One of the areas with so much to contribute the goals of the National Development Plan.
“Less finance, but a greater variety of products” sums up 2008 as far as financial services for the agricultural sector are concerned. This publication, the Yearbook on Agricultural Finance for 2008, seeks to reflect the main issues, actions, successes and failures experienced in Uganda during the year, in the overall area of financial sector support to agriculture – one of the areas with so much to contribute to achieving the goals of the National Development Plan.

The past year, 2008, has not been an easy one for those working in agricultural value chains, and seeking financial services - not only loans for working capital but more especially longer term finance for investment purposes. Data from the Bank of Uganda, presented in the chapter entitled ‘Trends in Agricultural Finance’, suggest that the overall volume of lending to the agricultural sector contracted slightly compared with the previous year. However, to some extent this was compensated by a substantial increase in the volume of leasing contracts for agricultural machinery.

Indeed, leases are one of the newer financial products now making their mark on agricultural value chains. The article in the Yearbook, ‘Will Leasing Boost Agricultural Finance?’ explores the advantages of this financial product, but also highlights urgent actions needed on the part of government to improve the effectiveness of leasing in boosting investment in farm production and in downstream processing.

Another notable new product is term finance for draught oxen purchase and for the acquisition of ox-drawn implements. The experience of one commercial bank that is a pioneer in this area of lending is covered in the article, ‘New Term Lending Products: Animal Traction Investment’.

Several articles cover the growth of structured finance products, where the existence of linkages other than finance facilitates the lending/borrowing process. Examples range from small-scale sugar and tea growers to a large cotton ginner/exporter. A related example deals with the largely negative experience of a seeds company using a novel financing model.

Turning now from products and mechanisms to institutions, the dilemma as to how best to ensure servicing rural areas with efficient and honest financial services for the benefit of farmers has yet to be solved. The record here is indeed patchy. One article shows how a successful SACCO has focused on agricultural lending; another deals with harnessing technology as a means of addressing structural weaknesses and operational inefficiencies in SACCOs. Despite a few bright spots, the overall task ahead to strengthen SACCOs is enormous – as suggested in the article on training SACCO managers, staff and directors.

Again on the institutional side, two of the early articles in the Yearbook take a critical look at the effectiveness of fiscal incentives designed to encourage commercial banks to lend to individuals and companies in agricultural value chains. The result has not been encouraging, but the articles point out how policy changes could be developed in a more fruitful manner – by involving intended beneficiaries in the formulation process.

It is hoped that the changes being introduced by government in 2009 will encourage rather than stifle the very necessary improvements in this area.

Finally the Yearbook includes articles from the Bank of Uganda on the ongoing study geared to calculating Domestic Resource Costs of a wide variety of commodities, and also from the World Food Programme on experiences with the domestic sourcing of foods such as maize.
One of the areas with so much to contribute to the goals of the National Development Plan.
BACKGROUND

The Government of Uganda made a commitment to its people to reduce absolute poverty to below 10% by 2017. The commitment was to be achieved through a national framework for poverty eradication - PEAP. The design of the Poverty Eradication Action Plan (PEAP) started in the mid-1990s and was endorsed in 2000 as the country’s PRSP (Poverty Reduction Strategy Paper – a World Bank initiative). As early as 1995, government realized that the macroeconomic policy reforms that had brought growth (10% in 1994) to the country in the early 1990s were necessary, but were not sufficient for poverty reduction. Therefore, there was need both for a shift in policy direction and for a comprehensive strategy designed to address the concerns of the poor.

PEAP was launched in 1997, and it was from PEAP that other plans and policies emerged, such as the Education Sector Investment Plan (ESIP), the Health Sector Strategic Plan (HSSP), the Road Investment Programme and the Plan for Modernisation of Agriculture (PMA). Their implementation was undertaken in the context of decentralization, privatization and the sector-wide approach. The 3-year PEAP was revised twice (2000 and 2004). It has now been replaced by the 5-year National Development Plan (NDP). The NDP presents overall national policy objectives and a development framework for key development thrusts with a theme on economic growth, employment and prosperity.

WHAT WAS PLANNED FOR IN THE PEAP TO ADDRESS AGRICULTURE AND AGRIBUSINESS FINANCING?

Before stating what was planned in the PEAP for financing agricultural business, it is important to indicate its role in agricultural development. Constraints to agricultural development are many. Access to financial services is only one response to these constraints, but improvements in the provision of and access to financing for agriculture can meet a range of needs, and it can be critical to the success of agricultural development programs. Indeed, many investments in agriculture depend on access to appropriate financial services. At the production level, financial services for agriculture can enable farmers to introduce external or purchased inputs such as: irrigation or other productivity-enhancing technologies; finance input and marketing costs; co-finance extension and information services; bridge the pre-harvest income gap; prevent forced sales of produce immediately following harvest at low prices; smooth seasonal income flows through deposit facilities, facilitate access to remittances, and bank overdraft lines; and eventually to insure against price or yield fluctuations. If agribusinesses cannot access financial services, their capacity to finance and supply farmers, and to buy and process farm produce, is restricted (Pearce et al, 2006).

Agricultural Financial Services (AFS) include; savings, credit, money transfers, leasing, and insurance for agriculture and agriculture related activities, which may be defined along enterprise value chains to include primary production, processing, distribution, and marketing. The farmers have had limited access to financial services. This limitation has particularly impacted the poor, agriculturally dependent households in rural areas.

Thus, the Poverty Eradication Action Plan (PEAP) and its supportive strategies, the PMA and the Medium Term Competitiveness Strategy (MTCS), articulated measures for the development of micro and rural finance. The PEAP recognized the need for better access to agricultural credit for smallholders as a key catalyst for enhancing production, competitiveness and incomes. It also recognized the need for legislative reform as a tool for mobilization of deposits from the public in a prudent manner.

It is important to note that there are two distinct systems that provide financial services. The first system is the formal financial sector, which comprises 20 commercial banks, 3 development banks and 5 credit institutions and 3 micro-deposit taking institutions, which are located mainly in Kampala and Jinja. Except for Stanbic Bank, and Centenary Bank, most of the commercial banks lack an adequate branch network and therefore are not very significant providers of financial services in rural areas.

The second system comprises institutions such as the Micro-Finance Institutions (MFIs), Civil Society Organisations (CSOs), Community Based Organisations (CBOs), so called “Village Banks”, private Money Lending Companies, and the Savings and Credit Cooperative Organisations (SACCOs).

In recognition of the above factors, under the PMA design, the importance of rural finance in the transformation of agriculture was recognised. It noted that access to finance was restricted for the majority of farmers. Thus, a complete pillar or thematic area was included in PMA² on rural finance services, with the objective of spreading sustainable financial services to underserved rural areas, to reach as many rural people as possible. Its long run vision is “an efficiently nationally integrated system of financial institutions and intermediaries capable of accomplishing financial intermediation in rural sectors”. The mission is to “to put in place a system and institutional arrangements that will ensure increased availability of market based rural financial services in Uganda on sustainable basis”.

The following have been the key strategic elements, to:

(i) focus on MFIs (microfinance institutions – including SACCOs) as an immediate strategy, given their comparative advantage in operating at the grass-roots;

(ii) target widespread geographical outreach in terms of service points per unit area given that agricultural production units are widely dispersed, small scale and diverse;

(iii) target coverage of a large proportion of the rural population by MFIs;

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1. One of the areas with so much to contribute to 2. The goals of the National Development Plan.

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1. Pearce Douglas (CGAP), Andrew Goodland, & Andrew Muliibi, with researcher support from Amabile-Baez (CGAP) & Irene Eseanyi, MRI. Post-review comments provided by Cornelis van der Meer, Carlos Garcia, Horstus Kja, Renato Khaypingo-Todd, William Steel, Jock Anderson, & Karine Saito.  

2. PMA has seven Pillars: Extenstion (NAADS), Research (NARS), Education, Financial services, Natural resources, Marketing and agroprocessing, and Rural infrastructures.
(iv) train MFIs and their clients for effective rural finance intermediation through use of international best practices; and,
(v) specifically target women groups in the delivery of MFI services

The Microfinance Outreach Plan (MOP) was finalised in October 2003 as the implementing vehicle for the above pillar, aiming at “expanding the outreach of sustainable microfinance in Uganda” with a target of creating 40 new MFI branches and 40,000 new clients by June 2006 through:

(i) Augmenting outreach with a shift from the current concentration in urban areas to rural areas;
(ii) Consolidating MFIs, including linkages between different tiers and the diversification of products; and,
(iii) Improving the environment for microfinance by strengthening the supervisory and regulatory framework and introducing an incentive scheme for MFIs that does not conflict with the regulatory framework.

Five policy issues were to be given high priority:

(i) Legal and regulatory framework to be spearheaded by the Bank of Uganda in collaboration with the micro-finance industry and other stakeholders;
(ii) Capacity building for MFIs;
(iii) Privatization of government credit projects/programmes by which the state would withdraw from direct delivery of credit and focus on policy formulation and capacity building;
(iv) Promotion of other MFI initiatives, including allowing foreign-based NGOs to enter and operate freely in the rural finance industry; and,
(v) Promotion of formal banking system involvement in rural finance.

WHAT IMPACT WAS ACHIEVED BY THE PEAP ON THE FINANCING OF AGRIBUSINESS?

While implementation of the PEAP/PRSP has not been a mean task, the country has reaped immense benefits particularly arising from expansion in service delivery to the poor. The proportion of people below the poverty line has fallen from 44% in 1997 to 31% in 2005 with 42% and 12% incidence among rural and urban dwellers respectively.

The micro-finance industry and the associated institutions have emerged mainly during the last 15 years and are providing services needed by the poor that cannot be accessed from the commercial banks. Their types of products and modes of operation differ from those of commercial banks and they have, to a large extent, developed a comparative advantage to provide financial intermediation in rural areas on a viable and sustainable basis. For example, by 2006, the microfinance outreach stood at 2 million Ugandans, though these were mainly residing in the major towns and along the major highways.

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The Micro-Finance Deposit Taking Institutions (MDI) Bill was passed by Parliament in November 2002. The Act arising from the Bill spells out operations of micro deposit taking institutions and enables MFIs to become licensed to intermediate savings while enjoying the benefits of supervision by the Bank of Uganda.

Access and availability of rural finance services improved with MOP implementation through the utilisation of the MCAP funds and capacity building to nine MFIs. This led to the establishment of 12 new rural branches reaching 23,000 new clients in line with the rural finance targets of 10 new MFI branches and 10,000 clients every six months agreed by the third PMA Joint Annual Review of November 2004. Figure 1 below gives an indication of the shares of loans per sector. Female borrowers dominate all categories of economic activities. For example, in 2007 they accounted for 72.4 percent of borrowers in commerce, 63.2 percent in services, 60.5 percent in animal husbandry and 47.7 percent in manufacturing. There are more savers than borrowers. There has been growth in loan portfolio (87 billion shillings) and volume of savings (129 billion shillings). However, the average loan size and savings remained low (UShs 262,553 or US$ 140 and UShs 160,713 or US$ 87, respectively) in all categories of institutions.

WHERE DID THE PEAP FALL SHORT?

Many Microfinance institutions (MFIs) have tended to avoid less densely populated or diversified rural areas and the financing of seasonal or longer-term crop and livestock activities.

The majority of MFIs are located in urban areas with good infrastructure. They have mainly supported petty trade or micro-commercial enterprises. Their products have also largely not been suitable for agricultural production because they have very short repayment schedules and periods, purely commercial lending interest rates, limited or no borrower education (financial extension services), and lack medium to long term financing and/or linkage to formal financial institutions.

The cost of borrowing has remained too high (2% to 20% per month from MFIs and money lenders, respectively) to be justified by the incidence of loan default and non-performance.

The rural input markets are not yet adequately developed and farmers in many parts of the country are unable to find improved farm inputs.

Medium to long term finance is also largely still unavailable for financing agriculture.

There also regional disparities in the spread of MFIs, with some districts especially in the Northern and Eastern parts of the country being least served. In particular, newly created districts have had and still have low MFI coverage.

WHAT LESSONS LEARNED ARE BEING CARRIED FORWARD INTO THE NATIONAL DEVELOPMENT PLAN (NDP)?

Principal lessons learned for supporting MFIs and other financial institutions to move into providing services for farmers are given below.

Poor smallholder farmers need the whole range of financial services: secure savings deposits; loans to purchase non-labour productive inputs; consumption credit for tiding farmers over a low season; for remittances and for financial transfers. Those farmers who are in the “commercial” category also need reliable and effective rural financial services. Through advisory services based in part on careful enterprise value chain studies, with identification of suitable investments, this group of farmers should be facilitated to invest in land improvement, to acquire new high yielding and labour saving technologies. They should also be assisted in managing the risks inherent in the farm production cycle. Therefore, these services need to be fully integrated into the NAADS programme and other related advisory services. Even for off-farm, non-agricultural activities, effective integrated financial services can help establish or expand family enterprises and, therefore, enhance households’ capacities to move from poverty to sustainable prosperity.

Lending to agriculture and specifically to small farmers is an unattractive to most financial institutions. Therefore, approaches should be explored to make the sector more appealing. Indeed, the principal problems associated with lending to smallholder farmers are known, they include:

(i) high demand for loans at the start of a season, followed by a period of several months without income during which it may be difficult to make repayments:

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* Based on the FINSCOPE Report, 2007 (DFID) Financial Sector Deepening project. Results of a national survey on access to financial services in Uganda.
Sample of 4,553 adults interviewed, results extrapolated to rural population using the 2002 census data. 77% living in rural areas and the rest in urban areas.
(ii) the difficulty of mobilising savings from agriculture;
(iii) the low number of commercial and semi-commercial farmers;
(iv) high costs in lending to large numbers of widely dispersed small farmers (searching, screening, monitoring and supervising loans);
(v) tendency towards ‘default’ by some farmers due to past experience of not suffering penalties following default or being ‘advised’ not to pay back by conflicting interests.

The majority of MFIs (63.7 percent) in Uganda fall within the category of small institutions, which include multipurpose NGOs, cooperatives (SACCOs) and informal organizations. This category of MFIs is limited by liquidity and is hence unable to provide larger sums for a longer period, which grossly affects the ability of economic activities to expand. They require improved collateral and character assessment, given that the current loan portfolio at risk is estimated at above 25 percent on average.

If they are to operate efficiently, these small MFIs require capacity building in the areas of book keeping, financial and business management, product development and diversification, improving their management information systems, building their asset base and applying the best practices in the industry.

OTHER LESSONS ARE:

- Farmers’ credit needs vary from year to year and from season to season. At critical or peak farming periods during the year, farmers need financial services because the realisation of income from the sale of farm produce and patterns of household expenditures do not often coincide. Flexible disbursement and repayment schedules are keys to successful agricultural lending, although they may increase default risk and present liquidity management challenges.
- Diversification at the portfolio and client household levels can reduce the risk for MFIs that expand their financial services to agriculture, but these strategies can also restrict access to services among farm households that depend on agriculture. Non-financial interventions to improve market access and infrastructure may make these clients more attractive in the longer term.
- Technology can help lower costs and expand rural finance operations, but first a careful cost-benefit analysis should be conducted, and the MFIs management information system (MIS) may need to be upgraded.

In the face of this situation, recent experience suggests that an optimum general policy is to encourage and enable the various components of the supply side to play to their different strengths.

Following this policy, SACCOs and MFIs that are in close proximity to rural communities should focus initially, and perhaps even primarily on the provision of secure savings services, with the public authorities supporting this with appropriate training and supervision. With this focus, clients of MFIs and members of SACCOs will be enabled to build a worthwhile “owned” base for investment, whether or not this is fuelled with some borrowing.

The emergence of savings and credit groups alongside or within farmer groups, if well regulated, are a good opportunity that the PMA and NDP could build on to make rural finance more relevant to small farmers.

MDIs and commercial banks could be relied on to do what they can do much better than Tier 4 institutions, i.e. make sound loans within the agricultural sector, especially the medium and long term loans that are so essential to building labour productivity within agricultural commodity value chains.

Following this policy of partial specialisation, the opportunities for working linkages (information sharing and funding) between Tier 4 on the one hand and Tiers 1, 2 and 3 on the other are huge. However, these require encouragement from the public sector, including from the regulatory entities.

Public investments can help microfinance providers meet the challenges of financing for agriculture by making adaptations to conventional financial products and delivery mechanisms. Equally important are public investments in building the capacity of the institutions so that they can become more responsive to the needs of rural based savers and borrowers. This includes close attention to the supervision that is essential for safeguarding savings deposits against losses from mis-management and fraud.

CONCLUSION

Uganda’s poverty eradication policy framework is undergoing significant change. The change involves moving the poor from poverty to prosperity using productive sectors such as agriculture to achieve the transformation. The country’s agricultural sector embraces a wide range of production, processing and marketing entities. The range involves enterprise size, enterprise familiarity and knowledge, as well as exposure to and nature of the interface with providers of financial and other services.

Given the variety of users of financial services, i.e. the demand side, the supply side – providers of such services need to be able to interface efficiently with a wide range of clients – or to specialise in just one section. The Ugandan financial sector is using both approaches. Those commercial banks with a well-developed branch network are tending to develop products targeted at farmers – albeit the more commercially-minded within the farm community. MDIs tend to follow the same pathway, while the smaller MFIs and SACCOs struggle to survive, riding on a clientele which is in precarious economic circumstances, while they too suffer from governance issues and lack of supervision, both leading to losses through poor management and even fraud.

Figure 1: MFI loans by sector as at 30 Sept 2004

ZONING FOR AGRICULTURAL DEVELOPMENT IN UGANDA

Uganda is blessed with a wide range of natural resources and a substantial agricultural potential. However, most production is still subsistence and production specialization has barely emerged. Similar agricultural enterprises can be found in many parts of the country. For example, maize can be grown in almost all districts. The result is high costs of product assembly and transport to markets. Economies of scale, the potential for which would attract agribusinesses and agro-industries into the production areas, are not currently in force.

In 2004, Government launched a national Agricultural Zoning Strategy to promote agricultural enterprises (crops, livestock and fisheries) in those agro-ecological zones of the country with natural resources and a substantial agricultural potential. The strategy, which is based on exploiting the principle of comparative advantage, maps Uganda into 10 agricultural production zones.

Besides economies of scale, other benefits of agricultural zoning include: making it easy to target provision of marketing services such as market information and extension and rural finance to farmers. It should also increase agricultural production and productivity, as well as facilitating greater efficiency in commodity value chains. In addition it makes it easier to plan and utilize zonal resources, such as infrastructure, more effectively.

The map below shows the agricultural production zones and the enterprises that have been prioritised for each zone.

Map of agricultural zones and selected enterprises
of commodity value chains. In 2005, USAID commissioned value chain analyses for maize, sunflower and cotton in producing areas of these commodities in Uganda. These analyses also provide a template for lending institutions to assess the risks and how to mitigate them with appropriate financial products. An example of the risks and opportunities for a maize value chain in Kapchorwa is reproduced in Table 2, taken from the USAID Uganda report of October 2005 entitled "Value chain governance and access to finance: maize, sugar cane and sunflower oil in Uganda."

**Table 2: Transaction Point, Risks and Financing Opportunities**

<table>
<thead>
<tr>
<th>TRANSACTION POINT</th>
<th>RISKS</th>
<th>FINANCING OPPORTUNITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Input supply node</td>
<td>Retail prices fall</td>
<td>Short term lending product of only 1 to 2 months to limit lender exposure</td>
</tr>
</tbody>
</table>
| Production        | Farmgate price below cost of production | - Forward contracting by major buyers  
                      |                                    | - Price and quantity guaranteeing before planting                                     |
|                   | Loan term longer than production, marketing cycle | - Adjust term of loan product to match seasonal production, marketing cycle |
|                   | Yield lower than expected             | - Design loan product to pre-finance a proportion of total cost of production  
                      |                                    | - Loans based on warehouse receipts so as to lend only post harvest                     |
|                   | Acreage borrowed for not realized     | - Design financing product where funds are only released against tasks realized in production and marketing cycle |
| Local traders     | Transport is inadequate               | - Offer finance and operating leases for trucks  
                      |                                    | - Make contracted transport part of the loan contract                                 |
|                   | Price is below cost of procurement   | - Finance only against forward contracts  
                      |                                    | - Opt for loans based on warehouse receipts so as to lend post delivery                   |
| Regional traders  | Transport is inadequate               | - Loan only to a trader who own or contract their transport                           |
|                   | Price is below cost of procurement   | - Finance only against contracts  
                      |                                    | - Loan only to traders with a healthy equity position                                   |
|                   | Traders may default willfully         | - Finance only borrowers that assign their sales contracts with their buyers to the lender for deduction of repayment |
|                   | Quality may be below contract specifications | - Finance only traders with verifiable access to proper cleaning and drying machinery  
                      |                                    | - Finance cleaning and drying facilities in addition to trade finance                      |

Though some of the financing opportunities are not financing actual production, by improving efficiencies in services as well as input and output markets, production is clearly encouraged. What this implies is that government, in collaboration with lending institutions, maps enterprise value chains (by quantifying expected costs, returns to investment and risks) in different agricultural production zones. This may enhance the relevant knowledge of lending institutions, and increase their confidence in the introduction of agriculture finance products in their portfolios.

Some companies have already invested in their supply chains through out-grower schemes built around centralized nucleus estates. The objective is to gain both quantity and quality in the production phase of the value chain. The typical pattern is that the companies provide inputs and services, such as seed, tractor or oxen services for ploughing; transport of product, as well as extension. Some companies provide these at no cost (with the implication that the costs of doing so are recovered when the harvest is delivered to the nucleus estate), others make a charge. In the latter case, the inputs and services are usually provided as a loan, again to be recovered on sale of the product. Still other companies focus on a buying contract to ensure farmers have a guaranteed market (and the processors have a secure supply of raw material), but do not extend credit for inputs and services.

