Towards Sustainable Development

POLICY BRIEF

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The Constraints to Irish Potato Value Chain Financing in Uganda

Executive Statement

This brief summarises the findings from the potato Value chain study on what constrains the financing of potato value chain activities in Kigezi sub-region[1]. Access to affordable finance remains a challenge to potato producers, input dealers, marketers and processors in Uganda. The key constraints to accessing credit from formal financial institutions are long loan application processes and collateral requirements. On the other hand, undercapitalization and high interest rates limit the capacity of informal credit sources to satisfy credit demands of the value chain actors. The value chain study results show that a majority of value chain actors rely on personal savings and small loans from informal credit sources. Most potato traders, and small-scale processors obtain loans from village savings and loan associations (VSLAs). Only 17% of potato producers, and less than 30% of agro-input dealers use formal sources of finance from commercial banks despite the low interest rates charged relative to the informal VSLAs. The consequences of limited financing of value chain actors are low productivity and technology adoption at farm level which affect the business growth in potato trading and processing. Therefore to unlock and deepen agricultural financing, formal financial institutions can leverage on both capitalization capacity and the relatively low interest rates to design credit packages for agricultural value chain actors with shorter loan application processes. In addition, formal

Introduction

The current focus of agricultural development emphasises a commodity approach, and stresses the development of agricultural value chains. Indeed, the National Development Plan 2015/16-19/20 states that the government will employ a value chain analysis to identify interventions that can aid spur agricultural sector growth[2]. One of the documented strategic pillars of boosting agricultural growth is opening up avenues to increase financing of agricultural sector activities. Apparently, agricultural lending by formal financial institutions is still low in Uganda because agricultural activities are considered risky. The National Agricultural Policy (2013) notes that agricultural production ventures are vulnerable to many risks including weather vagaries, pests and diseases, which increases the costs associated with agricultural loan recovery[3]. However, knowledge on the status on financing of marketing and processing value chain activities is scanty. This brief pieces together information on sources of agricultural financing in a value chain framework using potato as a case study.

Financing of potato production activities

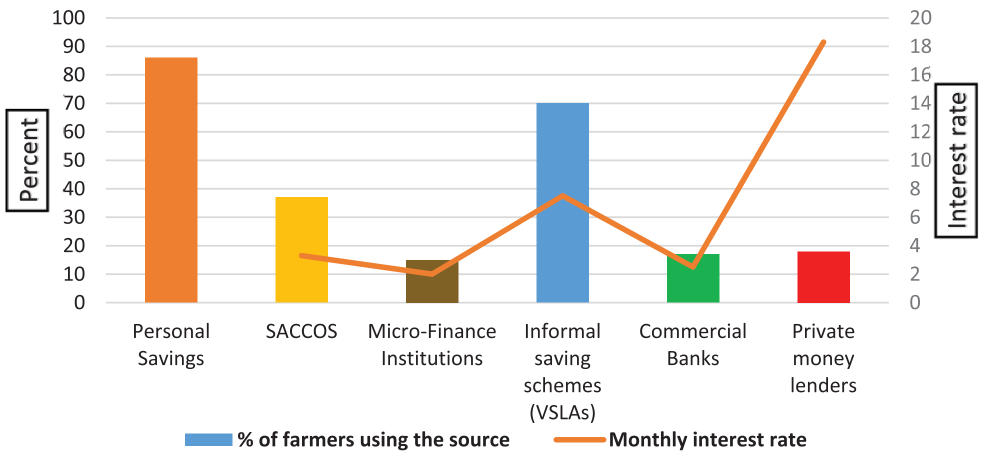
This study reveals that production is mainly funded using personal savings, and majority of farmers who use credit (70%) obtain loans from village savings and loan associations (VSLAs). However, one limitation is that such loans tend to be small, because they are drawn from farmer group savings, and VSLAs charge a higher interest- 8% per month- which is higher than most market rates (Table 1), with the exception of the private money lenders who charge 18% interest rate. Despite the high interest rates, farmers noted that VSLAs have better repayment terms because the owed amount is usually deducted from shares owned by the farmers. Interestingly, fewer (17 % and 15%) of farmers reported to have exploited the relatively cheaper credit sources such as commercial bank and MFIs which charge interest rate of 2.5% and 2%, respectively (Figure 1).

The value chain study also examined what discourages potato farmers from using the relatively cheaper funding from formal financial institutions and found that (i) lack of collateral (usually land); and (ii) fear of losing the property that is offered as collateral to the creditors. Other factors cited include: long loan processes and difficulty in paying back promptly, especially in cases where payback period does not match time of harvests. Another constraint to accessing funding from banks is location of formal financial institutions. For instance, most commercial banks only have branches in urban areas, which is far from rural farmers.

