study concludes that business registration can be mutually beneficial to business owner, the government and consumers. On one hand, formalization of businesses by registration and licensing has revenue implications to the government through the taxation channel. In addition, formalization of businesses facilitates the government role of regulation, which ensure conformity to a set of standards. By extension, standardization of products improves consumer welfare. On the other hand, registration and formalization facilitates businesses access to credit, especially through formal credit institutions and other support organizations. However, the outlined benefits are largely not realized due to a high level of informality across the potato value chain in western Uganda.

To promote registration, licensing and formality across all the value chain actors, we recommend the following interventions: (i) the

government should enforce registration at all levels of potato value chain. More importantly, there is an urgent need to register and certify all agro-input dealers to enhance adherence to the set standards. Processors and traders should also be registered and licensed (ii). The International Fertilizer Development Centre (IFDC) model of linking farmers to traders and processors should be replicated in the entire region. This will create linkages and reduce the distance to the market and/or input suppliers and hence cut on the transaction cost.

Traders that have conducted business along these informal trading relationships with farmers for relatively longer periods can be identified and put at the forefront in the piloting the concept of strengthening marketing institutions. These can be backed by marketing infrastructure development, for example in the building of community potato stores in the planning of a potato zonal investment plan (ZIP).

## Footnotes

- 1 Mbowa Swaibu and Mwesigye Francis (2016). Investment Opportunities and Challenges in the Potato Value Chain Uganda. Draft report produced by Economic Policy Research centre (EPRC) under the PASIC project
- 2 Uganda: Ex Post Assessment of Performance under Fund-Supported Programs and Public Information Notice on the Executive Board Discussions, 2006. IMF Country Report No. 06/24. International Monetary Fund.
- 3 Uganda Bureau of Statistics (2010). Uganda National Household survey (2009/2010). Socio-Economic Module: An Abridged Report.
- 4 Joseph Maweje (2013). Tax Evasion, Informality and the Business Environment in Uganda. Economic Policy Research Centre (EPRC). Research Series No. 113
- 5 Luswata and Mbowa (2015). Revisiting Uganda’s Inorganic Fertilizer Supply Chain: Need for a Stronger Regulatory System.

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