The companies operating in this way have tended to concentrate their activities in certain districts or zones. The companies include: British American Tobacco (BAT) for tobacco in the West Nile region, Mukwano Industries for sunflower in Lira, Tilda Company for paddy rice in Eastern Uganda, Kaweri Coffee Plantation for coffee in Mubende, and Dunavant for organic cotton in Acholi sub-region.

The scope of control of quality and quantity is tight, as input supplier, transporter, final buyer and loan financier are often the same company. The opportunity for lending institutions lies in financing large input dealers or service providers. Farmers can then assign their forward contracts to the lender and will deduct the repayments from the cash payments due to the farmers, repay the lender and pay the producers their balances.

The mutual benefits generated by this model are such that government should continue to support these contract farming linkages between farmers and big buyers/industrial processors. Indeed the NAADS programme has fostered business relationships between rice farmer groups in eastern Uganda with Tilda, sunflower farmers in Lango with Mukwano and tea farmers in Bushenyi with Igara Tea Factory. Government should look at other aspects of facilitating the chain including contract enforcement, market information services and providing the needed infrastructure.

The PMA Secretariat has also undertaken value chain analyses for 8 agricultural commodities. These are: maize in Busoga region, citrus in Teso sub-region, dairy in Western region, honey in West Nile, sunflower in central region, aloe vera in Tororo district; cotton and rice in Lango and Acholi sub-regions. One of the services explored is the availability and access to finance at all the nodes (transactions points) of the value chains.

Proposals on how to improve financial service delivery have also been developed by the PMA. The results will provide an input into strengthening value chains and their funding, within the national budgeting processes.
large scale farm production and downstream activities are substantial. They deliver their returns over a number of years and repayment similarly can and should stretch over several seasons. Given the forward price/marketing and other risks for the longer term investor, interest rates on such financing should be quite low if these desirable investments are to be made. This is recognized by some international financial institutions, such as the East African Development Bank, the World Bank and the African Development Bank, each of which has a window for long term lending to governments at very low interest rates.

To facilitate longer term agricultural financing, the government may seek to borrow from these institutions, and pass the money through commercial banks. These banks would then lend to farmers and agribusinesses at very low rates compared to prevailing commercial rates. This would be much lower rates.

CONCLUSION

The agricultural zoning strategy has several advantages. It provides an opportunity for Uganda to accelerate specialization of agricultural production based on zonal comparative advantages, making it easier for government and the private sector to concentrate their resources and services for a particular commodity or enterprise in a particular zone.

There are several examples in Uganda where production has evolved around the agricultural production zones and this provides an opportunity to develop financial products for particular commodities, either through the private sector or through government.

Government should therefore foster further agricultural development through its zoning strategy and provide (such as long term funding) to the private sector to foster the development of suitable agricultural financing products.
deliveries. Without this structure, financing of production is more difficult. The same can be said for financing of ginning, as loan repayment will depend on a throughput of guaranteed minimum volumes of seed cotton. If the seed cotton supply cannot be guaranteed, finance for ginneries can also not be extended.

ORGANIC VERSUS CONVENTIONAL PRODUCTION

In step with the demise in zoning and fueled by the inability of ginner to provide inputs and recover the input costs through cotton deliveries, organic cotton seemed to offer an opportunity to grow, process and export a lower input cost crop while still attracting a good margin for both farmers and ginner. Several exporters engaged in encouraging organic production, while also pursuing organic export markets.

Given the recent downturn in cotton demand, and the fact that organic cotton is a luxury item, prices for organic cotton globally have collapsed. Further, within Uganda, contamination from the spraying of DDT for public health reasons has also rendered organic certification (and recertification) impossible in many geographical areas.

CDO contends that certain ginner undertook organic production and marketing in good faith to support farmers with higher prices while they were unable to provide inputs because of free riding competition. CDO further contends that certain ginner undertook organic production and marketing to save costs and squeeze the highest margin possible out of farmers’ meager production while capturing high profits for themselves.

Again according to CDO, the small UGX 50 premium for organic cotton further underpinned the selling of conventional cotton from other areas in Uganda to the organic areas because chemicals are not detectable in cotton lint (only in the plant itself). The net result of this was that other ginner were starved for cotton and their businesses damaged. The author is aware that organic processors contend that yields are not significantly different and that the UGX 50 premium more than compensates for any reduction in yields. Field data, particularly from the now closed USAID/APEP project did not support this position though with the right improved organic inputs, this might be true. Nonetheless, reduced yields, unpredictable volumes and political discord discourage any value chain financing that might otherwise take place.

FORWARD PRICE SETTING

In 2008, there was a proposal for a jointly funded donor initiative (EC, GTZ-Sida and USAID) to set the forward price for cotton against a put option purchased on the New York Board of Trade. The hedge was meant to extend the benefit of establishing a minimum price to the entire cotton industry, even though the four largest merchant ginner (Dunavant, Olam, Plexus and Rheinhart) already hedged their forward price.

The idea was to set a guaranteed minimum price of UGX 550/KG for seed cotton for the whole country. This purchase price was calculated to be well above the farmers’ costs of production. If the price rose above that level ginner would pay market prices, otherwise they would pay UGX 550. The overall idea was that by locking in a profitable purchase price, financing could be safely extended to input suppliers, farmers, processors and exporters. The idea was presented to both CDO and UCGEA, UGCEA would not endorse the proposal without the full approval of CDO; CDO would not endorse the proposal without the full approval of UGCEA. Ultimately, UGCEA collapsed over the zoning and input issues and the forward price issue was no longer of significance.

According to CDO, they themselves issued an indicative seed cotton price of UGX 800; though this was not backed up by a counterparty as would have been the case in joint donor funded initiative. On 3 November 2008, the global price of cotton collapsed and ginner stopped buying in Uganda. On 23 December, the Government of Uganda re-evaluated the indicative price in discussion with ginner and lowered it to UGX 600. This included a UGX 150 subsidy from the government while ginner effectively paid UGX 450. Obviously, no financing took place against the indicative price announced by CDO and this is perhaps fortunate as lenders would have been unable to recover their loans following the price collapse.

POLICY ON INPUTS

As noted above in the discussion on zoning, input supply has been a critical consideration for ensuring productivity. When zoning was a new idea, productivity peaked because of access to inputs through the private sector. According to CDO, zoning dissolved because free riding among the ginner effectively eliminated input supply. As zoning was demising and after it had demised, input supply was completely overlooked as ginner turned to organic strategies to increase their revenues while reducing their costs and risks. CDO therefore took over the provision of inputs in the past season as they contended that the private sector had failed and that input supply for cotton was essentially a public function.

Unfortunately, the government also had limited success in delivering inputs. While in field demonstrations, high input cotton showed yields up to 1,500 KG/acre, getting the inputs to the farmers was practically impossible. CDO identified two culprits they considered responsible for the low demand and poorly organized supply of cotton inputs. The first was NAADS because it failed to instruct farmers effectively on the benefits of growing high input cotton. The second was UNADA because its stockists failed to penetrate rural areas and the marginal costs to poor farmers to travel to towns to purchase inputs rendered the cost price of the inputs too high. Further, it was felt that UNADA took no responsibility for farmer education and performance. Again, without reliable inputs, financing to the cotton value chain is discouraged. Minimum yields and ginner throughput cannot be predicted, and therefore repayments cannot be reasonably expected by lenders.

CONCLUSION:

As stated in the introduction, this article is largely academic due to the global economic crisis and its downward pressure on demand for commodities such as cotton. The genesis of this article was based on ongoing chaos in the cotton industry and particularly the public conflict between ginner and CDO. The ginner’s organization, UCGEA, has ceased to function and no longer represents the consensus of the private sector. Nonetheless, on the issues of zoning, organic production and marketing, forward price and input supply, the situation has been and remains grim. The total effect of all of these problems is discouraging for financing in the best of economic times. In the current global crisis the total effect of all of these problems renders financing unimaginable.

On a more positive note, the recent history, as outlined above, will doubtless be valuable as and when demand for cotton improves, and as the industry gets back on its feet. With appropriate structures, full cooperation between the entities involved and carefully designed transaction mechanisms, value chain financing in the Ugandan cotton industry will be possible and indeed beneficial to all parties.
1.4 Tax Exemption of Income Derived from Agro-processing
Christopher K. Musoke

The Honourable Ezra Suruma, the then Minister of Finance, Planning and Economic Development, proposed a change to the Income Tax Act in his 2008 budget speech. This was intended to encourage new investments in the processing of agricultural products in rural areas. The proposal was passed into law by Parliament through the amendment of Paragraph 21 by inserting Article 4 to the Income Tax Act Cap 340. This amendment requires an investor in agro-processing, who is desirous of benefiting from this exemption, to apply, at the beginning of their investment, to the Honourable Ezra Suruma, the then Minister of Finance, Planning and Economic Development, for a Certificate of Exemption using the prescribed form. The applicant will have to explain in the application what they mean by the terms above. The term “investment” refers to any outlay on land, plant and machinery, and any other expenses incurred in setting up an agro-processing unit. The term “agricultural products” refers to agricultural raw materials which are produced in Uganda, and the term “agro-processing” refers to the transformation of agricultural products into a different chemical or physical state. The numerous activities that take place between harvest or slaughter of the raw product and production of the final product.

**Investment:**
The choice to risk savings with the hope of gain.

**Plant and Machinery:**
Assets used for carrying on business which are not stock in trade.

When the certificate is granted, the investor would be exempted from Income Tax on the income accruing from the agro-processing activities. As is normal for such exemptions, the costs incurred in carrying out the agro-processing would also be excluded from being claimed against any other income. Although not mentioned in the tax amendment but following the normal practice, the accounts for the agro-processing would be disclosed separately if they formed part of the accounts that include other activities that are subject to tax. The exemption certificate is valid for three years and is subject to renewal on confirmation of compliance.

Interviews with two senior consultants with leading tax consulting firms in Kampala confirm that none of their clients in agriculture and or agro-processing have, as yet, expressed a desire to apply for the exemption. The exemption is for new investments and it is clear that with the global effects of the financial crisis in the US and other developed countries, there seems to be little chance for any substantial new investments in this sector, at least in the short term. Is this yet another failed policy where tax incentives are used to try and stimulate investment in agricultural value chains?

It is said that “the tax tail should not wag the commercial dog”. This has proved true in the two well intentioned attempts by the Ministry of Finance, Planning and Economic Development to, first, interest banks in lending to agriculture and, now, to attract investors to put money into agro-processing. Both these attempts have been made without fully analyzing why banks are not enthusiastic to lend to agriculture and why there are so few investments in agro-processing. In the previous Yearbook we looked at why banks consider agriculture as a high risk area. With the current amendment, it is pertinent to ask, “Why are there no substantial investments in agro-processing in Uganda, other than those that were made in the sugar, palm oil and sunflower industries?” (However, it should be noted that the investments in processing made in these three enterprise types have been made by large industrial complexes that grow – or contract the growing - and process the product, and one can safely assume that the respective investment decisions are both the results and parts of long term business strategies).

The Minister’s intentions are commendable. Value addition to agricultural goods in rural areas is necessary to be able to increase rural household incomes. Agro-processing investments outside Kampala would increase employment opportunities in these areas as well. It is early days to measure the impact of the Minister’s action, but ten months down the road one notes that the Commissioner General of URA has not, as yet, applied for the exemption. The exemption is for new investments and it is clear that with the global effects of the financial crisis in the US and other developed countries, there seems to be little chance for any substantial new investments in this sector, at least in the short term. Is this yet another failed policy where tax incentives are used to try and stimulate investment in agricultural value chains? I believe these two challenges can be subjects of PhD dissertations, but I will suggest some fundamental directions to be pursued by those responsible.

On policy formulation for the financial sector, I reiterate my assertion in the 2007 Yearbook article that the Ministry of Finance has to involve all stakeholders before undertaking piecemeal solutions to the broad agriculture sector challenges. Better analysis of the underlying problems needs to be made and suitable solutions would then be undertaken. We need to start “planning for generations” rather than for the short term!

Secondly, at the Agriculture Ministry level, there is a need to encourage a drive for comprehensive commercialization of agriculture - taking it as a business rather than a hobby, with policies aimed at achieving this desirable objective.

This will require Government to resolve the deadlock on the new Land Bill. The Ministry of Finance would then come in with all the appropriate tax amendments such as raising the tax threshold for farm workers, tax holidays on farms exceeding certain sizes, tax exemptions on farm inputs and equipment etc.

June is around the corner. We hope that the new Minister of Finance will read this article before then.

Now back to the basic question...some of the answers are:

- There are better earning investment alternatives in financial services and telecommunications, as we have seen in the last 12 months. Two new telecom companies have been established and five new banks have been licensed.
- There is no consistent supply of agricultural produce e.g. fruits such as mangoes, pineapples and oranges. A leading fruit juice producer currently relies on imported fruit concentrate to supplement deliveries by Ugandan farmers!
- What can be done to rectify the problem of poor policy making in the face of (i) the required improvements in agriculture and (ii) the needed strengthening of financial sector support to agricultural product value chains? I believe these two challenges can be subjects of PhD dissertations, but I will suggest some fundamental directions to be pursued by those responsible.
- On policy formulation for the financial sector, I reiterate my assertion in the 2007 Yearbook article that the Ministry of Finance has to involve all stakeholders before undertaking piecemeal solutions to the broad agriculture sector challenges. Better analysis of the underlying problems needs to be made and suitable solutions would then be undertaken. We need to start “planning for generations” rather than for the short term!
1.5 Is portfolio reclassification working for agricultural finance?

BACKGROUND
Why do financial institutions view agricultural production as far more risky than other sectors? Where has agricultural finance ever succeeded as a commercially viable service independent of government or donor support? Should banks be expected to respond to occasional incentives or do they need total solutions in order to increase their financing to agriculture? How can the risks and uncertainties which make agricultural lending unattractive be addressed in a comprehensive way, so as to make agricultural lending more attractive?

This brief article discusses the effects of recent Government tax related incentives to agricultural lenders. It is based on both qualitative interviews with selected banks/financial institutions and on the authors’ previous experience as a senior credit loan administration manager. After a general mention of the challenges of agricultural lending that financial institutions face internationally, the article narrows down to Uganda and focuses on the effectiveness of what has come be called agricultural loan portfolio reclassification.

Financing agricultural production has for long remained an unsolved challenge for many countries. The reasons are old, fairly obvious and well known: too much risk and uncertainty, lack of collateral, informality of most participants in the value chain, low margins and cash flows of agricultural producers (making the normal commercial loans too expensive for them) and inability of most financial institutions to tailor their financial product features to the agricultural enterprise needs.

In many developed countries, governments have adopted a combination of direct grant subsidies, subsidized loans, tax incentives, domestic protection and other measures to help agricultural producers stay viable. In developing countries like Uganda where resources are scarce, tax bases narrow and where government spending far exceeds domestic revenue, there are bound to be fragmented, less than fully effective attempts at promoting agricultural finance. Until agriculture related problems (including financial ones) are holistically addressed, it is difficult to set the scene for the healthy and sustainable growth of agricultural finance. Unfortunately for Uganda and other developing countries, efforts to address the fundamental problems of the agriculture sector are usually well meant, but not all-embracing.

RECLASSIFICATION AND ITS EFFECTIVENESS

Christopher Musoke’s article in the 2007 Agricultural Finance Year Book introduced readers to the problems that checked immediate effectiveness of the tax incentives introduced by amendments to the Income Tax Act in 2005 and 2007 budget speeches. In combination, the amendments granted of two incentives to agricultural lenders:

Exemption of interest earned by financial institutions on agricultural loans from inclusion in taxable income

Allowed the bad debts from the agricultural loan portfolio as a deductible expense for income tax purposes.

It was expected that these incentives would make agricultural lending more attractive and accordingly result into a build-up of loan portfolios to agricultural producers. While there seems to be some increase in lending to agriculture, this is not attributed to the reclassification incentives. Whereas reclassification is appreciated by lenders, it is not seen as being adequate to attract more agricultural lending.

NEED FOR A COMPREHENSIVE SET OF EFFECTIVE SOLUTIONS

The lenders have five main areas of risk that all need to be comprehensively and effectively addressed in order to boost active interest in agricultural lending:

Volatility of production and incomes of agricultural producers. Most farmers experience significant variances in their production volumes and produce prices from year to year. A typical case of this was maize in 2007 and 2008 where farm-gate prices dropped by more than 80 per cent between the planting season and after-harvest. Many farmers who had borrowed money were left unable to service loans and many lenders have become even more cautious.

SEASONALITY OF INCOMES.

Independently of volatility, the seasonal nature of farmers’ incomes poses another challenge. In a sense this is mainly an internal problem within the financial institutions themselves. Quite often, the banks’ desired repayment frequency does not match the farmers’ cash flow patterns. Few banks and other financial institutions have developed agricultural loan products based on down-to-earth research and knowledge of the totality of the farmer’s realities. Most banks that have lent to agriculture have either slightly varied their normal commercial loans or lent to large commercial agricultural enterprises.

LACK OF EFFECTIVE COLLATERAL OR EQUIVALENT LOAN SECURITY.

Lenders need collateral security for most of their loans as a fall back position. Those that are regulated are required to risk-weight their assets as support bases for their liabilities, and this serves to highlight, for lenders, the issue of collateral quality. Most agricultural producers either do not have adequate assets to pledge to lenders as collateral or have their assets located in fairly remote areas which makes their realization difficult in cases of foreclosure. This problem is compounded both by the informal nature of most producers and by the reality of communal/untitled land ownership.

LACK OF A WORKING STRUCTURE FOR AGRICULTURAL MARKETING.

This makes produce marketing quite expensive, which further reduces prices to farmers/agro producers. In policy and principle, this is to be addressed under the “Prosperity for All” scheme. In the mean time efforts by development partners are working in isolated cases for specific geographical areas and crops – leaving most farmers in need. Lack of long term funding liabilities, in local currency, for agricultural lending. Past attempts by Government at funding agricultural loan portfolios failed. The key causes were wrong product features, unresponsive credit delivery methods and sometimes severe abuse of the schemes by both the bankers and other powerful people.

LIMITED ABILITY OF AGRICULTURAL PRODUCERS TO AFFORD LOANS AT MARKET RATES.

Most agricultural products offer low margins in the value chain, and this restricts the affordability of market interest rates.

Of all the above challenges, reclassification addresses only the last one. In the hierarchy of challenges, this is the not the most important. The three most important challenges are product and income volatility (which makes agriculture to be seen by bankers as being overly risky), lack of suitable long term funding for agricultural loans and lack of effective collateral or guarantee mechanism to secure the loans to agricultural producers.

In the circumstances, the tax incentives afforded by reclassification can only be of severely restricted effectiveness. Financial institutions will not go into agricultural lending just because of the tax incentives, when the more fundamental issues which pose significant risks and hindrances remain unaddressed.

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1. Meaning the exemption of incomes arising from agricultural lending from income tax
2. Article 1.2: Taxation of Agricultural Finance
The table below highlights indicative solutions (which are in no way exhaustive) to the most fundamental challenges of agricultural lending in Uganda.

Any attempt to solve one or two of these challenges leaving out the rest is not likely to trigger increased interest in agricultural lending. Thus, while the portfolio reclassification as a stand-alone incentive and its attendant tax advantages will be enjoyed by financial institutions that have somehow already lent to agriculture, its effect in boosting agricultural lending is likely to remain minimal. For the government, the costs of portfolio reclassification cannot be justified by the benefits until all the above challenges have been fully addressed.

When all the challenges are effectively addressed, then portfolio reclassification as a sweetener can become a tool for attracting financial institutions into agricultural lending. In this regard:

Earlier efforts by Government to set up a sizeable guarantee scheme for agricultural loans should be pursued. Care should be taken that it is not hijacked or abused by people in places of responsibility. Effective implementation of this would address the fundamental challenge of loan security and make agricultural lending less risky for financial institutions.

The stated methods for zoning districts and regions for the most viable agricultural enterprises should be implemented systematically, on a massive, country-wide scale. This should facilitate ease of bulking produce, storing them and cooperation among producers to bargain with a stronger voice and get the best prices.

Government programmes to support the agricultural sector should put as much practical emphasis on the marketing side as they do on the production side constraints.

A Government owned institution, like the Uganda Development Bank Ltd, should develop an effective agricultural lending function whose successes can in the long run be emulated by other financial institutions. In this regard, Government would put resources into research and development of the agricultural finance products, their delivery, loan management methodologies and linkages with other public and private sector organizations. Once successful, the model could be availed to other financial institutions to replicate without restriction.
WILL LEASING BOOST AGRICULTURAL FINANCE?

BACKGROUND
Leasing has become the most popular mode of financing for productive asset acquisition in many countries. It affords the lessee the advantage of possessing and using the asset to generate revenue without paying for it with upfront capital. In the case of finance leases (most popular in Uganda) the lessee gets suitable financing for asset acquisition without the often prohibitive challenge of providing loan collateral.

In a practical sense, leasing is some hybrid between a financial product and a normal commercial transaction. The lessee buys the asset or a portion of its working life by paying in agreed installments, each of which compensates the lessor for both the asset price and the time value of money (interest).

Broadly speaking, there are two types of leases: operating leases (in which there is no intention that the lessee would eventually own the asset) and finance leases (in which the express intention from the onset of the transition is that the lessee eventually owns the asset. In developed economies with hundreds of equipment manufacturers, vendors, technicians and users, both operating and finance leases are popular. In cases of developing economies like Uganda, finance leases are more common.