Financing of agro-input dealers

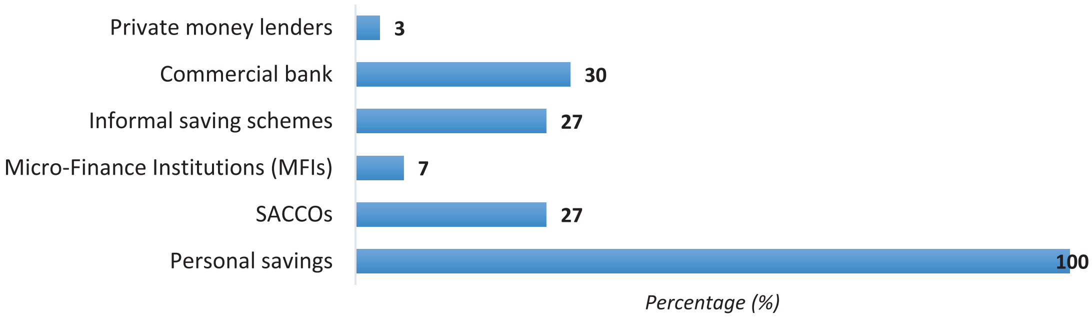
The agro input dealers play a critical role in the transfer of technologies that enhance productivity at farm level. However, they face financial constraints. Indeed, all of the surveyed agro-input dealers indicated that they mainly use personal savings while less than 30% of the input dealers use any of the available credit sources- both formal and informal. For instance, 30% use commercial banks; Infromal savings and SACCOs (27%); MFIs and private money lenders, 7% and 3%, respectively (Figure 2).

Figure 1: Sources of finance for potato production and interest rates



Source: Computed using the data from PASIC Community and Market Survey of potato VC actors (May, 2015)

Figure 2: Sources of funding to agro-input dealers, %



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

Note: The percentages above are computed from multiple responses, that is why their total is greater than 100. We use the number of borrowers in the computation

Financing of potato marketing and value addition

Table 1: Amounts of money (UGX) typically borrowed to finance potato related investments

Source of loan	Processors			Traders	
	Minimum	Maximum		Minimum	Maximum
Informal Savings schemes (VSLAs)	275,294	719,706		540,000	1,533,684
SACCOs	150,000	250,000		1,100,000	1,650,000
Commercial Banks	1,000,000	4,250,000		2,230,000	6,500,000
Microfinance institutions				400,000	400,000

Source: Authors' calculations using 2015 potato value chain survey data

Like farmers, potato traders and small-scale processors also mainly obtain loans from VSLAs, but largely rely on personal savings to invest in their businesses. As mentioned above, the major limitation of VSLAs is that the sizes of approved loans are usually smaller than what is required. Indeed, Table 1 shows that processors and traders that have used banks can borrow almost four times what they get from informal saving schemes.

This is consistent with FINSCOPE III Survey 2013 report, which indicated that over 85 percent of borrowers received loans not exceeding one million shillings[4]. Evidently, processors and traders have not exploited cheaper sources of financing that lend sizeable loans at a competitive interest rate, notably; MFIs, Savings and Credit Cooperatives (SACCOs) and commercial banks (Table 2).

Conclusions and Recommendations

One of the major pathways to enhancing potato production and productivity, marketing, and value addition is increased access to cheap finance. However, the study revealed that financing is still a constraint at all levels of potato value chain. Most of the value chain actors use informal finance sources, which offer smaller than required size of loan and charge high interest rates. The value chain actors also reported that collateral requirements, long loan application processes and short repayment periods that do not march harvest timings are the major hindrances to the use of formal credit sources. The following interventions are proposed:

- The formal financial institutions should leverage on both high capitalization; and the relatively low interest rates to

Table *2*: Sources and costs of financing investments in the potato value chain

Source of financing	Percentage using source of financing		Monthly interest rate (percent)	
	Processors (n = 30)	Traders (n = 30)	Processors (n = 30)	Traders (n = 30)
Personal savings	100.0	100.0	N/A	N/A
SACCOs	6.7	13.0	4.0	9.8
Microfinance institutions		3.0		
Informal saving schemes (VSLAS)	56.7	63.0	6.7	5.2
Commercial banks	10.0	20.0	2.5	2.5

Source: Authors' calculations using 2015 potato value chain survey data design credit packages for agricultural commodity value chain actors with shorter loan application processes. Such credit packages need to match the loan repayment periods with crop harvest times as this will calm farmers' concern that servicing loans before harvest is difficult and that they might not meet their obligation of timely loan repayment.

- There is need to strengthen and formalize the informal lending schemes so as to facilitate their loan recovery efforts, and together with development partners should capitalize them so that they are able to meet size of loans demanded by farmers.

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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 The republic of Uganda (2015). Second National Development Plan (NDPII), 2015/16-2019/20.
3 MAAIF. (2013). The National Agriculture Policy. Entebbe, Uganda: Ministry of Agriculture, Animal Industry and Fisheries.
4 FINSCOPE III Survey 2013 Findings Unlocking barriers to financial inclusion in Uganda. November 27, 2013

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