LEASING IN UGANDA
In some form or other (mostly informal), leasing has existed in Uganda for a long time. As a financial product provided by formal financial institutions, however, leasing came to the limelight when DFCU Ltd in the 1990s championed the incorporation of Uganda Leasing Company Ltd.3

In the years that followed interest in the product picked up and today, leasing is a recognized financial product. At least five formal financial institutions now have leasing, in some form, among their financial products.

The institutions that have started a leasing business have experienced rapid growth in their lease books. In nearly all cases, the financial institutions have realized faster growth in the lease portfolio than they planned. In general, leases are easier to build up than traditional loans for a number of reasons:

- Less paper work and time-taking appraisal, client evaluation, documentation and security registration processes needed
- In most cases, there is no need for collateral and thus there is more effective demand for lease finance among people with good businesses but inadequate assets to put up as loan collateral
- Until now, funding liabilities other than locally mobilized deposits have generally been available to most lessors who sought them
- Some assets like cars, construction and some small scale processing equipment have a secondary market and are therefore suitable for leasing.

1. Which later became DFCU Leasing and was eventually absorbed within DFCU’s operations

KEY CHALLENGES TO THE GROWTH OF LEASING IN UGANDA
The foregoing paragraphs stated that there is a high potential for lease finance in Uganda. Owing to the unsupportive environment for leasing and informality of many businesses, however, lessors in Uganda are experiencing significant challenges in further growing their lease portfolios. Key among these are:

Unsupportive taxation.
All leasing transactions are subjected to VAT whereas the other financial service transactions from all financial institutions are not. This makes leasing, which is otherwise a suitable financial mechanism for all types of businesses, less attractive than it should be. The wear and tear on equipment is for income tax purposes allowed to the lessee who in most cases does not pay formal corporation tax and therefore cannot benefit from the allowance.

Disclosure and prudential requirements.
The regulated financial institutions which are subjected to prudential norms have the challenge of maintaining the balance between liabilities and risk-weighted assets. Leasing with no collateral can be treated as unsecured lending and given unfavorable risk weighting. Additionally in keeping with legal form, lessors sometimes classify the leased assets among their non-current assets, which would give a wrong impression that they over-invested in fixed assets.

Little secondary market for the leased equipment.
From the lessors’ viewpoint, there should be a vibrant secondary market for the assets they lease out. This enables them to repossess the assets from defaulting lessees and sell or lease them again. Without this, the lessors’ position in the lease relationship is weakened because lack of options when they repossess the assets. It is because of this that all institutions with a lease portfolio have leased mainly motor vehicles, buses, trucks and movable construction equipment, since for these assets a lively secondary market exists in Uganda.

Poor maintenance and high rates of depreciation.
Many lessees use the equipment leased to them in conditions and circumstances that promote high wear and tear. Defaults sometimes occur after the machines are run down due to careless, inadequate maintenance and poor care use during their early life. In such cases, lessors might not realize the full extent of the outstanding amount when they resell the asset.

Supply constraints.
There are many practical constraints on the supply side of the leaseable assets – poor quality, irregular supplies, no local equipment manufacturers, and long lead times for the importation of certain assets. Scarcity of well experienced technicians, repairers and spares. This often causes breakdowns and down time which can reduce the lessee’s ability to service the lease on time.

Funding.
Whereas funding for leases has in some cases been available to the institutions that sought it from international financing institutions, the majority of financial institutions do not have ready and suitable funding for leases. Since most leases are medium term, there is a limit on the extent to which they can be funded from short term or demand deposits. Besides, even the these deposit liabilities are not abundant.

Failure to assess needs properly.
Lessees and lessors do not always accurately assess the lessee’s requirements, and this sometimes has disastrous consequences. A common example is a request by a small farmer for funding to acquire a “walking tractor”, which he can only use during the planting season – approximately one month in a year. Whereas it might be more viable to lease a specialized service provider a big tractor to plough for various farmers at a fee, the preference to own the walking tractor can get the farmer stuck with a financial obligation for an asset that does not generate adequate cash flow to service the obligation.
In addition to the already mentioned challenges, it is not easy to divert assets without necessarily owning it and leases are the farmer gets the benefit of using productive assets whereas they need financing for assets they should eventually own; traditional bank loans have had limited success in financing agriculture; farmers and/ or drain working capital from the lessee. For banks that lease assets, it is usually the down payment requirements that is fulfilled last.

**LEASING AS A FINANCING MECHANISM FOR THE AGRICULTURAL VALUE CHAIN IN UGANDA**

In principle, leasing should be suitable for financing agribusiness development: farmers and other actors in the value chain lack collateral for loans whereas they need financing for assets they should eventually own; traditional bank loans have had limited success in financing agriculture; the farmer gets the benefit of using productive assets without necessarily owning it and leases are not easy to divert.

In addition to the already mentioned challenges, leasing to the agricultural value chain faces the following:

- Small, not easily identifiable equipment.
- Costs of repossession could sometimes exceed amounts recovered in case the lessee defaults.
- Diseconomies of scale in providing low value equipment to farmers in diverse geographical locations.
- Irregular supply of equipment and parts.
- Seasonality of incomes, rendering the normal monthly or quarterly installment payments unsuitable.

Overall, it is still early days to discuss success with leasing as an agricultural financing mechanism— but does leasing promise a breakthrough for Uganda’s under-financed agricultural producers? The answer to this is conditional; “yes” if the above problems will be addressed and related tax laws (VAT and wear-and-tear allowance on leased assets) will be amended to become more conducive to the lessor, and “no” if the status quo on these will be maintained. At the moment, all leasing transactions are subject to VAT while other financial services are not.

This makes any lease financed equipment more expensive than it would be if it was loan financed. This is compounded by the fact that most SME agricultural producers and processors are not VAT registered and thus cannot take advantage of VAT input refund. They are seldom formal tax payers who would benefit from the wear and tear deductions that the existing tax regime allows.

A number of financial institutions that have considered introducing leasing into their operations have instead resorted to incorporating some features of leasing into their loan products. This way they afford themselves and their clients some advantages of leasing without getting entangled in the tax complexities.

An example is when banks introduce asset based loans (loans for purchase of assets, secured on those very assets). This falls short of leasing in that the asset belongs to the borrower during the loan period and thus its realization in case of default can be more complicated than repossession of a leased asset. This is a disincentive to the lessor.

If all the challenges mentioned above are resolved, leasing to agribusiness will become more attractive. The most prospective value chains for this would be those that are already fairly monetized — like coffee, cotton, rice, maize, tea, sugar cane, fruits and vegetables.

High demand for small scale agro processing equipment exists among farmers in these enterprise categories and in the transport sector. For produce/commodities that are not much traded, leasing or other financing mechanisms are still unlikely to be a suitable solution.

Commodity trade is the backbone of Uganda’s economy and contributes nearly 80% to the Gross Domestic Product (GDP). It is also dominated by agricultural commodities most of which are supplied by smallholder farmers.

Prior to liberalization government controlled the commodity marketing chain from production to marketing through an elaborate system of primary societies at village level, through to cooperative unions and state-run marketing boards. Nearly everything from inputs distribution and agricultural extension to primary processing, quality control, export processing and marketing was controlled and supervised by government. Government was also responsible for fixing commodity prices and margins along the entire marketing chain. This was meant to insulate the producers from market volatility. Nearly 95% of government revenue was derived from export of cash crops primarily coffee, cotton and tea, which sectors also employed nearly 70% of the country’s population, both directly and indirectly. The sectors were under the overall control of state-run marketing boards.

More importantly government was responsible for ensuring availability of production credit and trade finance to fund the various sector activities along the marketing chain. Trade finance for the private sector was available in the form of overdrafts for local traders who had contracts to supply semi-processed produce to the marketing boards. These overdrafts were usually highly priced and secured by fixed asset collateral.

Following liberalization, government gradually disengaged itself from the marketing and financing process for agricultural commodities. Marketing boards were privatized and the private sector became responsible for the activities along the marketing chain that had hitherto been the responsibility of government.

The genesis of the development of commodity linked financing schemes in Uganda can be traced to the emergence of market reforms in the early 1990’s. Market liberalization, as the reforms were referred to at the time, encouraged government to disengage from directing commercial activity in the commodity sector and develop the private sector to fill this role. But first, some history…
During the disengagement process, it was also understood that while the liberalization policy was timely and cost effective, at least in as far as it addressed the various institutional bottlenecks that had constrained the growth and development of agricultural commodity trade in Uganda, it was also going to take a lot more to get the private sector prepared for the complexities of international commodity trading and risk management.

The government and policy makers addressed this predicament by establishing commodity regulatory authorities. These bodies, including UCDA for coffee and CDO for cotton, were mandated to guide the private sector in promoting and implementing technologies for improving crop production and yields, availing inputs, accessing credit, quality assurance, market information, domestic consumption and risk management.

The response was remarkable. In the coffee sector, the number of exporters increased from the one marketing Board to over 140 private traders within three years. In the cotton sector the installed ginning capacity for lint increased from 50,000 bales in 1994 to 840,000 bales in 2007. The producer’s percentage share of the export price increased from a mere 5% in 1992 to over 75% in 2006. The liberalization policy seemed to have paid off.

Two significant challenges however, remained. Access to efficient, sustainable, affordable credit remained a major challenge. Without financing there could be no meaningful development. The other was the inexperience of private traders and commercial banks in export marketing, documentation and price risk management. The local traders and cooperative unions who had hitherto been supporting semi-processed commodity to the export marketing boards now had to do much more, notably arrange funding for the export oriented operations. They were also required to negotiate prices which required intricate knowledge about terminal markets and differential pricing as well as the use of complex risk management tools to hedge against market volatility.

As if this was not daunting enough, they now had to compete with multinational trading companies who could readily access cheap off shore finance. Today, cotton and coffee processing and export are dominated by foreign companies – the lead cotton ginner is reported to control over 50% of the market.

The problem of access to credit was compounded by the fact that the local traders did not have the fixed asset collateral to secure the working capital required to fund the large contracts required by international buyers. The lack of experience in commodity trade and lack of risk management instruments, coupled with the high operational and covariant risks in turn made commercial banks very nervous about commodity financing.

It is around this time that the sector regulatory agencies started taking deliberate efforts to explore areas for possible support to the traders, particularly in the area of commodity risk management, to make them more attractive prospects for the ‘inexperienced trader’. To the leads of support became of vital importance. The first focused on getting local traders proficient in international commodity trading and risk management. The second was to design appropriate trade financing schemes that would mitigate the inherent performance and transactional risks associated with product quality, market, storage, price volatility, valuation, legal constraints, lack of insurance, etc. Financiers were encouraged to take a serious look at prospects presented by the agricultural export sector and its highly positive risk/return ratio.

In 1994 the Uganda Coffee Development Authority (UCDA) in conjunction with UNCTAD and the World Bank commissioned a series of training programs for coffee exporters, in risk management, international trade documentation and export marketing. It is also around this time that the Eastern and Southern African Trade and Development Bank (PATA Bank) and SGS, an international inspection company, proposed the first inventory-based credit facility for the coffee sector, using warehouse receipts.

Under this arrangement, commercial banks were encouraged to appraise inventory backed financing schemes where credit could be extended to commodity traders against sales contracts and stocks received and certified by an independent third party. The third party would guarantee the weight and quality as well as the trader’s performance on the contract including repayment of the credit facility. The facility would be secured by warehouse receipts issued by the third party to the financing bank as collateral.

The financing bank would only release the export goods to the final buyer on receipt of the sales proceeds. Such proceeds would in turn be applied to repay the credit.

However, the question remained, what was so special about warehouse receipt financing that would guarantee the performance of the hitherto inexperienced trader and or mitigate the various risks highlighted above?

According to Budd (2001), grain warehouse receipts were first used in Mesopotamia in 2400 BC and the first form of paper money used in the United Kingdom were negotiable silver warehouse receipts. The use of warehouse receipts has often been associated with structured financing transactions. These transactions basically assure the financier that if a transaction proceeds normally then they will be automatically reimbursed (i.e. the loan is self-liquidating), and if it goes wrong the lender has recourse to securely managed collateral that can be liquidated with minimum difficulty and cost.

Couler and Onumah (2002) define warehouse receipts as documents issued by warehouse operators as evidence that specified commodities, of stated quantity and quality, have been deposited at a particular location owned by named depositors. The depositor may be a producer, farmer group, trader, exporter, processor or indeed any individual or body corporate. The warehouse operator holds the stored commodity by way of safe custody; implying he is legally liable to make good any value lost through theft or damage by fire and other catastrophes but has no legal or beneficial interest in it.

However, in case of liquidation, the warehouse operator’s creditors will not be able to seek recourse to the commodities stored, as legal title remains with the depositor or bona fide holder of the receipt. The only exception is the warehouse operator’s lien covering outstanding storage costs.

In many countries warehouse receipts can be transferred to lenders under pledge, an arrangement under which title to the goods and any appreciation in value of the asset, less the cost of storage and finance, remain with the borrower. The lender can dispose of the goods only in the event that the borrower defaults on his payment obligations. The receipts may also be transferred to a trade counter-party, allowing the holder to take delivery of the commodity upon presentation of the warehouse receipt at the warehouse.

After a few persuasive trials in 1997, piloted by subsidiaries of international inspection companies acting in this case as collateral managers, some of the commercial banks in Uganda had a change of heart and decided to give it a try. While the risk of default remained high and the system lacked a regulatory regime, participating banks preferred a financing model structured for larger scale operators who could make a minimum equity contribution to the transaction. The model involves lending against non-negotiable and non-transferable warehouse receipts issued by collateral managers under tripartite collateral management agreements involving the bank, borrower and the collateral manager.

This preferred model rests on the credibility of the collateral manager (which is the inspection company acting as warehouse operator), in the liberalised marketing environment with significant performance and credit risks, the collateral manager could provide the confidence for banks to contemplate financing export transactions. This is especially so because the European-based parent companies of the inspection companies could provide various kinds of professional liability cover that provide additional comfort for lenders.

Financing large scale operations not only enjoined the trader to the transaction through their equity contribution but also lowered the operating costs for the bank in the areas of loan administration and oversight supervision.

However various limitations have been identified to the scope and benefits from these tripartite collateral management arrangements, including:

- The main users tend to be large operators, who own or can rent entire warehouses or silos, and can afford high fees (usually in thousands of US dollars per month). Their services are not available to farmer groups or traders who wish to deposit relatively small volumes of a commodity (e.g. 50 – 100 tonnes).

- The system is predominantly used as a component in financing import and export transactions, but rarely used for non-tradeables, except where the depositor is a large processor or major trading company.

- In Uganda, this has greatly limited the benefits of the warehouse receipt system in domestic agricultural trade.

- Like other operators, collateral managers sometimes experience losses through theft and fraud. Where losses occur, their liability tends...
to be limited by indemnity clauses in the storage contracts, and sometimes discourages banks from providing finance against collateralized inventory. The recent case involving a local wheat and coffee trader and the Swiss-based COTECNA Management Company is a case in point.

- The warehouse receipts are non-transferable and cannot be used as delivery instruments against contracts, thereby limiting their use in facilitating trade.

In 2001 Government, together with the Common Fund for Commodities and the European Union, started a financial deepening program to widen the scope of warehouse receipt system usage by implementing a regulated warehouse receipt system.

The program objective was to foster the development of a national network of privately managed warehouses, authorised to issue transferable warehouse receipts under a robust certification and inspection regulatory regime.

Confidence in the system would be guaranteed by a privately run, self-financing regulated agency insulated from government control. This agency would certify and inspect the warehouse operators authorized to issue warehouse receipts against stored commodities. Certification would be voluntary and based on the ability to meet and maintain qualifying criteria including suitability of warehouses, experienced management and personnel, minimum net worth, insurance and bonds.

In May 2006 in response to a key requirement of the banks, Government passed the ‘Warehse Receipt System Act into law. It also created a regulatory authority for the system called the Uganda Commodity Exchange (UCE). The overall objective of the UCE, a privately-run agency tasked with regulating, licensing and supervising the system, is to enhance rural livelihoods in Uganda by increasing agricultural productivity, quality and profitability, in a sustainable manner.

This objective is expected to be achieved by improving the efficiency of the marketing of agricultural commodities, through two ‘resolutions’:

1. An efficient, effective and properly-regulated WRS in place, based on a network of certified and well-managed commercial warehouses and

2. Ensure commercially-viable volumes and values of commodities traded through UCE to defray the costs of operating a warehouse receipt system

During the pursuit of this mandate, the UCE has managed to achieve the following gains:

- Designed and put in place the general regulatory and developed the contractual framework governing the operation of licensed warehouses;
- Developed grading systems for grains and drafted the standards for coffee, cotton, beans, maize and rice;
- Determined and implemented a form of electronic warehouse receipts for Uganda and managed the development of the electronic system (eWRS) linked to that of South Africa;
- Recruited and trained regulatory, IT and other staff in technical duties and general programme implementation;
- Promoted the warehouse receipt system with the World Food Programme (WFP), which is one of the larger volume buyers for grains;
- Commenced the design and implementation of a comprehensive communications strategy to expand WRS and give a wider role of Uganda Commodity Exchange;
- Revised the strategy for the development of UCE, its role in commercial agricultural and support to farmers and producer groups
- Four financial institutions have shown a readiness to finance UCE backed warehouse receipts
- Warehouse regulations have been put in place to support the implementation of the various functions of the Authority
- A comprehensive profile of all the agricultural commodity warehouses, country-wide, has been undertaken, together with the Ministry of Tourism, Trade and Industry
- Three warehouses, in Jinja, Kasese, and Masindi and one warehouse operator Coronet Consult Limited, have been licensed to operate under the system

- 48 tones of maize deposited by Rock Trust, a small holder farmer group in Mayuge district, was recently sold to the World Food Program (WFP), the largest regional food buyer, through the system.

The WFP Director Mr. Samkange recently hailed the system for allowing WFP to directly access small scale farmers who grow the qualifying produce. He also noted that the partnership with UCE was exciting and presented WFP with an opportunity to remove two key obstacles to direct WFP procurements from farmers; namely quality and storage. WFP has subsequently committed to buy up to 150,000 MT of food through the system from small holder farmers over the next three years.

Various challenges however still exist for the successful outcome of warehouse receipt operations on a wider scale in Uganda. The main challenges are in the area of scale economies and engendering confidence among the bankers to operate at a smaller scale. Warehouse receipt systems favour major scale economies, both in terms of managing warehouses and providing regulatory oversight or certification.

Indeed the management and regulatory costs associated with 1,000 and 10,000 metric ton warehousing sites are not very different.

UCE is addressing this challenge by:

(a) making the system open to all players including large players like the World Food Program who are being encouraged to participate from the outset;
(b) starting with large warehouses in the major places of concentration, and

(c) rapid profiling of the grades of various storable commodities traded in Uganda so that the number of qualifying commodities can increase.

UCE has also commissioned a study to assess the feasibility for improving credit accessibility to the grain sector in Uganda through networking and cooperation with the banking sector. Initial findings indicate that the banks are showing strong interest but are concerned that the system should be sufficiently regulated by UCE and can be used to minimize the performance risk and risk of fraud at producer level as well as facilitate the liquidation of collateral quickly and at low cost.

In conclusion, for countries in transition and developing countries like Uganda, where commodity subsectors have undergone liberalization, the quick establishment of credit flows is crucial to the success of reforms. Warehouse receipts provide a method of collateralizing agricultural commodities and lowering the risk to the lender, thereby lowering financing charges to the borrower.

In addition, warehouse receipts provide a marketing tool to the emerging private sector, thereby allowing the orderly withdrawal of the state from commodity marketing.

The experience of several developing countries that have tried to establish warehouse-receipt systems indicates that, in order to work well, warehouse receipts need a recognized basis in law, so that the ownership established by the receipt is not challenged.

Equally important are provisions for performance guarantees and the establishment of systems for warehousing inspection and crop-quality determination.

References

One of the areas with so much to contribute to the goals of the National Development Plan.
The size of the business is impressive, and significant for the agriculture sector, as indicated in the data that follow below.

In terms of savings mobilization, the POs that work with MSC, as at end of 30th November 2008, have mobilized savings amounting to over Ush. 40b (US$ 22m). This has been as a result of more members joining the POs who have in turn saved both voluntarily and or compulsorily as a condition for getting a loan.

The trend in borrower distribution by sector is as follows: 57% of the borrowers are in commercial activities, 36% in agriculture-related activities and 7% use the credit for uses such as the payment of school fees, home building/improvement investments, expenditure on social activities etc.

MSC TRAINING

The overall cumulative repayment rate of POs to MSC as at 30th November 2008 was 89%. The amount in arrears (principal) was some Ush. 648m (US$0.38m) giving an arrears rate of 7%. These data underline the need to improve performance in the SACCO/Microfinance sector. Clearly this is not only a matter of improving day-to-day operations, but also of addressing overall PO governance and management shortcomings.

This is very well understood by MSC, and one of the measures in delinquency control adopted by the company is a continuous training programme in various fields for both managements and board members of the organizations. The courses cover agricultural loan decision-making (especially techniques for more rigorous appraisals), and recommended procedures for loan follow-up. Both of these are designed to improve on-farm loan productivity and PO repayment performance.

MSC has supported the training of staff and directors of 428 Partner Organizations. A total of 1,295 trainees, of whom 48% were women, benefited from 12,691 person days of training.

The staff development is mainly in the form of workshops, training courses, study visits, seminars and conferences. The company has registered an increase of 28% in offering training in Agricultural and Rural Lending since 2007. Over 50% of MSC’s staff and PO staff has received training in Agricultural and Rural Lending. The training is offered by the Uganda Institute of Bankers - Microfinance Competence Centre (MCC) and is done in phases. So far three have been completed. Each phase involves about twenty POs with two members of staff from each institution being included in the exercise.

The objective of the course is to enable participants to offer technical assistance to institutions that are handling the agricultural loan product. Specifically the aim is to improve the appraisal of credit applications from farmers and rural micro entrepreneurs, and to develop and implement techniques and strategies for managing costs, risk, delinquency and default in agricultural lending. To monitor effectiveness of this and other MSC activities, the company carries out bi-annual operational research, which assesses its performance in credit and capacity support delivery. Assessment of MSC Training in Agricultural and Rural Lending.

SUMMARY

Given the weaknesses in the Tier 4 sector of Uganda’s financial system, any entity with responsibilities that centre on strengthening SACCOs and other Tier 4 MFIs faces a very difficult task. This article explains the actions of one such entity, the Microfinance Support Centre (MSC) Limited. It describes its mandate vis-à-vis its partner organizations (SACCOs and MFIs), outlines the training inputs provided by MSC, and how these have been evaluated.

Given the challenges, and the necessarily modest input from MSC, in terms of time and resources over the period covered, the continuing weaknesses in the Tier 4 sector can hardly be surprising, prompting the need for re-doubled efforts in capacity building.

BACK GROUND INFORMATION

The Microfinance Support Centre (MSC) Limited is a government-owned company established in 2001 to manage the Rural Microfinance Support Programme (RMSP) and other government supported microcredit programmes. The MSC was designed with a view to significantly improving the delivery and outreach of sustainable microfinance services in the country. As such it is one of the key players in implementing the government’s vision of transforming the economy. Given this mandate, it is clear that training and other capacity building activities form an important part of the work of MSC.

The company executes its mandate through implementing a Strategic Plan. This calls for credit and capacity building services to be extended to partner organizations (POs) all over the country.
METHODOLOGY AND DATA ANALYSIS

The post training assessment was done in three stages. In the first stage, questionnaires were drafted and administered to a small, core group of POs and their clients. This was followed by a more widespread test of the questionnaires. In the third stage the main survey was implemented.

The assessment used both qualitative and quantitative data. Apart from the basic questionnaire, additional reports (a type of secondary data source) written by trainees were consulted. For primary data generation, respondents were drawn from among PO managers. The information gathered from POs included performance indicators before and after MSC training interventions, the number of trainings received from MSC and the type of training interventions offered by MSC. More questions were based on changes in their performance as a result of the trainings received from MSC.

SAMPLING PROCEDURES AND SAMPLE SIZE

The study covered five regions of MSC that have varying socio-economic activities. These regions included: Gulu, Mbale, Masaka, Mbarara and Kabale. The distribution of surveyed POs and their respective clients is indicated in the table below.

<table>
<thead>
<tr>
<th>No.</th>
<th>Region</th>
<th>Districts</th>
<th>Name of PO/Institution</th>
<th>No. of respondents</th>
<th>MSC Region</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>North</td>
<td>Oyam, Kitgum &amp; Lira</td>
<td>Alurkot, Kitgum SACCO, Gulu SACCO &amp; Makonya</td>
<td>8</td>
<td>Gulu</td>
</tr>
<tr>
<td>2.</td>
<td>East</td>
<td>Tororo, Pallisa and Sironko</td>
<td>Bukedi teachers, Sironko and Aminanara</td>
<td>6</td>
<td>Mbale</td>
</tr>
<tr>
<td>3.</td>
<td>Central</td>
<td>Masaka, Luwero, Kampala</td>
<td>MAMIDECOFI, Victoria Basin, NEDA, RUCREF, SMS, Mulago II SACCO</td>
<td>12</td>
<td>Masaka Kampala</td>
</tr>
<tr>
<td>4.</td>
<td>West</td>
<td>Kabale, Rukungir, Ntungamo, Bushenyi, Mbarara</td>
<td>Kyamuhunga, Rukooma, ISSIA, Ibanda SACCO, Kebisoni, Kigarama Nyarwanya, Mpororo, Ryakarimira, Rwerere SACCO and Mitaano SACCO</td>
<td>22</td>
<td>Kabale Mbarara</td>
</tr>
</tbody>
</table>

POs in the Sample by District and MSC Regional Office. Source: Post training evaluation report 2008

Forty-eight (48) borrowers were randomly selected from 182 institutions that had received training. These SACCO members and MF clients were interviewed by MSC staff, using a pre-tested questionnaire. The results are given in the next section of this article.

PO Staffs Receive Training Organized by MSC in Agricultural and Rural Lending

BENEFITS OBTAINED FROM THE TRAINING

The current low level of competence of many if not most MFI and SACCO managements and staff is widely acknowledged. Low salaries and very limited scope to improve levels of remuneration mean that support organizations are faced with a daunting task in building and retaining capacity in this difficult sector of the finance industry.

Nevertheless, the MSC impact assessment survey reveals that POs that received training benefited in various ways, and that the most profound gain was improvement in efficiency of operations (claimed by 62% of respondents).

The ability for the survey to lead to precise quantification of the benefits was somewhat limited. Clearly more in-depth research, focused inter alia on incremental PO performance, would be needed to reveal the true effectiveness of MSC’s training, as well as the capacity-building provided by other entities supporting the Tier 4 sector in Uganda.

The other benefits claimed include improved income of the institution (46% of respondents) and acquisition of new skills (39% of respondents).
The purpose of the article is to provide some pointers for those considering computerization as a means of addressing some of the major problems with SACCOs in Uganda. The material given below is based on the experience of the GTZ/Sida FSD Programme’s pilot MBWin computerization initiative, namely Muhame, in the west and Agaru, in the north, have reduced their monthly interest rate charges from 3% flat to 2.5% declining (a move that means, effectively, halving the total interest costs on most farming loans).

The FSD Programme has facilitated the establishment of a local installation and servicing company, and has also contributed significantly to establishing a computer laboratory and training facility at the Uganda Institute of Bankers (UIB). This UIB facility is well-suited for the training of SACCO personnel.

Target readership and purpose

Those to whom this chapter is particularly relevant are likely to be in the following groups:

- SACCO supporters, such as staff of cooperative apex bodies e.g. UCSCU, UCA
- SACCO boards and managements,
- Government – politicians and officials,
- Development partners

The purpose of the article is to provide some pointers for those considering computerization as a means of addressing some of the major problems with SACCOs in Uganda. The material given below is based on the experience of the GTZ/Sida FSD Programme’s pilot MBWin computerization initiative, namely Muhame, in the west and Agaru, in the north, have reduced their monthly interest rate charges from 3% flat to 2.5% declining (a move that means, effectively, halving the total interest costs on most farming loans).

What challenges can be addressed, at least in part, by computerization?

- Ensuring the safety of members’ deposits
- Poor book-keeping skills at grassroots levels
- Out-of-date records
- Susceptibility to mistakes and/or fraud
- ‘Artisanal’ image of non-computerized institutions
- High administrative costs, and/or malfeasance losses, leading to the need for high interest charges on loans

Steps in computerization: institution selection

It is important to establish a set of criteria which will guide the type and level of intervention provided, and the priority to be accorded in the face of a demand/supply imbalance. These criteria may include, but are not limited to:

i. Competition: Identification of institutions in areas which are underserved by regulated financial institutions should be a major priority factor. This is supported by point ii below:

ii. Supervision: Consideration should be given to institutions that regularly subject themselves to scrutiny and/or various kinds of audits by external bodies to review their financial performance, in order maintain transparency. Such scrutiny includes but is not limited to:

- Regular audits as indicated in the SACCO By-laws

Benefit/cost considerations

MIS Support is expensive. The costs involved were described in the 2007 Agricultural Finance Yearbook. The first reaction for those considering MIS Support might be to attempt a rigorous benefit/cost analysis for any given case. This should certainly be done; however, there is an important caveat. A moment’s thought will reveal that some of the benefits – especially those concerned with safeguarding members’ savings deposits, and similar governance/management issues, cannot be ‘costed’ as easily as say a reduction in direct administrative costs. Again, over time, the best test is two-fold: first, the proven safety of deposits; second, the ability of a SACCO to lower interest rates on loans to members.
- Voluntary supervision by apex bodies. In this case, the Uganda Cooperative Savings and Credit Union (UCSCU), the apex body for financial cooperatives i.e. SACCO’s.
- Rating by a rating agency, Planet Rating (if a development partner can subsidize the cost)
- Utilization of an organization’s own internal tools used for appraising institutions. For example a light due diligence (LDD) tool.

iii. Size or scale of the institution: Institutions can be categorized according to the number of their members and scale of operations (even analyzing the number of daily transactions). FSD has developed criteria for SACCO’s that warrant computerization i.e. due to the number of members and the scale of their operations.

- Greenfield SACCO’s, also known as start up institutions; typically these recently established institutions have less than 300 members. They can have their back office functions outsourced i.e. managed by a data service centre, also known sometimes as a bureau.
- Medium sized SACCO’s; being institutions with between 300 and 1,000 members (this is subjective). With appropriate rationalization these can also have their back end services outsourced i.e. managed by a data processing centre.
- Large SACCO’s - Institution’s with over 1,000 members. These have probably reached a scale where their operations warrant in-house computerization.

**STEPS IN COMPUTERIZATION: THE ENVIRONMENT**

Factors to consider include: the environments that many of these institutions operate in, the level of computer proficiency of the staff, and the standard and availability of IT support services. Finding the most appropriate solution is a constantly evolving but extremely beneficial process.

**WHAT IS THE PROBLEM AND WHY THE CONSTANTLY EVOLVING PROCESS?**

The reality is that there are at least three different service providers involved in developing a solution: the hardware, software and energy providers. From a practical point of view, sitting in Kampala, a call from an institution over 100kms away could trigger several questions. For example…

In many cases, an institution’s first thought is to contact a local technician who may not have the requisite skills but tampers with the equipment (doing more damage in the process) and abrogates the warranty! The reality is that expert help is needed. This often calls for a lot of resources, sending teams out to diagnose and rectify the problems.

In order to avoid misunderstandings between service providers and clients, it is imperative that all parties discuss the apparent problems, initially on the telephone. It is even better, resources permitting, for the parties to meet on-site, with the staff of the institutions, to appreciate the realities of the problems and find practical solutions.

The process is constantly evolving since the capability and supply of support can be expected to change, especially in the medium term.

**STEPS IN COMPUTERIZATION: HARDWARE SELECTION**

Many standard desktop computers operate efficiently in environments with modest levels of dust. However, many rural SACCOs operate in areas with particularly high levels of dust. This can seriously affect their functionality. Choice of computer hardware is extremely important in order to prevent frequent breakdowns.

In this regard, GTZ/ Sida /FSD has done extensive testing on different hardware options in order to identify an appropriate Ugandan solution. This was made possible by the fact that the identified hardware manufacturers agreed to work with the software developers on the design of a more durable server that could withstand the conditions within the rural areas of Uganda.

In circumstances where hardware is provided to a number of institutions there are clearly there are advantages in using standardized hardware, as local personnel then have the opportunity to become very familiar with the equipment, to the ultimate benefit of SACCO clients.

**STEPS IN COMPUTERIZATION: SOFTWARE SELECTION**

Decisions on the type of operating system can impact on the operations of an institution because some MIS systems are more closely geared to SACCO needs than others.

Cost may also be a factor, along with susceptibility to virus attack. In remote areas, where continual access to anti-virus software and updates may be limited, it is imperative to decide on an appropriate operating system, and to ensure that the configuration of the server and its client units is designed to keep the system protected from viruses.

User rights regarding access to the server, both remotely and logging directly, should always be severely limited to prevent unauthorized users installing programs and viruses. It is imperative that users know the rules, and adhere to them.

Just as standardized software provided to a number of institutions is advantageous, standardized software and configurations will help streamline the administration of the servers in different SACCOs. Only the printer configuration may change from one site to another.

Though there are simple and effective backup procedures, it may even be more appropriate if the backed up documents are maintained outside the institution. Then, in event of fire, there is a disaster recovery system in place.

**STEPS IN COMPUTERIZATION: POWER SUPPLY, FOCUS ON SOLAR EQUIPMENT**

The 2007 Yearbook on Agricultural Finance included an article on computerization that outlined the basic argument for solar power. The situation has not changed in 2008.

Suffice it to note that the system should be set up to take the calculated load of the equipment. Any use of unnecessary peripheral items will cause overload on the system and undesirable drainage of the batteries. Such prohibited items include: music players, electric kettles and even phone chargers.
It is important for all service providers to provide operating manuals (a list of Do’s and Don’ts) for the managements and staff of the institutions. This enables easy troubleshooting by the staff of the institution and in many cases a quicker diagnosis and resolution of the problem by the support team.

**STEPS IN COMPUTERIZATION: SELECTION OF IN-HOUSE VERSUS BUREAU COMPUTERIZATION**

**In-House Systems**

This support involves the provision of the solution to individual institutions. For example, in 2008, GTZ/Sida/FSD computerized Alutkot Farmer’s SACCO’s branch in Aboke. Agaru SACCO which includes its main office in Kalongo town and the branch in Pader town was also computerized.

This brings to eight the number of institutions computerized out of the target of 12 institutions in this pilot programme. FSD hopes to markedly increase this number, in 2009, through the piloting of Data Resource Centres.

**BUREAU OR DATA SERVICE CENTRES**

In an attempt to achieve an even greater impact, the GTZ/Sida FSD programme and DED are in the process of piloting a Data Service centre in collaboration with another institution. A preliminary feasibility study indicated the viability of the programme. The plan is to establish a centralized processing facility, using a tried and tested Management Information System to record and analyze financial data from the participating SACCOs. The resulting analyses will then be shared respectively with each institution, highlighting areas of weakness and opportunities for improvement. The partner organization will then provide the follow up, capacity building and mentoring.

A cost sharing arrangement is being discussed where the partner organization will provide the office space and human resources, GTZ will provide the equipment (hardware and software) and DED will second an Advisor to oversee the operations of the centre. The results of this pilot will be shared with stakeholders in the industry to determine the possibility of replication.

**STEPS IN COMPUTERIZATION: SPECIAL NEEDS OF FIS WITH Branches**

During operations in existing MBWin installations that have branches, the need has been identified for the easy, electronic consolidation of data over the whole financial institution. A module within MBWin, called MBMIS, has been developed in order to do this task. A pilot installation will be started in the first quarter of 2009, with roll-out to other FIs with branch networks envisaged during the year.

**STEPS IN COMPUTERIZATION: SUPPORT**

It is extremely important for a sustainable support structure to be established to address problems as they arise. Furthermore, it is also imperative for the support system (company) to treat support as a commercial operation, because this is the only way it will remain sustainable in the long run. In the short run, donor funding may subsidize the operations, but in the longer run building a large client base, whilst providing a variety of services, will ensure the sustainability of such support. GTZ FSD’s intention is to have an exit strategy instituted whereby support and training can be ably handled by the local company. MBWin East Africa Ltd. This company was registered in 2008.

**OVERALL IMPACT**

By December 2008, eight pilot SACCOs were operating with solar-powered computers, using the FAO/GTZ MBWin banking MIS (management information system). Four of these are in the north of the country. One of these has achieved considerable growth in its loan portfolio, especially in financing the agricultural sector.

As noted above, two of the SACCOs in the GTZ/Sida FSD pilot programme have passed on the benefit of computerization to their members, by adjusting the method of interest calculation from 3% flat to 2.5% declining.

Furthermore, a team of local support staff, that has been trained at the MicroBanker International Training Centre in Bangkok and has a variety of skill sets, has recently registered a local company called MBWin in East Africa. The FSD Programme has supported this development, as it constitutes an exit strategy whereby FSD can confidently hand over support and training to this company.

Experience has shown that the larger SACCOs are usually able to pay for the computerization support services. In many cases such institutions have gone ahead and procured additional equipment without donor support.

In December 2008, GTZ and the Helsinki School of Economics (HSE) commenced a joint research activity with the objective of investigating the costs and benefits of computerization in the SACCO sector of Uganda, with a special focus on member impact. The two partners have agreed to conduct an in-depth analysis, with an expert from the HSE carrying out on-site work over a period of one year.

The results will be shared within the international “Making Finance Work for Africa” initiative, for the benefit of microfinance institutions throughout Africa.

**FINALLY - A WARNING**

It is fitting to close this article with a warning. Computerization of SACCOs, whether by means of an in-house system, or a shared data centre, can only be successful when it is handled by competent personnel. Many choices have to be made – as outlined above. Expert advice is essential so that the optimum selection is made in any given case.

Above all, the importance of training SACCO staff cannot be over-emphasized. Fortunately the facilities for such training now exist in Uganda, and full use should be made of this infrastructure.
One of the areas with so much to contribute to the goals of the National Development Plan.
3.1 TRENDS IN AGRICULTURAL FINANCE IN 2008
Irene Sekamwa

BACKGROUND
The information on bank advances to the Agricultural Sector was first compiled for the 2007 Agricultural Finance Yearbook. The second Yearbook, for 2008, builds on the earlier work. Like for the previous year, information is collected on the total agricultural loans for each quarter. It is hoped that by the close of 2009, sufficient information will have been collected to enable a better comparative analysis, including the ability to more accurately identify and quantify trends—an essential tool for policymakers.

The availability of agricultural finance for small and medium scale enterprises has generally remained limited despite Uganda’s growing banking industry. Although this topic has been given little attention, there is now a renewed interest in the area by the public and private sectors as well by development partners.

The reasons for this are many and varied but could include the greater volume of information now available on the terms of trade for agricultural commodities, as well as the competition within the financial sector which is spurring innovation and the development of new loan products for agricultural commodity value chains.

During this year, the number of total regulated financial institutions increased by 26% (by 6 from 23 in 2007) as a result of the lifting of the moratorium on new banking licences. Newly licensed Commercial Banks like Eco Bank, Equity Bank, Fina Bank, Global Trust Bank, Kenya Commercial Bank and United Bank for Africa joined the market. As a result of the opportunities brought about by the moratorium, some financial institutions endeavored to open more branches, while others have now merged with existing financial institutions. For example Equity Bank has merged with Uganda Microfinance Limited, and Global Trust Bank has merged with Commercial Microfinance. This has led to the reduction in the contribution of credit institutions and MDIs to the total number of regulated financial institutions by 4.7% and 0.4% respectively.

AGRICULTURAL LENDING BY CATEGORY OF FINANCIAL INSTITUTION
Commercial banks still remain the biggest contributors to agricultural lending, contributing 94.2% of the total amount lent out for agriculture in 2008, although their contribution to agricultural lending reduced by 3.2% in 2008. As in 2007, they are followed by MDIs and Credit Institutions whose contribution has increased and decreased respectively by 3.4% and 0.1% respectively. Note: the data on advances in this article excludes the value of leasing contracts.

However, 6.9% of the total regulated financial institutions do not engage in agricultural lending at all. This is for the reasons as already explained in the 2007 Agricultural Finance Yearbook.

Diagram 3 indicates that lending to agricultural production, as a percentage of lending to the total value chain, was highest in both years, though there was a reduction in the amount lent in 2008 (8%).

In terms of the contributions of each stage of the value chain, in 2008, lending to agricultural production contributed 36% of total agricultural lending, followed by agricultural processing whose contribution increased by 17% from 17% in 2007 to 34% in 2008. Lending to agricultural marketing contributed the least in 2008. Its contribution fell by 9% from 39% in 2007 to 30% in 2008.

Agricultural Finance Lending by Repayment Period
Diagram 4 illustrates that most of the agricultural finance lending was short term (> 1 yr); contributing 67% of the total lent out to agriculture in 2008. This was followed by medium term lending (1 – 3 yrs) which contributed 27% and long term lending (3+ yrs) which contributed 6% of the total lent out to agriculture in 2008. However, this illustration may not reflect a true picture of agricultural lending. This is because some financial institutions have MIS systems that are incapable of classifying these activities. Also, and as noted above, the data on lending to agricultural value chains in this article excludes the value of leasing contracts.

From Diagram 5, we see that total agricultural lending in 2008 reduced by 5.5% from 2007. Although there was a notable increase in the number of licensed commercial banks during 2008, by the time the data were collected, not all of these new financial institutions had started substantive operations, and therefore had not yet started lending.

CONCLUSION
From the 2008 statistics, agricultural lending contributed 11.9% to the total lent out from all the regulated financial institutions, i.e. in Tiers 1, 2 and 3. This suggests that agricultural finance still contributes a relatively small percentage to the total loan portfolios of these institutions, highlighting the scope for additional policy actions to revamp the performance of the agricultural finance sector.

However, a caveat is in order. There is reason to believe that there is still scope for improvement in the quality of the data being collected in this area – as explained above. It is hoped that as this situation improves, the future will see more reliable time series and comparative analyses, for publication in subsequent editions of the Yearbook.

INTRODUCTION:
Smallholder green leaf tea growers, like any other smallholder farmers in Uganda, have conventionally been excluded from formal lending, ostensibly on the flawed premise by financial institutions of being very risky and unprofitable to service. As a result, either the green leaf tea buyers have had to step in to fill the financing gap by providing in-kind input credit and cash advances for labour costs to the growers, or the growers have had to fend for themselves to access the required inputs and labour, often in both cases resulting in lower productivity and production due to either or a combination of delayed or non-access to inputs, and sub-optimal green leaf plucking.

The other fundamental problem associated with the buyer input credit for the growers is the high risk of credit non-recovery, as the growers will often present a myriad of household financial obligations to the buyer in order to postpone the loan repayment. In extreme cases the grower beneficiaries of the input credit may opt to assign their output to their neighbours in an effort to frustrate the credit recovery by the buyer. These phenomena exist because “the buyer assumes the role of the lender without knowing the rules of the game”. The above situation existed for a long time in Kayonza in South Western Uganda. This area has a substantial number of tea outgrowers with established smallholder tea estates, a functioning tea processing factory that guarantees to purchase all the good quality green leaf tea produced by the growers in the area, and financial institutions with branch operations within reasonable proximity to the tea growers and tea factory, but traditionally with no lending to the outgrowers. Where the factory made efforts to provide fertilizer inputs, the inputs were in most cases procured late and often in inadequate volumes to satisfy all the growers’ demands.

In spite of the above situation the task of extending formal credit to the growers cannot be indefinitely insurmountable. A solution can be found. This
article describes an approach based jointly on careful financial product design and the creation of adequate mechanisms for collaboration.

**BACKGROUND:**

In 2006, the USAID/Rural SPEED (Rural Savings Promotion and Enhancement of Enterprise Development) project developed a pilot effort targeted at formal financing for inputs for the smallholder tea producers in Kayonza, using a structured trade finance model under its two key thrust areas of Linkage Banking and Agricultural Finance. The pilot was targeted at addressing the problem of the low tea production arising from the inability of the tea farmers to access fertilizer inputs either at all or in time. Fertilizer purchases are a major cost item for tea growing in the case of established tea production operations. Historically, a public sector factory would supply subsidized tea production inputs to the growers on credit and recover the subsidized cost (albeit with difficulties) from green leaf tea deliveries by the growers.

However, this same factory had later been privitized through a transfer to the tea growers themselves and therefore no longer had the GOU budget to draw down on for subsidized fertilizer supply and had, thus, terminated fertilizer supply to smallholders in order to concentrate on its core business of green leaf tea processing and made tea marketing. As result, the quality and volume of green leaf tea deliveries to the factory was progressively declining. Thus, seeking a solution to this problem was an obvious activity for Rural SPEED as it could impact up to 4,000 smallholder tea farmers.

There was only a single point of sale for the green leaf tea (the factory) which eliminated most of the risk to credit recovery, the return on investment for fertilizer to the growers was extremely positive, the farmers were familiar with fertilizer use through the well established and factory-facilitated extension system, tea as a horticulture crop was resistant to many vagaries of climate, and tea is harvested biweekly, thus yielding regular and predictable cash flows.

**FINANCIAL PRODUCT DEVELOPED:**

In order to ensure successful development and eventual delivery of an appropriate financial product, Rural SPEED partnered with several organizations. In the first place Rural SPEED carried out a tea value chain mapping and analysis activity in Kayonza to establish potential low-cost high-profit financing opportunities and the financial synergies within the entire chain. Consequent to the value chain analysis, Rural SPEED facilitated the development of a financial product for the tea inputs by Kayonza Microfinance SACCO and linked the SACCO to Centenary Bank for a wholesale tea inputs loan to be retailed by the SACCO to growers. Through direct payment to the fertilizer supplier, Centenary Bank loaned UGX 107,000,000 to the Kayonza Microfinance SACCO in kind as fertilizer. The SACCO provided this fertilizer to 100 prequalified tea grower members who subsequently delivered their green leaf tea to the Kayonza Tea Factory. Kayonza Tea factory processed the green leaf tea into made tea and sold it through the Mombasa auction.

Payments to Kayonza Tea factory for the auctioned made tea were channeled through Centenary Bank which deducted the loan repayments and transferred the balance to the SACCO which then deducted its service fees and deposited the balance into its members’ savings accounts. The loan to the Kayonza Microfinance SACCO from Centenary Bank was underwritten by a 50% guarantee facility with Danida’s Agricultural Loan Guarantee Company.

**PERFORMANCE:**

The original facility to Kayonza Microfinance SACCO was repaid in full according to Centenary Bank’s terms. Based on the new relationship with the tea growers, Centenary Bank also organized a letter of credit (LC) for the tea factory valued at USD 56,790. Following the use of the LC and the full repayment of the structured trade loan to the growers, Centenary Bank approved a new LC worth USD 25,925 for the factory and a new facility using the same structured trade system for the SACCO, worth UGX 100,000,000. Based on this experience, Centenary Bank has since made further loans to tea growers in Mabale and Mpanga. Since the inception of the program developed with Rural SPEED, Centenary Bank has loaned approximately UGX 550,000,000 to tea growers and processors.

**IMPACT OF THE LOAN PRODUCT:**

Though a pilot, the tea inputs loan facility has had visible impact that can successfully be scaled up and replicated. First, the timely availability of good quality inputs has highly impacted the productivity and production at the smallholder tea grower level. The high responsiveness of the tea crop to fertilizer usage is a long tested variable and the loan beneficiaries are reaping this benefit. Secondly, Kayonza Microfinance SACCO has been able to increase its portfolio, increase its membership by providing a highly valued service, improve its lending practices and most importantly successfully link with a commercial bank, thus projecting a better risk perception of a lower tier financial institution by a bank. Third, the risk perception for smallholder borrowers within Centenary Bank has changed and the bank has been exposed to the mechanism of structured trade finance deals.

Finally, the facility has enabled the factory to access a steady supply of good quality green leaf tea and its fears of potential decline in production as a result of its withdrawal from supplying inputs have been allayed. The factory has been relieved of the financial burden of supplying the inputs and the associated risk of non-recovery and has thus been empowered to fully concentrate on its core processing and marketing activities.

**OPPORTUNITY AND CHALLENGES:**

In spite of the fact that this facility has functioned well from both the lenders’ and borrowers’ perspectives, it has not as yet been effectively replicated and scaled up for bigger and broader impact, not only for tea but also for other crop and livestock enterprises. From a development perspective, this is unfortunate as there are many potential borrowers among tea growers and other agribusiness outgrowers with similar profiles who could both access credit and improve their household incomes if the appropriate structured trade finance instruments were to be designed and then introduced by financial institutions.

There are two clear constraints to the realization of these opportunities. These are: 1) identification and/or development of the supporting structures necessary for minimizing the costs and risks associated with identification and servicing of borrowers (SACCOs, input suppliers and off-take buyers willing and able to assume these roles), and 2) access to adequate offsetting liabilities to put the loan products into the market.

Among tea growers alone there are as yet over 3,000 potential clients from Kayonza who have not been exposed to the pilot loan scheme, while four other factories conduct business with their outgrowers as well, including Igara, Kyamuhunga, Mabale and Mpanga with their combined catchment of over 8,000 growers. Also there are other tea operations with viable smallholder tea outgrowers in Hoima, Kyenjojo and Mukono. These too could be financed with similar structured trade finance facilities. Thus horizontal replication and scalability of the Kayonza pilot is both feasible and viable.
Beyond tea growers, there are 25,000 sunflower outgrowers selling their produce to Mukwano Industries on the basis of fixed price contracts allowing annualized Internal Rates of Return in the region of 100% (far above the costs of financing). Other agro buyers (such as Olam for sesame, Afrori for maize and others) and dairy products dealers could replicate these efforts of contracting outgrowers with a locked-in supply of inputs and implements with recovery made from the marketing outlet, if they were given the chance, thus providing a multi-enterprise replication of the Kayonza pilot.

Expansion of this type of structured trade financing has been constrained by three factors. The first is the limited capacity of lenders to develop and deliver these products. This is due primarily to the fact that lenders have a traditional product mix that is working rather well for them and that this type of creative lending requires effort to establish. Second, the lenders themselves often lack knowledge of and effective working relationships with agribusinesses, and are therefore not aware of these low cost, relatively high volume and profitable financing opportunities. Third, big lenders (banks) lack the knowledge about the suitability of working with lower tier financial institutions and often consider them as very weak and risky and thus try their best to avoid working with them – or only do so when significant and effective technical assistance is organized. Fourth, and perhaps most significant, some lenders face shortages of offsetting liabilities necessary to finance the delivery of these products (which can absorb large amounts of loanable funds).

Again, the above challenges are not insurmountable. There are multiple efforts to steer the agricultural finance agenda in Uganda, backed by clear and proactive government policies. A number of donor-funded programs with agricultural finance mandates can build on the successes in the Kayonza pilot and improve smallholder access to finance by Ugandan farmers. This they can realize by: 1) completing value chain analyses of specified commodities; 2) assisting financial institutions to develop structured trade finance products; 3) linking banks with viable SACCOs; 4) providing other technical assistance to key players in the value chains and; 5) providing guarantees (if required but with emphasis on risk sharing between the guarantor and the lender) to the lenders. The last item has particularly proved to be an appropriate incentive for lending to agriculture that is otherwise conventionally perceived, by lenders, to be very risky and non-profitable.

INTRODUCTION

Agriculture is and will continue to be the largest employer in the Ugandan economy for the foreseeable future. Although most of this employment is engaged at the subsistence micro level, its ability to transform this sector is greatly constrained by a myriad of factors, among them limited access to formal financing. The bigger and medium financial institutions view the smallholder agricultural operators as too risky and too costly to service, while the smaller financial institutions (majority of them rural-based and thus being in better position to cost-effectively serve the agribusinesses within their proximity) lack the financial and technical capacities to do so.

There have however been modest attempts made by a number of rural-based financial institutions working at the micro level to finance agriculture and agribusinesses, though their attempts still remain “pockets of progress”. In this regard this article focuses on one such institution, Kyamuhunga Sacco, located in Ishaka, Bushenyi district, and its contribution to the transformation of the livelihoods of its membership, most of whom are primarily engaged in agriculture.

Like many rural Saccoos, Kyamuhunga Sacco was established with the mission of providing high quality products and services aiming at meeting members’ needs. However realization of this mission in regard to meeting the needs of the agricultural-based membership was for a long time a challenge for the Sacco. The members’ needs to finance agribusinesses (especially production) required loans with grace periods, a condition the Sacco could not fulfill, since it lacked the necessary financial capacity. As such the Sacco risked losing membership as it could not meet the priorities of its members. To KYAPS this was a cross road. It focused the Sacco on the reality that lending for agriculture was not an option, but a “necessary evil” which had to be embraced.

INITIAL PERCEPTION ON AGRICULTURAL LENDING AT KYAPS

By 2004 KYAPS did not have a clearly defined lending product for agriculture, the enormous pressure from the members for proper agricultural loans to cater for broader agribusiness coverage and also to suit the farming cycle’s situations notwithstanding. Only two loan products: first, a loosely defined generic loan product with generic loan terms which did not specifically match the requirements for agriculture, but which nevertheless was available for farming investment; second, loans for input purchase, especially for tea inputs and loans for produce transportation.

These agricultural loans were perceived to be risky and were not popular with the Sacco loans officers. If they could be avoided at all, the Sacco staff would feel better. For this reason, the interest rates for agricultural loans were fixed at higher levels than those for other loans. Table 1 below shows the loan products provided by KYAPS in 2004, and their respective terms:

<table>
<thead>
<tr>
<th>Term</th>
<th>Product Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural Lending at KYAPS</td>
<td>Loans for input purchase, especially for tea inputs and loans for produce transportation</td>
</tr>
</tbody>
</table>

1. 80% of KYAPS members are engaged in agricultural activities mainly tea production and marketing, poultry farming, pineapple farming, bee keeping, banana rehabilitation, cattle rearing and cotton growing.
CHALLENGES TO LENDING FOR AGRICULTURE BY KYAMUHUNGA SACCO BEFORE 2004

- The climatic/seasonal changes affected farmers’ yields, thus impacting negatively on the anticipated income of the borrower. Examples of severe weather events are drought and hailstorms.
- Some of the crops (like tea) for which agricultural loans were being sought required long gestation periods, yet the forms of credit available could not match these requirements.
- The SACCO lacked appropriate skills to handle agricultural lending. Even developing such skills among staff and Board members was beyond the financial capacity of this nascent SACCO. Yet it was clear that a programme of continuous and regular training for staff, Board and members was needed.
- High interest rate caused by insufficient owned funds. The Institution borrowed on high interest and was therefore forced to lend also at high rates.
- Multiple borrowing was common. Most farmers had a tendency to borrow from various micro finance institutions, despite having just one income source from which to make repayments. This complicated loan recovery for Kyamuhunga, as well as the other MFIs involved.
- At the start, agricultural lending lacked unique features to differentiate it from other forms of lending.

- All forms of lending carried similar terms, with similar maturities, with no grace periods

The impact of the then lending methodology included diversion of lower priced loans to finance agriculture by the clients. As a result of poor structuring of loans the agricultural borrowers ended paying poorly, some dropped out of the system and others started looking at the Institution negatively. The SACCO’s PAR was consistently in double digits because of the distortion by the loans invested in agriculture, coupled with the restricted abilities of the borrowers to meet their repayment schedules.

THE ROAD TO PROPER AGRICULTURAL LENDING BY KYAPS

In 2004, KYAPS received technical and financial support from the Micro Finance Support Center Ltd to pilot agricultural lending. KYAPS staff was given the appropriate training. In addition to MSCL, KYAPS also received technical assistance from USAID’s Rural SPEED project in form of staff and board training, and membership sensitization. Also, Rural SPEED assisted KYAPS in designing an appropriate agricultural loan product, and linked KYAPS to Centenary Bank. Centenary Bank provided further training and mentoring for a KYAPS agricultural loans officer at its Mbale branch. In addition, KYAPS received three motorcycles from Rural SPEED to assist in increasing outreach and efficiency in monitoring. It should be noted that the support provided by the two agencies was complementary in nature. With the above support the institution had a strong base, gained experience in agricultural lending and the product was rolled out.

TABLE 1: KYAPS Loan Product Conditions in 2004

<table>
<thead>
<tr>
<th>Loan Product</th>
<th>Interest Rate (% per month)</th>
<th>Loan Term (Months)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural loans</td>
<td>2.5</td>
<td>6</td>
</tr>
<tr>
<td>Business loans</td>
<td>3.5</td>
<td>24</td>
</tr>
<tr>
<td>Solar loans</td>
<td>2.5</td>
<td>24</td>
</tr>
<tr>
<td>School fees loans</td>
<td>3</td>
<td>-</td>
</tr>
<tr>
<td>Rainwater loans</td>
<td>3</td>
<td>24</td>
</tr>
<tr>
<td>Boda boda loans</td>
<td>3.5</td>
<td>24</td>
</tr>
<tr>
<td>Overdraft facilities</td>
<td>5</td>
<td>1</td>
</tr>
</tbody>
</table>

Currently, interest on agricultural loans is at a favourable 2.5% per month. In addition, there is a six months grace period (depending on the agricultural activity to be financed), and an extended loan period of up to two years. Table 2 below shows the different agricultural sectors funded by KYAPS and their respective loan structuring details.

Table 2: Agricultural loans provided by KYAPS

<table>
<thead>
<tr>
<th>Product Description</th>
<th>Interest Rate (% per month)</th>
<th>Grace Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tea growing and rehabilitation</td>
<td>2.5</td>
<td>6</td>
</tr>
<tr>
<td>Kyera okole (Green leaf tea)</td>
<td>2.5</td>
<td>0.5</td>
</tr>
<tr>
<td>Poultry and Bee keeping</td>
<td>2.5</td>
<td>4</td>
</tr>
<tr>
<td>Banana plant growing and rehab</td>
<td>2.5</td>
<td>6</td>
</tr>
<tr>
<td>Pineapple growing and rehab</td>
<td>2.5</td>
<td>6</td>
</tr>
<tr>
<td>Cotton growing</td>
<td>2.5</td>
<td>4</td>
</tr>
<tr>
<td>Cattle rearing</td>
<td>2.5</td>
<td>6</td>
</tr>
</tbody>
</table>

Permutation of agricultural rates was necessary.

Since the introduction of the formal agricultural loan product, the SACCO has registered tremendous growth in the numbers of agricultural savers, and in the number and volumes of agricultural loans. Table 3 below shows the predominant position of agricultural savers and borrowers in the SACCO, as at end of January 2009.

Table 3: Number of agricultural savers, and borrowers

<table>
<thead>
<tr>
<th>Item</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of savers/members</td>
<td>8002</td>
</tr>
<tr>
<td>Number of agricultural savers</td>
<td>6401</td>
</tr>
<tr>
<td>Total number of loans</td>
<td>1558</td>
</tr>
<tr>
<td>Number of Agricultural loans</td>
<td>1001</td>
</tr>
<tr>
<td>Volume of total loans</td>
<td>1,136,690,991</td>
</tr>
<tr>
<td>Volume of agricultural loans</td>
<td>718,429,837</td>
</tr>
<tr>
<td>PAR more than 30 days</td>
<td>4.3%</td>
</tr>
</tbody>
</table>

By composition over 60% of the total loan portfolio is agricultural, business loans take up 30% and the rest 10%, as shown in the diagram below.

Diagram showing KYAPS loan portfolio composition

![Diagram showing KYAPS loan portfolio composition](image-url)
THE OTHER IMPACTS OF AGRICULTURAL LOANS INCLUDE;

- Due to support from MSCL, KYAPS has been able to provide adequate, timely loan amounts to its agricultural borrower members.
- The agricultural loan borrowers use the loans for the purposes for which they are intended and there are no identifiable cases of loan diversion by borrowers.
- The Staff and Board skills have tremendously improved and the perception of agricultural lending has been substantially demystified.
- This has resulted in improved service delivery from trained staff that is able to address the varying needs of the members.
- Delinquency management by KYAPS has greatly improved as a result of proper structuring of agricultural loans and thus eliminating the artificial default (due to mismatch of incremental income from the loan-financed investment and the schedule of loan servicing payments).
- Members’ confidence in the SACCO has increased and the members have improved on their savings culture which has also enhanced their repayment performance.
- Boosting the members’ saving culture, they receive attractive interest both on savings and on time deposits.

LESSONS LEARNED
The successful agricultural lending by KYAPS has demonstrated that lending for micro level agricultural activities is highly feasible. The key parameters to address are clearly the development of suitable loan products that match the unique requirements of agricultural businesses, the possession of appropriate skills, and access to loan funds for further on-lending. Technical support is also very important for lower tier financial institutions that consider venturing into agricultural lending.

3.4 FINANCIAL INSTITUTION CLIENT PERSPECTIVE FROM KAPCHORWA
Asaph Besigye

BACKGROUND:
In 1999 maize farmers in Uganda’s maize production cradle of Kapchorwa sub-region, with support from the then USAID-funded IDEA project, were ushered into formal bank borrowing to enhance their production activities. A number of farmers have since accessed loans from Centenary Bank, mainly for maize production. Several of them have accessed repeat loans, season after season, and almost all of them have fully and timely repaid their loans. The loans have positively impacted maize production in terms of volume and quality in the area, and have greatly changed both the agricultural production and social landscapes.

Subsequent to the realization of higher maize volumes that were enabled by production loans, a gigantic farmers’ organization, Kapchorwa Commercial Farmers Association (KACOFA), was formed to further provide cohesion of the farmers and to better exploit market and technical support opportunities. KACOFA has over time managed to garner commercial volumes of produce and marketing contracts, in addition to technical support, all of which have benefited its membership.

In addition to promoting the production of maize grain, KACOFA managed to explore a further linkage that enabled the farmers to engage in production of barley under contract with Uganda Breweries. The pre-season barley production contracts, spelling out the minimum price and guaranteeing the purchase of the entire crop, provided enormous encouragement to the farmers and has propelled the production levels to substantially increase every season.

PERFORMANCE LEVELS AND TREND

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Loans</th>
<th>Volume of loan UGX</th>
<th>Recovery realized</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>27</td>
<td>31,000,000</td>
<td>100%</td>
</tr>
<tr>
<td>2000</td>
<td>102</td>
<td>115,000,000</td>
<td>99%</td>
</tr>
<tr>
<td>2001</td>
<td>400</td>
<td>400,000,000</td>
<td>97%</td>
</tr>
<tr>
<td>2002</td>
<td>550</td>
<td>700,000,000</td>
<td>96%</td>
</tr>
<tr>
<td>2003</td>
<td>600</td>
<td>740,000,000</td>
<td>96%</td>
</tr>
<tr>
<td>2004</td>
<td>610</td>
<td>750,000,000</td>
<td>96%</td>
</tr>
<tr>
<td>2005</td>
<td>640</td>
<td>450,000,000</td>
<td>96%</td>
</tr>
<tr>
<td>2006</td>
<td>600</td>
<td>740,000,000</td>
<td>96%</td>
</tr>
<tr>
<td>2007</td>
<td>700</td>
<td>750,000,000</td>
<td>97%</td>
</tr>
<tr>
<td>2008</td>
<td>730</td>
<td>800,000,000</td>
<td>97%</td>
</tr>
</tbody>
</table>

Volume of loans provided to KACOFA maize farmers by Centenary Bank [May be a bar chart would be better]
OTHER FINANCIAL PRODUCTS ACCESSED BY KACOFA FOR ITS FARMERS

The success realized from the Centenary Bank production loans, especially the big volumes of good quality maize grain, meant that KACOFA had a new challenge - assisting farmers to access a better market. Though this challenge was surmounted by securing a contract from World Food Programme (WFP), there was immediate need for the mobilization of volumes that met WFP quality standards. One key to this was encouraging farm management practices to meet quality as well as quantity goals, and to do this through ensuring access to a significant part of the value being created on the farm, soon after harvest.

Through joint collaboration between KACOFA, USAID Rural SPEED project, USAID APEP project and WFP, KACOFA successfully managed to establish Uganda’s maiden grain warehouse receipt system. This enabled the farmers to use warehouse receipts to access loans from Stanbic Bank (Kapchorwa Branch) in 2006. This facility, new for Ugandan grain growers, and also new in the Kapchorwa District, brought a number of benefits. Farmers were able to access finance to re-invest in their farming activities and to meet their other domestic and social needs, even before the actual marketing of their produce. Highly appreciated was the fact that this credit was easy to arrange; given the fact that the farmers were neither required to provide collateral and nor were they physically followed up for loan recovery.

The Stanbic Bank warehouse receipt loan facility of UGX 350 million was successfully repaid and it enabled KACOFA to market a total of 5,000 mt, worth UGX 1.1 billion to WFP, directly benefiting more than 1,250 farmers. The pilot warehouse receipt system enabled KACOFA to identify key performance requirements, such as quality enhancing equipment, the necessity for high volumes and the need for rapid turnover of produce in the collateral-managed warehouse, all of which are important to defray the high collateral management costs associated with the warehouse receipt system.

Naturally these costs are relatively substantial for high volume and low margin commodities like maize. KACOFA is in the process of addressing the cost issue, and will re-initiate the warehouse receipt system not only for maize but also for other crops like barley and coffee.

In the meantime and in order to stay the course of its commitment to enhance the continued functioning of the maize value chain for its farmers, KACOFA accessed a loan facility of UGX 200 million for crop marketing from Centenary Bank Mbale branch in 2007. The facility has since been successfully repaid.

On the barley production and marketing side, KACOFA has been successfully accessing in-kind credit (seed, fertilizer and crop protection chemicals) and also produce buying finance from the contract buyer’s representative. This indicates the existence of a potential formal financing opportunity. Should the buyer credit cease to exist and in order for the farmers to gain greater financial confidence, formal bank credit should be a feasible and viable option. The pre-planting production contracts should provide a substantial incentive for production credit for the farmers. Similarly the guaranteed market for the entire barley produce ought to provide similar incentive for lending for production bulking and marketing.

KEY CHALLENGES

The main challenge for accessing production loans was the distance to the service point for both processing and repaying the loans. The bank branch in Mbale is quite distant from Kapchorwa, and this was a disincentive to both the farmers and the loans officers. This problem was surmounted by securing a contract from World Food Programme (WFP) and it meant that KACOFA could process the transactions at the farm level.

Another challenge was the capping of the production loans to a maximum of UGX 10 million. This constrained the larger farmers’ initiative to expand their fields beyond the financially-enhanced capacity. The maize production undertaking was not profitable and farmers would reap more profit through field expansion if adequately funded. In order to address this challenge, KACOFA (in collaboration with USAID IDEA project) had to seek alternative loan sources from Standard Chartered Bank. This intermediation effort, though successful, was yet a new trek. It meant that Standard Chartered Bank had to understand the market to which it was being introduced. From the side of Centenary Bank, it lost an opportunity for further business in a market in which it had invested to harness, and the borrowers had to revert to enduring the long distance to Kampala to access the Standard Chartered Bank loan facility.

The warehouse receipt system, though most convenient for accessing marketing finance, is an expensive undertaking for the nascent rural farmers and farmer groups. The high requirements for achieving suitable collateral-managed warehousing facility (notably insurance, secure premises and, cleaning and drying facilities), in addition to the high collateral management cost is not a task to be handled by a rural farmers organization unless there is external financial support.

REASONS FOR GOOD PERFORMANCE

In spite of the daunting challenges, the performance of the financial facilities provided to the KACOFA farmers was excellent. A number of reasons provided for this performance are summarized below.

• A proactive lending approach prevailed, with good lender-borrower relationships. This helped to lower access costs for the borrowers and transaction costs for the lender. KACOFA, through its loan task force committees, helped to mobilize and vet the farmers for easy loan application processing by Centenary Bank staff. The Association also ensured follow up of loan repayment, and this greatly eased the workload of the loans officers. To KACOFA, the loans were not only perceived as benefiting the individual farmers per se, but also were an opportunity to enhance the reputation of the commercial farming community as borrowing bank clients. The borrowers had to pay fully and on time lest the bank’s classic perception of risk of lending to the farmers would be endorsed.

• The structuring of the production loans which adequately matched the timing of the activity cash flows enabled the farmer borrowers to concentrate on production activities without worrying about pre-harvest repayment installments that are associated with conventional loans. The repayment of the principal and interest was structured to match the realization of sales proceeds.

• Adequate monitoring of the loans by the loan officers ensured non-diversion and inculcated the need for proper management of the field activities by the borrowers. In addition, it made accessing of the repeat loans easy, cost-effective and timely, as the loan officers gained increasing understanding of their clients.

• Technical assistance, including collateral leveraging (USAID-IDEA, USAID-APEP, USAID-Rural SPEED, Danida ABDC, Enterprise Uganda and WFP among others), has over the years helped to forge productive relationships between farmers and banks. Moreover, it has helped to develop and [[innovative mechanisms and thus overcome traditional lending constraints e.g. the Warehouse Receipt System that successfully circumvented the highly restrictive traditional collateral requirement that has been such a challenge to the realization of rural Uganda.

• Access to finance for the key transaction points in the value chain, i.e. spanning beyond production credit has been vital. The augmentation of the production loans with the credit for marketing greatly improved the capacity of farmers to adequately accomplish their activities and repay their loans easily.

• Creativity and flexibility within the bank has permitted easy access and interaction between the borrowers and loan officers. The bank has, over time, ensured that there are loans officers solely dedicated to handling agricultural clients.

• There is a critical mass of borrowers with positive and pragmatic borrowing attitudes, happily coupled to appropriate skills and experience. This lowered the loan delivery costs and enabled the bank to build a profitable maize loan portfolio.

• The strong farmers’ organization, with the capacity to marshal access to profitable markets and external technical support is another key to the success of the Kapchorwa enterprise. KACOFA has, over time, not only concentrated on production-related support for its members, but has also focused on securing profitable market opportunities.

• The selection of a highly marketable commodity has enhanced the active performance of the farmers and their repayment capacity.
IMPACT OF THE FINANCIAL FACILITIES

There has been enormous impact of both the production and marketing loans in Kapchorwa. A win-win situation benefiting the farmers, KACOFA and the banks has been enhanced. At farmer level, production and productivity has increased substantially. On a district level, the volume of maize produced in Kapchorwa has in the last decade been increasing year after year. The farmers have also been able to diversify commercial production beyond maize to other crops, using the higher incomes generated from maize and also leveraging funding from other sources. As for KACOFA, its profile has been lifted and its effective representation of farmers recognized. In 2006 KACOFA received a Best Practice Award from the European Union-funded Civil Society Capacity Building Programme. In addition, KACOFA has been able to grow its membership from 27 in 1999 to 3,015 by the end of 2008.

The banks have benefited by realizing profitable lending operations in the area and also gaining a better understanding of the financing needs of the sector. To KACOFA, it is undoubtable the experience gained by both Centenary Bank, Standard Chartered Bank and Stanbic Bank through their lending operations in Kapchorwa can be successfully replicated by these and other banks in other areas in Uganda. KACOFA attributes the opening of Centenary Bank branch in Kapchorwa town at the end of 2008 to the positive gains realized by Centenary Bank from the loans extended to the farmers. This branch will provide a real breakthrough for further financial facilities, including deposits/savings as there is high attachment by farmers and civil society to Centenary Bank in the area.

WHAT LESSONS ARE LEARNED FROM THE LENDING ACTIVITIES IN KAPCHORWA?

There are clear lessons to be learned from the formal financing products for Kapchorwa farmers and for the farmer’s association. These are summarized below.

- Proper and right structuring of loan products (meeting both borrower and lender requirements/priorities) is key to successful agricultural lending. Agricultural lending is unique and therefore calls for a special effort in product design.
- Technical collaboration enhances performance by both farmer borrowers and lenders, and thus substantially reduces the lending risk. Borrowers, acting alone, would face virtually insurmountable hurdles. This in turn would increase the perception of risk by potential lenders.
- Financing the value chain ensures realization of maximum borrower efficiencies.
- There is need for lenders to be alongside rural clients as their businesses grow – just as banks do with their urban clientele.
- Innovativeness by lenders is of crucial importance for sustainable agricultural lending. This overcomes the nostalgia of “this is how we do business”, leading to a more borrower-responsive approach. Successful agricultural credit must be demand and not supply driven. This demands that lenders must gain an intimate and detailed knowledge of agricultural value chains.

3.5 NEW TERM FINANCE LENDING PRODUCTS:
ANIMAL TRACTION INVESTMENT
Julius M. Segirinya
Credit Manager, Agricultural Finance (Centenary Bank)

BACKGROUND
Animal traction basically refers to the use of draught animals to provide motive power for machinery. Agricultural machinery of different types is necessary for improving labour productivity, increasing the scale of production, improving on-farm transport and ensuring timely farming operations in Uganda. Animal draught power has been widely used in the Teso sub-region and in the wooded savannah districts of Lira, Apac, Gulu, Kingum and Pader as well as parts of Kapchorwa, Pallisa and Tororo in the eastern part of the country. The use of animal draught power in these areas has, however, been negatively affected by various factors including insurgency in the north and cattle rustling in the north-east and east by Karimojong warriors. This caused a shortage in draught animal power that led to less land being cultivated and gradual transformation of the area from a cash crop to a subsistence economy. Notwithstanding these problems, the farmers from these areas still have a persisting desire to use animal draught power for enhancing agricultural production. Various cattle restocking initiatives by the Government and some donor agencies have alleviated the animal shortage problem – at least for the near term.

JUSTIFICATION FOR ANIMAL

TRACTION LOAN PRODUCT
Three major reasons can be cited for Centenary’s decision to adopt the animal traction loan product:

- Centenary Bank Ltd. is a financial institution that was established with the mission to “provide financial services particularly microfinance to all the people of Uganda in a sustainable manner and in accordance with the law”. The extension of a diversified agricultural loan product package to the Bank’s farmer-clients on medium-term basis fits well in the Bank’s mission. The animal traction product also provides another opportunity to further expand the Bank’s agricultural finance services in a diverse, competitive market.
- Agricultural mechanization enhances agricultural production through expanding the land area under cultivation, ensuring that farm activities are carried out according to schedule, and reducing the drudgery associated with farming activities, among others. In Uganda, the level of farm mechanization has deteriorated over the past years to very dismal levels – only 10% of the country’s farming population has access to agricultural machinery, with the rest depending on human powered technologies based on hand tools (hoes, sickles, axes, etc).
This has caused a tremendous reduction in labour productivity and, consequently, significant reductions in yields and farming household incomes. Centenary’s intervention is aimed at supporting its farmer-clients to improve labour productivity and increase production at this level.

- High demand for the animal traction loan product: According to a number of studies carried out prior to the introduction of the animal traction loan product, the demand for oxen and ox-drawn equipment is high in the regions where animal draught power has traditionally been used over several decades. The high demand for animal draught power stems from the absence of alternative forms of mechanization, high cost of hiring labour, and the historical attachment to this form of technology. Although the utilization of draught animals in farming operations was interrupted by insurgencies and cattle rustling, many farmers expressed the desire to restock and resume the use of animal-drawn equipment, principally to open up land. However, in order to restock and acquire machinery, the farmers needed investment capital. Centenary Bank thus moved in to fill this financing gap.

INTRODUCTION OF ANIMAL TRACTION LOAN PRODUCT BY CENTENARY

Centenary Bank’s agricultural lending programme has entailed the extension of mainly short-term working capital loan products (one year or less) for micro-entrepreneurs and SMEs. However, the Bank recognized that many of its customers were in need of term financing products to enable them to invest in agricultural machinery, equipment, as well as land property. This necessitated the development of a term finance product for agricultural clients wishing to increase the scale of their operations through mechanization and improved land use. To this end, the Bank partnered with the GTZ/Sida/BOU Financial Systems Development Programme to carry out a study aimed at assessing the economic and financial viability of investing in farm power and mechanization, and the potential for developing appropriate medium-term financing products - that could take the form of loans and/or leases.

After a thorough study involving several missions to the field, it was concluded that there existed a huge demand for draft animals and traction equipment in the regions where animal traction has a long tradition and where the farmers are well-acquainted with using draught animals, mainly for ploughing.

The study recommended the introduction of the animal traction loan product on a pilot basis in one or two areas with a high potential demand. Kumi and Soroti areas in the Teso sub-region were selected for the pilot on the basis of their good history with animal draught power. A team of credit supervisors and branch officers conducted a series of mobilization and sensitization activities to screen potential beneficiaries, identify sources of animals in the targeted area, and enroll veterinary assistants who would carry out pre-disbursement health checks on the animals. A partnership was established, with one of the main, local agro-processors buying commodities from farmers, to make payments to cattle traders in the markets.

In total, 60 animal traction loans were disbursed during the pilot to smallholder farmers in Kumi and Soroti, who are involved in the production of various crops that include cotton, sesame, peas, and sunflower. The average loan size for each animal draught power set (2 oxen, an ox-plough, yoke and other accessories) ranges between Ushs 1.2 million to Ushs 1.4 million, although farmers with a more demonstrable repayment capacity were able to acquire more than one set.

Centenary Bank limited the number of loans to 60 since it was regarded as a pilot that involved a significant amount of staff capacity building together with the development of systems designed to improve efficiency within the lending process. The loan product has so far performed quite well with many farmers registering higher crop production due to the increased cultivated acreage that has been made possible by the application of the draught animal technology. Not only will the increased cropping area produce incremental income, but additional revenue was generated from hired ploughing services. Indeed, a field study conducted by the Bank in October to assess the progress of the scheme revealed incremental cropping area of some 4 – 5 acres per borrowing farmer, and additional income to the farm from hired services amounting on average to Shs.240,000.

The groundwork for roll-out of the product in Lira and Kapchorwa has been finalized and it is expected that the first animal traction loans will be disbursed in these areas during the first season of 2009.

As in the case of other agricultural production loans, the major threat against animal traction credit is the production risk – essentially the inability of the farmer to realize the volume and/or quality of the commodity that he planned for at the start of the season. This is often attributed to systemic weather factors like drought, floods, etc.

FUTURE PROSPECTS

Depending on its success in the pilot and initial roll-out areas, the animal traction loan product will be extended to those regions where it has been traditionally and historically used by the farming communities. The areas so far earmarked include Hoima, Masindi/Kigumba, and Gulu – the last-named depending on the return of peace in the North and subsequent resettlement of internally displaced persons in the rural areas.

The Bank is also exploring the possibility of introducing related conservation agriculture products to help farmers reduce the amount of farm power and investment required to open up land. Conservation agriculture is a type of farming based on integrated practices such as zero or minimal tillage, crop rotations and permanent soil cover.

Ploughing is replaced with weed control procedures involving herbicides and/or the use of special implements such as cutters and mulchers. Sowing is done directly into the ground, through the mulch formed from the wilted weeds and residues of previous crops. Special implements are needed for conservation agriculture, but because the soil is not turned over, the amount of power required is significantly lower than that needed for normal seedbed preparation.

CHALLENGES

1. Assessing the farmer’s repayment capacity

The ability of beneficiary farmers to repay an animal traction loan is complicated by the longer loan terms with irregular production periods between seasons. This implies that the credit analyst has to gather very detailed information from clients who maintain no records and/or may not be able to furnish the officer with sufficient reasonable data to make a case. On the supply side, this tends to affect the officer’s ability to book loans at the rates required by the Bank.

2. Designing appropriate repayment schedules

As noted already, animal traction loans are term finance investment loans with periods spanning across 2 years unlike most seasonal production loans that are often limited to one year. Payments are thus supposed to be linked to produce sales at the end of each production season. The difficulty of ascertaining future production is attributed to the staggered nature of the output and the many grace periods that have to be awarded between seasons to allow for crop maturity.

3. Availability of draught animals

The availability or unavailability of draught animals is a major challenge in some of the targeted areas. As mentioned at the outset, animal numbers in the regions that are traditionally known for animal traction were reduced tremendously by rebellions and armed cattle thefts. In Lira district for instance, the cattle population fell from an estimated 240,000 cattle to less than 9,000 heads in 1990. This number was reduced even more with the renewed outbreak of violence between 2003 and 2006.

In some of the areas where we have assessed the potential for introducing the animal traction loan product, the demand for draught animals seems to outstrip the supply. This makes it difficult for the Bank to extend a reliable, reputable product that can build much-needed client confidence. Governmental and non-governmental initiatives...
to re-stock oxen may confuse bank clients as they might think that the Centenary Bank funded oxen are a gift, not an item to be repaid.

4. Availability of animal draught power equipment

Looking at the history of animal traction in Uganda, there should ideally be no shortage of animal draught power equipment, since the technology was introduced in Uganda in 1909 with the first locally-fabricated ploughs delivered in the 1920s. It is worth noting however that the growth of the animal draught power industry has not been consistent owing to years of political turmoil.

Whereas the equipment is readily available on the market in some animal traction regions, it is rather scarce in some of the other areas where it can potentially be used and, as such, transportation arrangements have to be made with suppliers to deliver ox-ploughs to areas experiencing scarcity of supply. This too has implications on the final market price.

5. Labour intensive product

The process of making an animal traction loan is more labour intensive when compared to other products of the same category. The loan officer has to travel to the cattle market to oversee the purchase and handover of the animals to the client, brand the animal and ensure that a thorough pre-disbursement health check is done by the vets prior to handover. In addition to this, loan officers have to painstakingly conduct rigorous interviews during the data collection stage in order to put together all the information needed for a reasonable credit proposal.

The complexity of these activities tends to slow down the rate of loan processing. This has the effect of making the animal traction loan product less attractive to loan officers, as the inability to achieve loan targets means less income in form of bonuses.

6. Risk management

Risk mitigation is an important prerequisite to a successful animal traction loan product, especially because of the prolonged loan term. Production risks of a systemic nature such as drought, floods, and animal disease epidemics pose one of the biggest challenges to the implementation of the programme as they lead to widespread losses, thereby rendering the farmer incapable of servicing their loan. Risk management alternatives being considered for the future include loan guarantees, crop insurance, and animal insurance.
One of the areas with so much to contribute to the goals of the National Development Plan.

commodity case studies
INTRODUCTION:
There are many different ways that Uganda’s agricultural enterprises are financed. While most people who monitor the sector or whom are engaged in the sector itself are aware of the various financial product offerings available within Uganda itself (lines of credit, trade finance, overdraft facilities, traditional loans, etc.) most are unaware of how large international firms finance their operations. This article discusses how Olam Uganda Limited, a fully owned subsidiary of Olam International based in Singapore, finances its local operations. Further the article explores the interaction between global financial markets and Olam’s local operations and decisions. Finally, the degree to which Olam Uganda has engaged in value chain financing and its experience with that is covered. The author gratefully acknowledges Iyer Suresh of Olam Uganda for his frank and honest input without which this article could not have been written.

BACKGROUND ON OLAM:
Olam International works in 53 different countries trading agricultural commodities. *Olam Uganda Limited* is one of Uganda’s major agricultural trading firms. Trading operations have included importation of sugar, rice and milk powder and exportation of cocoa, cotton, coffee and sesame. Recently, the majority of the importation side of the business has stopped due largely to tariff structures in the cases of sugar and milk powder and international price movements rendering the cost of rice too high to be competitive in national retail markets. It is interesting to note, however, that while tariffs impede importation of certain commodities into Uganda, these commodities are at times re-exported by Olam to neighboring countries such as Burundi, Congo, Rwanda and Sudan through Uganda. Olam’s exports have continued with the most significant export being coffee, followed by cocoa, sesame and cotton. Olam is a small player relative to total coffee exports, but Olam is probably Uganda’s most significant exporter of cocoa and sesame. Cotton exports have been relatively insignificant for Olam and others in the past two years due mostly to the low production Uganda has offered the international market (Olam exported 30,000 bales of the 150,000 bales Uganda produced in 2008).

FINANCING AT OLAM:
Olam, by and large, borrows its working capital from Olam International in US Dollars at rates ranging from 7% to 9% per annum. This is treated as a line of credit that is settled against exports of commodities. All of Olam’s local operations (that is Uganda and all others) have the option of financing with local borrowing or financing from Olam International. Until recently financing in US Dollars in Uganda has not been remotely competitive for Olam Uganda Limited and thus they have opted to borrow from Olam International. Recently, US Dollar interest rates from Uganda’s international banks have been competitive with Olam International financing. Although competitive, the rates are not competitive enough to entice Olam Uganda Limited to borrow locally.

INTERNATIONAL MARKETS AND OLAM’S OPERATIONS:
Like all export driven firms, Olam’s capacity to buy, process and export products is wholly dependent on the interaction between the international trends in demand (price and quantity) and the expectations of Ugandan suppliers of commodities. While most readers will be well aware that international commodity prices have, by and large, collapsed in the past months after achieving historic highs, most smallholder producers are not aware of this reality. Hence, for an export firm such as Olam that intermediates between international buyers who want smaller volumes and expect to pay lower prices and sellers who expect the robust market of the last years to be a continuing and unmitigated phenomenon, business is difficult to say the least.

Olam cited several examples. While cocoa export volumes had been rising in spite of the fact that Uganda’s cocoa is an inferior product compared to West African cocoa, global demand for cocoa in general has collapsed, as it is a luxury item. Nonetheless, producers continue to believe that they are in a positive market and have increased volumes of production as a result. Although supply is high and demand is low for their product, producers simply do not see any reason why the local cocoa price has fallen.

Export of cocoa through Olam is 50% of what it was last year. Olam itself, wisely, is not interested in speculating by buying high and stocking cocoa. The company is well aware that the interest incurred on the purchasing credit is a very unforgiving ongoing expense, while, given the trends in commodity markets, it has no confidence that the market for cocoa will rise within the time frame that might make such speculation a sound business decision.

Sesame is a similar case. While Uganda’s sesame is a fine product once processed, the global demand is simply low. Farmers and farmers’ organizations expecting the astronomical prices they received in 2007 (even reaching UGX 4,000 per KG) are simply not willing to accept that the price of sesame has collapsed globally, following falling demand. As a result, Olam’s regular suppliers are withholding sesame and asking a price that is equal to the landed price in the Far East markets. That is, producers are expecting to receive in Uganda the same price that buyers are paying in China. Obviously, this kills any incentive for Olam to buy.

VALUE CHAIN FINANCING:
Given that Olam has both now and historically been able to access low cost, dollar denominated credit, the author inquired if they would be willing to extend this low cost credit down the value chain to their suppliers and producers. It seems a reasonable question given that costs of financing in Uganda have always been high and there is no reason to believe that commodities purchased and sold in dollar terms couldn’t support borrowing in dollar terms.

In the past Olam engaged to a degree in value chain financing. They tried to provide financing directly to agents to buy product for them to save the agents the exorbitant costs of credit and they tried to sign forward contracts with producers guaranteeing a price and quantity well in advance of delivery, while providing the producers with production finance. In both cases, Olam suffered negative experiences. Buying agents simply failed to supply. Forward contracts to agents were written off losses on buying agent advances exceeded the profits on the goods they delivered. Worse, forward contracts with pre-financing performed less well. In fact, farmers and farmers’ organizations simply side sold their products and failed to repay the credit, as demand grew more robust and middlemen offered slightly more than the agreed forward contract price.

Clearly, when the global demand and prices for Olam’s export commodities were high, Olam, as a firm, was more willing to attempt to innovate with a value chain financing strategy that served both their interests and the interests of their suppliers. In the current difficult market, conservatism is not a choice; it is a necessity. Interestingly, many lenders have found it impossible to offer credit at low rates in step with international borrowing rates for US Dollars. As all readers will be aware, production and marketing credit in Uganda Shillings ranges from effective lows of 22% to effective highs of over 100% per annum, from registered and non-registered lenders. Further, accessing such finance is difficult for borrowers, since even at these rates, lenders fear risks of non repayment and feel that such rates may not cover their losses. Perhaps, Olam has simply learned the same lesson.
4.2 FINANCING SUGAR PRODUCTION AT KINYARA SUGAR LIMITED CASE OF THE OUTGROWERS’ SCHEME.
Moris Ngabitho, General Manager, Kinyara Sugarcane Growers Ltd

In the year 1996, after the commissioning of Kinyara Sugar Works Limited by His Excellency the President of the Republic of Uganda, Yoweri Kaguta Museveni, the Outgrower Scheme was also launched as an approach towards poverty alleviation in Masindi rural areas. (Kinyara Sugar Works Limited later became Kinyara Sugar Ltd).

It was expected that the Outgrower Scheme would create employment, introduce small holder farmers into commercial farming and increase rural incomes. From that time to date outgrowers have been major partners of Kinyara Sugar Ltd (KSL) as suppliers of over 42% of the total cane requirement at the total capacity of 64,000 tonnes of sugar cane per annum. It is expected that by the time KSL starts producing 100,000 tonnes of sugarcane per annum the outgrowers will be supplying over 55% of the total sugarcane requirement of the mill.

The supply of sugar cane to KSL by the farmers has been made possible by financing from the miller under a scheme called the Outgrowers’ Development Scheme of Kinyara. The scheme has made it possible for 3,176 farmers to grow cane on approximately 11,789 hectares of land, by close of December 2008. The current financing is over 6.0 billion Ugandan shillings, from Kinyara Sugar Limited to farmers. This sum represents approximately the total credit/loan outlay to farmers, exclusive of interest. The area of cane (main crop plus ratoon crop) that has been developed on financing from the miller has a value of over 45 billion Ugandan shillings. The out grower scheme that has been taken on by the current owners of KSL, the RA Group, started in the year 1996. This was after the local political leadership and farmers resisted the expansion of the mill’s capacity based on increasing the area of the nucleus estate through buying the additional land from the indigenous people in the neighborhood.

The outgrower scheme started with difficulty because the existing banks in Masindi, then the Co-operative Bank and Uganda Commercial Bank (UCB), were not willing to finance cane farming, due to the risks they associated with this enterprise. These risks were seen by the banks to include: accidental cane fires, long gestation period of the crop, and inability of farmers to make regular loan repayments over the period of the credit. The banks were further negatively influenced by the sad experience they had with the Rural Farmer’s Scheme of UCB. Generally, financing sugarcane farming was not in their overall strategy. It should further be noted that the loan recovery method suggested was supposed to be at the end of the period i.e. at harvest time in one installment. This loan recovery mechanism was foreign to Ugandan banks at that time.

Through concerted efforts by the then management of Kinyara Sugar Limited, by politicians and by farmers’ leadership, financing was secured from Stanbic Bank in Kampala, but with a guarantee of KSL. The scheme was based on the arrangement that funds be advanced to KSL and then used to service the sugar cultivation activities of the farmers in kind. KSL provided the service either directly or indirectly through the use of contractors who are then paid by the farmer (KSL).

The services financed under this arrangement are: up-to-date land development activities such as land survey, ploughing, harrowing, furrowing; seed cane supply and fertilizer supply. Under this arrangement the farmer allocates the land to KSL for cane growing and pledges to maintain the cane for the purpose of supplying the miller under an agreement called the Cane Production Contract (CPC). The CPC is the basis of this relationship between the miller and the farmer. It has been the tool of execution of this financing, with each party having obligations and responsibilities, all clearly stated. The loan agreement is annexed to the CPC, and is signed by the farmer and the miller. In doing so the farmer acknowledges that the loan from the miller will be repaid from sales proceeds of cane. The miller’s interest is flexible, as it is calculated monthly on the basis of the prevailing interest rate of Stanbic Bank. The interest rate to be paid by farmers has been a contentious issue, especially as it was believed that some of the outgrower financing was from KSL’s own resources, rather than on-lending from Stanbic Bank.

Despite this issue, the financing of the outgrower scheme by KSL has had a number of benefits. These include: the introduction of previously small-holder farmers of subsistence nature to commercialized farming, indirect creation of employment for over 15,000 people in the district, increase of farmers’ household incomes, increase of the tax base, enhanced contribution to the gross domestic product, improved land use.

However the interest rate remains a major hindrance to this development coupled with high inflationary rates that Uganda is registering and in particular food prices. There is a likelihood of competition for land between sugar and food crops because of among other factors the high interest rates.

An important issue for outgrowers is the perception that the quantum of financing is insufficient. Many feel that the funds advanced by KSL are not adequate to cover such activities as: bush clearing, weeding (manual, chemical, and mechanized), cane farm guarding, land leasing, general farm maintenance and supervision. This is because in financing cane maintenance and supply the farmer ends up losing other sources of income such as that from animal husbandry, growing food crops and other activities. It is very common now to find cane farmers who have no diversification of income sources, because all family resources have been allocated to the cane enterprise. There are many cases of farmers who have not been able to maintain their former enterprises, after starting cane farming.

In summary, it is clear that outgrowers (and probably KSL too) would prefer that funding for on-farm production be sourced directly from banks. However, it is not clear how this could be arranged, given the huge costs that lenders would need to meet in order to extend credit to this group of clients. These costs include such items as information acquisition, as well as the costs and risks of operating a secure mechanism for loan delivery and amortization outside of the transactions in which the farmer is already automatically engaged.
In Uganda, the domestic rice trade structure can be classified into two markets, namely for paddy (unmilled rice) and for processed rice. The major market for paddy is the processing industry and the demand for this raw material by the processors is derived from the demand for milled and polished rice, mostly in the urban areas. Therefore, the contribution of rice production to small farmers’ income and rural employment is linked to the availability of a thriving consumer demand in urban centres and in the regional markets.

The rice marketing channels can be categorized into three main stages namely primary, secondary and tertiary. The primary stage involves farmers and rural traders/processor agents as the key players. The secondary stage consists of processors and semi-urban traders, while the tertiary stage consists of urban traders and importers. Different market outlets charge a variety of prices, which differ depending on processing, quantities offered, quality, distances, and other factors.

Due to the small number of actors, poor road networks and insecurity in some of the major rice growing areas, there is poor market information flow between rice farmers and traders. These results in unfair marketing practices, but this is changing due to the increasing number of traders competing for the commodity from the farmers.

**FARMER’S COST OF PRODUCTION:**

The mode of smallholder production is categorised into technologies used: Traditional (subsistence); Improved low input technology; and Improved high input technology. Each of these has different associated cost and yield levels, as depicted in the table below. In a typical upland rice production situation in Uganda, the only cost of mechanization is land tillage, while labour and input requirements constitute the bulk of the other costs. In this analysis, subsistence or traditional technology refers to use of home saved seed or grains bought from local markets. The crop is planted using traditional sowing or broadcasting method.

The average total cost of traditional upland rice production per acre is UGX 249,000 per acre. The improved low input technology refers to use of improved seed in association with improved/recommended crop husbandry practices, with an average total cost per acre of UGX 354,000. The improved high input technology encompasses the use of chemical fertilizers and herbicides in addition to all aspects of improved crop husbandry practices, with an average total cost per acre of UGX 578,000 basically due to the high cost of fertilisers.

The resultant, expected paddy rice yields per acre of the three technologies are 800kg, 1500kg, and 2400kg per acre respectively.

Regional comparison shows that tillage costs are relatively lower in the eastern and northern parts of the country where animal traction is practised. In central and western Uganda, the tillage costs are more than double due to high tractor charges. The average cost of tractor ploughing per acre is UGX 80,000 compared to UGX 30,000 for animal traction. The labour charges are similarly higher in the west; hence the higher total cost of production as shown in the table below.

**Cost of Production in Selected Districts (Shilling/Acre)**

<table>
<thead>
<tr>
<th>DISTRICT</th>
<th>Traditional</th>
<th>Low Input</th>
<th>High Input</th>
</tr>
</thead>
<tbody>
<tr>
<td>EASTERN REGION (OX PLOUGH)</td>
<td>249,000</td>
<td>354,000</td>
<td>578,000</td>
</tr>
<tr>
<td>MID WESTERN REGION (TRACTOR)</td>
<td>400,000</td>
<td>521,500</td>
<td>678,500</td>
</tr>
</tbody>
</table>

Source: APEP Field Survey 2008
Gross Margins:
The gross margin in rice production is mainly dependent upon the yields since sales price and labour charges are relatively invariable and beyond the farmers’ sphere of influence. Over the past year, the average farm gate price of paddy in the country has been UGX 800-900 per kg, having risen from an average of UGX 400 prior to the global food crisis.

Gross Margin (gross profitability) analyses shows that at current average farm gate price of UGX 800-900 per kg of paddy, return on investment for traditional farming systems is still positive, unlike other crops such as maize. The profitability increases with investment in improved technologies across the categories with high gross margins of up to UGX 1,800,000 per acre for High input production using ox-plough.

Gross Margins (UGX per Acre)

<table>
<thead>
<tr>
<th>Location/District (OX PLOUGH)</th>
<th>Traditional</th>
<th>Low Input</th>
<th>High Input</th>
</tr>
</thead>
<tbody>
<tr>
<td>EASTERN REGION (OX PLOUGH)</td>
<td>640,000</td>
<td>1,200,000</td>
<td>1,800,000</td>
</tr>
<tr>
<td>MID WESTERN REGION (TRACTOR)</td>
<td>410,000</td>
<td>963,500</td>
<td>1,481,500</td>
</tr>
</tbody>
</table>

Source: APEP Field Survey 2008

The profitability of rice production can be illustrated using the unit cost of production (UCOP) concept or cost of production per kg of paddy. The UCOP decreases with improving levels of technology as yields increase accordingly. The UCOP concept is seen as a vital tool in illustrating the justification of increased investment in inputs which is otherwise seen as exorbitant in the farmers’ context. Farmers’ mind sets tend to be focused on the total cost of production only with no focus on return to investment. A further comparison of farm gate price (output) in relation to UCOP (input) shows that high input technology has the highest output: input ratio, followed by low input technology and lastly traditional. Unlike in most other crops, where the output:input ratio are often less than 1.00 for traditional methods, the current rice prices allow even traditional upland rice production to exceed the output:input ratio of 2.00 implying that the farmer still spends less money to procure a unit of paddy than he/she gets for every unit sold.

Unit Cost of Production (UGX/Kg of Paddy) and Output: Input Ratio Analysis

<table>
<thead>
<tr>
<th>Location/District (OX PLOUGH)</th>
<th>Traditional</th>
<th>Low Input</th>
<th>High Input</th>
</tr>
</thead>
<tbody>
<tr>
<td>EASTERN REGION (OX PLOUGH)</td>
<td>312</td>
<td>236</td>
<td>257</td>
</tr>
<tr>
<td>EASTERN REGION (OX PLOUGH) (Output:Input Ratio)</td>
<td>2.56</td>
<td>3.39</td>
<td>3.11</td>
</tr>
<tr>
<td>MID WESTERN REGION (UCOP)</td>
<td>444</td>
<td>316</td>
<td>283</td>
</tr>
<tr>
<td>MID WESTERN REGION (Output:Input Ratio)</td>
<td>2.03</td>
<td>2.85</td>
<td>3.18</td>
</tr>
</tbody>
</table>

Source: APEP Survey Findings 2008

Cost Factors for Large Milling Costs

The milling costs of large millers vary greatly, due to a number of factors. These have been noted to range from as low as UGX 11.10 to UGX 150 per kg of milled rice.

The factors that greatly vary in the 11 large mills in Uganda include inter alia:
- Automation/Mechanisation of operations
- Overhead costs
- Electricity tariff rates vary with the milling time. Off-peak (cheaper electricity) periods usually occur at night.
- Efficiency of machinery
- Higher machine efficiency in terms of the Out-turn ratio of milled rice per unit of paddy. This has been noted to vary from 60% to 75% in various mills surveyed.
- Cost of Finance

Where pertinent, the interest to be paid on the financing of the mill procurement and installation can impact significantly on the milling cost.
- **Volumes of Paddy**

Economies of scale do lower the unit cost when milling large volumes of paddy compared to small volumes. Continuous milling saves on idle labour and machinery cost. According to the survey conducted, milling 5 MT and less would cost as high as UGX150 per kg of milled rice while 65MT and above can cost as low as UGX.11 per kg of milled rice.

- **Depreciation**

The depreciation costs will vary with the procurement cost of the plant and the expected lifespan. Most of the new machinery surveyed has an average lifespan of 7 years.

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### Impact of Increasing On-farm Input and Output Prices

<table>
<thead>
<tr>
<th>COST/ACRE (UGX)</th>
<th>Previous (Before 2008)</th>
<th>Current (Jan onwards)</th>
<th>Change</th>
<th>% Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ploughing (exem)</td>
<td>35,000</td>
<td>50,000</td>
<td>15,000</td>
<td>43%</td>
</tr>
<tr>
<td>Seed</td>
<td>54,000</td>
<td>66,000</td>
<td>12,000</td>
<td>22%</td>
</tr>
<tr>
<td>TSP</td>
<td>25,000</td>
<td>50,000</td>
<td>25,000</td>
<td>100%</td>
</tr>
<tr>
<td>UREA</td>
<td>50,000</td>
<td>100,000</td>
<td>50,000</td>
<td>100%</td>
</tr>
<tr>
<td>Transporting</td>
<td>18,000</td>
<td>22,500</td>
<td>4,500</td>
<td>25%</td>
</tr>
<tr>
<td>TOTAL COST (UGX/ACRE)</td>
<td>471,800</td>
<td>578,300</td>
<td>106,500</td>
<td>23%</td>
</tr>
<tr>
<td>YIELD UNMILLED (KG/ACRE)</td>
<td>2,250</td>
<td>2,250</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>UCOP (UGX/KG)</td>
<td>210</td>
<td>257</td>
<td>47</td>
<td>22%</td>
</tr>
<tr>
<td>PRICE AT MILLER (UGX/KG)**</td>
<td>400</td>
<td>800</td>
<td>400</td>
<td>100%</td>
</tr>
<tr>
<td>GROSS INCOME (UGX)</td>
<td>980,000</td>
<td>1,800,000</td>
<td>900,000</td>
<td>100%</td>
</tr>
<tr>
<td>NET INCOME (UGX)</td>
<td>428,200</td>
<td>1,221,700</td>
<td>793,500</td>
<td>185%</td>
</tr>
</tbody>
</table>

However, on the other hand, the food crisis led to the doubling of the rice prices from an average of UGX 400 to UGX 800 currently thus greatly increasing the net margins per acre by an average of 185% despite the increasing cost of production resulting from increased input prices. It was therefore a blessing in disguise to the producers that the food crisis that emerged after the increasing input and fuel costs resulted in the increasing cost of production resulting from increased input prices. It was therefore a blessing in disguise to the producers that the food crisis that emerged after the increasing input and fuel costs resulted in the increasing cost of production resulting from increased input prices.

### Impact of Increasing Input Prices and Food Crisis

Rice production is particularly affected as other commodities by both the increase in input prices and the world food crisis. Increasing world prices of fertiliser as well as the increasing local fuel costs have had a significant impact of the cost of production of rice.

From the table below, the key inputs affected were ploughing, seed, fertiliser and transport costs, that resulted in an overall average increase in the cost of production of rice per acre of 23%.

<table>
<thead>
<tr>
<th>Percentage Changes from 2008 Onwards: Rice Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
</tr>
<tr>
<td>50%</td>
</tr>
<tr>
<td>100%</td>
</tr>
<tr>
<td>150%</td>
</tr>
<tr>
<td>200%</td>
</tr>
</tbody>
</table>

---

### 4.4 SUNFLOWER VALUE CHAIN ANALYSIS

David Luseesa
Extension Services Manager
Mukwano Group of Companies

**BACKGROUND**

The sunflower value chain has a significant influence on the livelihoods of small scale farmers and small businesses involved in trading, transportation and oil milling, mainly in the Northern and Eastern regions of Uganda.

Despite this important, current economic role, a role that could be enhanced to transform the lives of about 12 million Ugandans in its predominant growing areas, the sunflower industry equally has a pool of constraints that limit its capacity to generate the desired productivity, incomes and employment.

These constraints include but are not limited to: poor availability of agro inputs, weak producer organizations, lack of market-oriented production, lack of market information, and difficulties with access to and cost of finance. Currently, the industry is crushing at less than 50% of installed capacity, due to low supply of raw materials. The enhanced competitiveness of the sub-sector hinges on improved efficiency of the chain players including agro input suppliers, producers, traders and millers.

The sunflower value chain has a significant influence on the livelihoods of small scale farmers and small businesses involved in trading, transportation and oil milling, mainly in the Northern and Eastern regions of Uganda.

**FARM PRODUCTION LEVEL**

Sunflower has one of the shortest growing seasons of major cash crops in the world. It is ready for harvesting 90 to 120 days after planting. The average yield is about 1,500 kg/ha. However, depending on weather and cultivation conditions, yields can vary between 500 and 3,000 kg/ha. Farmers’ production methods can be grouped into three categories namely: subsistence or traditional, low external input and high external input technologies.

Subsistence or traditional production – this refers to the use of home saved seed and/or open pollinated varieties such as “sunfola”; and non-adherence to proper agronomic practices. The cost of production per acre is usually low compared to other technologies. It is estimated at Uganda shillings three hundred forty thousand (Ushs 340,000) per ha. The yield is low, typically some 625 kg/ha.

Low external input technology – this refers to the use of improved “hybrid” seed as the only external input and adherence to proper agronomic practices. The cost of production is estimated at Uganda shillings five hundred and five thousand (Ushs 505,000) per ha. The yield is estimated at 1,500 kg/ha.

High external input technology – this refers to the use of improved “hybrid” seed, herbicides and fertilizers, and adherence to proper agronomic practices. The cost of production per acre is usually the highest compared to the other technologies. It is estimated at Uganda shillings seven hundred eighty six thousand two hundred fifty (Ushs 786,250). The yield is estimated at 2,250 kg/ha.
Sunflower sale prices (farm gate)

The average margins for producers highly depend on the level of output per unit area and price at the time of selling. The table below shows the average monthly price per kg for hybrid sunflower over the last 12 months. The average farm gate price had an upward movement from Ushs 400 to 550 between February and November 2008. However, due to the recent fall in global vegetable oil prices, the farm gate price has fallen to Ushs 450 per kg.

### TABLE 2: Sunflower monthly average prices for hybrid varieties (Ushs/kg)

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Feb</td>
<td>Mar</td>
</tr>
<tr>
<td>Price</td>
<td>400</td>
<td>400</td>
</tr>
</tbody>
</table>

Source: Mukwano Extension Services, 2008/09

The gross margins estimated at the time of preparing this paper, by production technology, are indicated in Table 3 below.

### TABLE 3: Profitability Analysis of Sunflower Production by Technology

<table>
<thead>
<tr>
<th>Activity / Input</th>
<th>Subsistence</th>
<th>Low external input</th>
<th>High external input</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yield (kg/ha)</td>
<td>625</td>
<td>1,500</td>
<td>2,250</td>
</tr>
<tr>
<td>UCOP (Ushs/kg)</td>
<td>544</td>
<td>337</td>
<td>349</td>
</tr>
<tr>
<td>Price (Ushs/kg)</td>
<td>350</td>
<td>450</td>
<td>450</td>
</tr>
<tr>
<td>Return On Investment</td>
<td>0.64</td>
<td>1.34</td>
<td>1.29</td>
</tr>
<tr>
<td>Gross Margin (Ushs/ha)</td>
<td>(121,250)</td>
<td>169,500</td>
<td>227,250</td>
</tr>
</tbody>
</table>

Source: USAID APEP Field Survey, 2008 and Mukwano Extension Services, 2008/09

The profitability analysis of sunflower production by technology at the present farm gate price(s) indicates the following:

- Although the level of investment is very low under the subsistence technology, the output is at the same time low. This culminates into a situation where the cost of production per kg of output (UCOP) is very high i.e. Ushs 544 compared to the selling price of Ushs 350 per kg. The farmer instead of making a profit, s/he loses up to 36% of the investment made when using this method.

- For the low external input technology of production, more investment is required than for subsistence production but it also gives a higher output. As a result, the cost of production per kg is reduced to Ushs 337 compared to selling price of Ushs 450 per kg. Thus, the farmer is able to make profit of up to 34% as return on investment.

- The highest level of investment is observed under the high external input technology. At the same time, it gives the highest output. The cost of production is Ushs 349.5 per kg which enables the farmer to make up to 29% as return on investment at a selling price of Ushs 450. Although the UCOP of production is higher than under the low external input technology, the gross margin is highest under this technology. The high UCOP is a result of the recent increased in fertilizer prices globally. The increased margin that comes with increased investment is the reason farmers should think of moving away from the traditional through the low external input to the high external input technology.

### Table 4: Sunflower value chain with 50% commercial finance from Centenary Bank

<table>
<thead>
<tr>
<th>Activity</th>
<th>Low external input</th>
<th>High external input</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inputs</td>
<td>120.0</td>
<td>120.0</td>
</tr>
<tr>
<td>Labour</td>
<td>291.7</td>
<td>182.8</td>
</tr>
<tr>
<td>Marketing</td>
<td>10.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Finance (12%) – 6 months</td>
<td>26.2</td>
<td>26.2</td>
</tr>
<tr>
<td>Farm cost of production</td>
<td>227.7</td>
<td>227.7</td>
</tr>
<tr>
<td>Gross margin by farmer / kg</td>
<td>88.0</td>
<td>73.4</td>
</tr>
</tbody>
</table>

Source: USAID APEP Field Survey, 2008

Financing in the Sunflower Value Chain

Two types of intermediate markets exist:

- Mukwano out-grower scheme – the bulking arrangement is conducted by site coordinators at parish level stores. The site coordinators are appointed by the company. The company pre-finance the site coordinators to buy sunflower oilseeds from the farmers at a pre-season price. Handling and transportation to the Lira warehouse are catered for by Mukwano. On delivery of the oilseeds, the site coordinators are paid a commission of Ushs 20/kg. Note: under the current Mukwano out-grower scheme, the company ensures access to superior hybrid seed, but does not finance the purchase by farmers of this input. The financing by Mukwano comes in at a later stage, and is for purchase of farmers’ production (sunflower seed) by site coordinators.

- Other buyers, i.e. private traders or small millers – depending on the perception of business opportunities – place their buying points in trading centres, easily accessible by sunflower growers. These traders and millers finance their oilseed procurement and delivery to point of sale, mostly in Lira town. Many of these traders and millers use own finance.
The price paid by millers is usually negotiable, but typically falls in the range of Ushs 40 to 50 above the farm gate price (price paid to growers at the farm). The farm gate price is largely influenced by the Mukwano pre-season price.

Opportunities and Risks

It is quite clear that sunflower production is profitable. However, agriculture is, by nature, a risky business. To mitigate against these risks, several conditions must be met. Such conditions include: reliable supply of high quality inputs, guaranteed market at a price announced prior to planting, provision of extension services, and the short production and marketing cycle. The sunflower sub sector fulfills all these conditions. There is, therefore, a clear opportunity for lenders to take advantage of lending to sunflower growers.

Sunflower per se has a very short value chain. This creates an opportunity to lenders because the players are easily identifiable and traceable. However, this fact may also down play the role of the lender due to the limited lending opportunities across the chain.

Weather, pests and diseases implicit to agriculture remain a serious issue for any lender to farming.

VENTURE CAPITAL FINANCING FOR VICTORIA SEEDS LTD.

Richard John Pelrine

BACKGROUND:

As all readers of the Yearbook are aware, access to finance for Uganda’s agribusinesses is difficult at best. Commercial lenders are very risk averse and as a result impose strict requirements on their potential borrowers. Among a lender’s normal requirements is collateral. It is not unusual for a lender to require collateral coverage far greater than the value of the amount borrowed. Another issue faced by borrowers is the inability to secure term financing for longer term investments, as lenders themselves lack the term liabilities to offset term loans. Finally, another important issue in Uganda is that the cost of borrowing is exorbitant (normally ranging from 18% to 25% per annum) and worse, of course, for longer term investments as high interest accrues on high interest. Thus, investments in long term capital assets by local agribusinesses are very difficult if commercial borrowing is required.

In 2006, Victoria Seeds Limited (Victoria), then a small seed merchant, planned to build a seed multiplication and marketing operation in Gulu. Victoria lacked the capacity to self finance this planned expansion. After consultation with banks and advisors from donor programmes, it became clear that lenders were not in a position to offer loans to Victoria to realize this goal.

Victoria therefore opted to accept an offer from African Agricultural Capital (AAC) to finance this expansion, in return for a guaranteed return on their investment and a percentage of Victoria’s revenues if Victoria performed well. This, by design, gave Victoria access to capital for term investment, with no collateral requirements and an interest rate that was below market as long as the company was not earning profits.

The investment itself was not straight equity (the traditional venture capital model) but rather a quasi-equity investment instrument that behaved somewhat like equity and somewhat like debt. AAC structured the agreement so that the relationship could be converted with mutual consent to straight debt or straight equity.
The facility was agreed and put in place in 2007. In spite of the innovative aspects of this facility, and despite the fact that it seemed to overcome some of the traditional constraints on agribusiness finance (and particularly term finance), satisfaction of both parties has been low. This article was written on the basis of three questions posed to both AAC and Victoria and the responses, therefore, speak for themselves.

The author acknowledges the kind cooperation of the two companies in the preparation of this article.

**QUESTIONS AND ANSWERS:**

The three questions posed to the two companies were: 1) Has equity financing helped Victoria Seeds, if so how; if not, why not? 2) Is equity financing better than traditional lending; if so, under what circumstances? and 3) As an investor in Victoria Seeds, does AAC offer other benefits that improve the performance of the business (management support, mentoring, etc.)? These questions were posed to each firm. The responses by AAC appear first as AAC was the first company interviewed.

**Has equity financing helped Victoria Seeds, if so how; if not, why not?**

**AAC’s Response:**

From AAC’s perspective, we can’t actually tell if the money was used in the way it was intended, which was for developing the Gulu facility or if it was used to pay off lenders. Clearly from Victoria’s side, it has been an expensive investment after adding up the guaranteed return and the premium based on performance. Nonetheless, it is still cheaper than commercial borrowing and the financing was provided without the restrictions that commercial lenders impose.

**Victoria’s Response:**

While it seemed a good idea at the time and many of the development partners encouraged Victoria to pursue equity financing, in hindsight, we gained no advantage from equity financing and actually suffered problems. For example, when you are borrowing from a bank for a fixed asset, you begin to pay interest only when the asset for which you are borrowing is in place. When we received the investment capital from AAC, they required us to immediately begin paying interest on the debt even though the foundation bricks for the facility we were building in Gulu were not even laid. If the asset isn’t there, obviously it is not yet generating revenue. The result was that we had to immediately start paying the debt out of our working capital, which in turn negatively impacted our operations. In fact, the quasi equity arrangement stressed our business to a far greater degree than a loan from a bank would have done.

**Is equity financing better than traditional lending; if so, under what circumstances?**

**AAC’s Response:**

Quasi-equity financing is more expensive in the long term than straight debt but in the short term it creates less stress on the client’s cash flow. This is because if in the beginning the new venture the client is undertaking is loss making, they only pay the interest and are not required to pay a percentage of the marginal revenue. Therefore, while the business develops the money is cheap but after the business is developed the cost of this finance is similar to commercial rates. Finally, under the facility negotiated with Victoria, the client has the option to convert the investment to straight debt and pay it off.

**Victoria’s Response:**

Basically, Victoria has been paying as much for the quasi-equity investment as we would pay for a commercial loan. In fact, Victoria doesn’t consider this equity financing as AAC is paid no matter what our performance and are therefore not sharing the risk. As explained above, the downside was that we were required to start paying before the asset we financed was complete. By the time the asset was functioning we had to pay both the interest rate and a premium on our revenues that was as costly as any loan from a commercial lender. Another major issue is that AAC doesn’t understand MSME finance. When Victoria borrows from a bank, the bank understands our business and takes an active interest in our success, even advising us on ways we can increase revenues and lower costs. They realize that their success and our success are linked. Further, AAC doesn’t take an interest in providing mentoring and advice that will support our success.

**As an investor in Victoria Seeds, does AAC offer other benefits that improve the performance of the business (management support, mentoring, etc.)?**

**AAC’s Response:**

AAC maintains a strong relationship with the business. We insist on good corporate governance and sit on the client’s Board in an advisory capacity. This role is not to bend the client’s business toward our internal goals but rather to support the client to best realize their business plans. We receive monthly financial statements that we carefully review and we provide regular advice to the client through their Board of Directors on this basis. AAC feels that technical assistance should rest with the investor rather than with us, as they understand their businesses and goals better than we do as investors. We currently do not provide any technical assistance to Victoria Seeds.

**Victoria’s Response:**

AAC does not understand the needs of an SME. As stated above, while our bankers are very interested in our success, AAC has only been interested in receiving their payments. Further, Victoria Seeds has a development vision in addition to being a for-profit firm. We are willing to work at a lower profit in order to provide seeds to Uganda’s farmers. We expect our [financing] partners to respect our vision and share it. This has not been the case [with AAC]. When we consider how AAC failed to understand our business and we realize the problems that this has caused, we think that it would have been much better for us to remain a seed merchant instead of a producer because the costs to the original business have been too high.

**AUTHORS’ CONCLUSIONS:**

In interviewing these two firms, it was clear that neither party had any bad intention toward the other before or after this arrangement was agreed. Both companies, in fact, contend they are acting from a development perspective, complemented by a profit motive. What seems to be true is that neither firm clearly understood the specific objectives of the other. Unfortunately, after contracts were signed, it was too late to revisit either what had been agreed or the reasonableness of that agreement.

Both firms are, in fact, young as businesses. As a result of this, both may have entered this situation with a small degree of naiveté that more mature businesses may not have had.

Victoria is typical of many young agribusinesses in that it had term finance needs, but encountered difficulties in accessing affordable, correctly-timed investment funds, without encumbering the company’s assets. What lessons then does this example provide in such a situation?

As a model for other firms, the quasi-equity financing mechanism between AAC and Victoria must be rated as a largely inconclusive experience.

One simple lesson learned clearly is that the investee didn’t understand the cost implications of the quasi-equity investment and clearly the investor didn’t understand the expectation of the investee. Thus education of the counterparties is something all readers can take from this article as a priority for such innovative agreements in the future.

Such education should clearly include in-depth discussion (with examples) concerning contractual details such as grace periods (and trigger points) for interest payments, degree of and mechanism for management support, together with an a priori assessment of the needs for technical assistance, and the respective roles of investor and investee in arranging this support.

AAC has several other investments beyond Victoria Seeds. It will be interesting to see how these evolve in the coming years.
One of the areas with so much to contribute to the goals of the National Development Plan.
High up in the chilly hills of Kapchorwa district, Annet Muchas and her children briskly cut down dry stalks of maize. They go through an estimated half-acre of land before working backwards, picking up each stem, peeling off the shriveled shells and hurling the cobs into heaps.

Soon afterwards, a donkey arrives to ferry an estimated 80 kilos of the harvest – its first trip for the day. Its task is to take the maize to the Muchas family granary, a basket structure erected adjacent to their mud house in a quiet valley nearby.

“We are going to eat most of the maize,” Muchas says, as the animal teeters down the stony slope. “If we had better seeds, we would have better harvests. We could even sell a substantial portion of what we grow.”

Some distance away from Muchas’s village, after “beating” their harvest, two women winnow away some of their dry beans. And, more legumes get thrown away with the chaff. By the time they are done with their post-harvest chores, the women remain with about half a basin of sad-looking seed, victims of the “beating”, but also of the poor rains in 2008.

## WAREHOUSE RECEIPT SYSTEM (WRS)

An event that took place along Kiira Lane, Kyabazinga Highway near Jinja town on 17 December 2008, marked a milestone in the trading agricultural produce in Uganda. At the Agroways warehouse, WFP signed a Memorandum of Understanding with Uganda Commodity Exchange (UCE) to begin buying food through the WRS.

“This is an exciting day for WFP,” the Representative Stanlake Samkange said at the ceremony, “farmers in Uganda have been faced with the lack of proper stores and equipment to dry, clean and bag their maize. With this infrastructure now in place in licensed facilities, farmers can sell more high quality food to WFP and beyond.

“The opportunities are unlimited because WFP can absorb whatever Uganda’s small-scale farmers are able to produce,” Samkange added, “I would like to have 15-20 percent of our total purchases come directly from small-holder farmer groups and co-operatives.”

In summary, a properly-functioning WRS in Uganda should convey the following benefits:

- Farmer groups have a new direct link to the single largest buyer of food in Uganda. This represents a big opportunity for increased household incomes and better quality of life for the poorest people.
- They have a central licensed location to have their produce cleaned, dried, graded, bagged and stored for as long as they like, before they sell it at a time they choose.
- Farmer groups have a guarantee that while at the licensed, managed warehouses, the quality of their produce will not significantly deteriorate.
- Some farmers were experiencing up to 40 percent post-harvest losses. Losses can be substantially reduced with farmers depositing their produce at the licensed warehouses immediately it is harvested.
- Farmer groups now have a central location to access market information, undergo training and share experiences.

- The warehouse receipt is a legally tradable document of title that can help farmers access bank loans. In addition, a forward sale contract will enhance a farmer’s credit-worthiness.
- With their maize meeting internationally accepted standards, the farmers can sell it anywhere in Uganda and beyond, with or without WFP.

## PURCHASE FOR PROGRESS (P4P)

As historic as the agreement was, however, it is only part of a range of innovations that WFP has come up with to expand agricultural and market assistance in Uganda with the over-arching goal of supporting the Poverty Eradication Action Plan and, later on, the National Development Plan.

Under an initiative called Purchase for Progress (P4P), WFP will partner with Government organs such as the National Agricultural Advisory Services (NAADS), agricultural non-governmental organizations, financial institutions/ the private sector and the Food and Agriculture Organization. The P4P initiative will invest in the strengthening of market infrastructure and enhancement of agricultural productivity, and ultimately contribute to improved incomes and quality of life for small holder farmers. The P4P will begin with operations in 15 districts of the country.
Starting this year, projects will include assistance with and/or encouragement of:

- Construction of market access roads
- Construction of market collection centres and installation of cleaning, drying and bagging equipment
- Increasing access to market information
- Training farmers and medium-scale traders in improved post-harvest handling, storage practices and marketing
- Providing ‘appropriate-technology’ farming equipment and inputs
- Development of effective and sustainable agro-input stockist systems
- Innovative procurement systems, including forward contracts and direct purchases
- Expansion of the WRS in collaboration with UCE
- Increasing access by smallholder farmers to agricultural financing.

WFP will lay much emphasis on enhancing access by smallholder farmers to agricultural financing, which remains one of the major challenges facing farmers in Uganda. By guaranteeing to buy their harvested crops, banking/financial institutions will have greater confidence in lending money to farmers.

By 2011, through P4P and other market support mechanisms, WFP hopes to double the amount of food it has been buying in Uganda annually in recent years to more than US$100 million worth.

WFP will continue to support big commercial suppliers as well as medium-scale traders. Most importantly, however, the UN agency will strive to ensure that the benefits go down to people like Annet Muchas and her neighbours on Kamatelong village – those souls that awake as early as 5am to sing to their oxen as the animals plough and clear their fields for a new day.

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Exports play an important role in overall economic growth, which in turn is key to reducing poverty. An increase in the volume and value of exports helps increase employment and income of the poor, since most of the exports are agricultural, accounting for about 50% of the total value of exports, while small farmers produce most of the agricultural exports. Promoting Uganda’s effective participation in international trade through the export sector in a profitable and competitive way is hence an important channel for increasing economic growth and reducing poverty. At the macro level exports play a significant role in the country’s Balance of Payments position, in terms of meeting the country’s external obligations.

The Bank of Uganda (BOU)’s vision is to foster price stability and a sound financial system conducive to macro-economic stability, economic growth and poverty eradication. Its mission is “to foster price stability and a sound financial system”, with a view to promoting and maintaining the stability of the value of the currency of Uganda. An appreciation of the Uganda shilling creates a negative impact on the economy through making exports more expensive to produce and less competitive abroad.

The prudent macro – economic management BOU role of stabilizing inflation and exchange rates therefore extends to creating favorable conditions for export growth and ensuring export competitiveness. The Domestic Resource Cost (DRC) ratio has been used as a measure of the competitiveness of a country’s tradables, and is also a measure of comparative advantage in the production and marketing of the commodity. The DRC ratio is defined as the ratio of the domestic costs incurred for a unit of foreign exchange earned from the export or saved from import substitution of a tradable commodity. If the ratio is less than 1 (DRC<1), a comparative advantage exists in producing and trading the commodity in question and vice versa.

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DRC ratios for BOU used to be compiled by the former Agricultural Secretariat (AGSEC) of BOU from 1983 to 1996, and later Agricultural Policy Secretariat in MFPED until 2002 when it was finally closed. This created an information gap for policy makers, especially BOU which requires DRC ratios frequently in its research function. The BOU has therefore decided to carry out a study on how to establish an institutional framework for compiling DRC ratios and an Index of Agricultural Production (IAP) on a sustainable basis. The study involved recruiting three consultants whose Terms of Reference (TOR) include: Providing policy makers with regular and timely information on the competitiveness of export commodities with particular reference to the costs of production and the break-even exchange rates.

This report (December 2008) is the third one of the DRC Reports produced to provide information on the competitiveness of export commodities with particular reference to the costs of production.
and the break-even exchange rates. It covers 12 commodities, namely; beans, cocoa, coffee, cotton, fish, flowers, hides and skins, maize, tea, tourism, vanilla and education.

It should be pointed out that, for the remaining commodities namely, gold, cobalt, tobacco, electricity and soap there have to-date been difficulties obtaining data on them for all the four processes that are involved in the compilation of the DRC (production, marketing, processing and exporting). As such, computation of the DRC ratios for these commodities is to-date pending more data availability. Efforts to obtain complete data on these commodities are ongoing.

DATA COLLECTION METHODS/ DISTRICTS COVERED

The data on these commodities was collected using questionnaires administered to producers, traders, processors and exporters, during June/July 2008. The districts covered depended on sources of each commodity and these included: Kampala, Mukono Wakisito, Jinja, Iganga, Kamuli, Kabarole, Kayunga, Kyenjojo, Masaka, Mayuge, Mbarara, Bushenyi, Kaase, Mbale, Tororo, Busia, Arua, Lira and Dokolo.

RESULTS

Table 1.1 below indicates the DRC Ratios, the export prices and the break-even exchange rates of the above commodities, for the period 2005/06 - 2007/08. Where DRC Ratios were previously calculated by the Agricultural Secretariat, they have been presented for comparative purposes. The results indicate that a majority of Uganda’s exports are competitive and profitable during 2007/08.

However, beans, maize and tea estates were not profitable and competitive as shown by high DRC ratios of 2.19, 0.95 and 0.9, respectively. However, though a majority of Uganda’s exports are competitive and profitable, the export sector is faced by both economy-wide and sector-specific constraints that hinder its stronger performance.

ECONOMY-WIDE ISSUES

As regards economy-wide issues, much more attention needs to be given to:

(i) Infrastructure with power as the immediate priority.
(ii) Transport
(iii) High cost of finance
(iv) Rising prices
(v) Exchange rate fluctuations.

These are all adversely affecting performance of exports through escalating the costs of production, marketing, processing and export.

As regards power, reducing the cost of energy and increasing its availability would reduce the costs of production in Uganda. This is crucial for maintaining the competitiveness of existing exports which depend on energy to greater or lesser extents. As regards transport, there is a need to expand air freight infrastructure and facilities; and to accelerate the program to improve rural roads and railway networks thus reducing transportation costs and increasing returns to production.

Addressing these constraints would help provide a stronger enabling economic and business environment to support the expansion of existing exports as well as the diversification into other exports.

Nevertheless, the provision of an appropriate enabling environment by itself may not be sufficient, and there may also be sector-specific constraints to exports that need to be tackled as follows:

SECTOR SPECIFIC ISSUES

Beans:

The main issues with respect to beans are:
- Poor yield as a result of unpredictable weather patterns
- Attacks from animals that prey on the crops
- Unreliable rainfall patterns that affect the drying process
- Flooding due to poor drainage affects the produce
- Shortage of labour especially during the harvest season
- Limited start up capital
- Some roads are insecure; and,
- Insufficient storage facilities.

Cocoa:

The main issues with respect to cocoa are:
- The existence of pests and diseases in the districts
- Lack of proper drying facilities
- Lack of market and price information.

Coffee:

The main issue with respect to coffee is:
- There appear to be poor relations between primary processors and UCDA's field staff, in the process of UCDA ensuring that high quality coffee is processed.

Cotton:

The main issue with respect to the cotton sector is improving profitability, which would depend in part on raising yields through high quality seeds, availability of affordable inputs to farmers, and improving capacity utilization at ginning level. The cost of hiring land in the East and North East is also increasing the cost of production.

Fish:

The main issues with respect to fish are:
- Insecurity on Lake Victoria. Thieves raid the fishermen in the waters and steal either the fish nets, fish or the boats or all;
- Weak beach management units;
- Bad fishing methods used by many fishermen: wrong sizes of fish are caught leading to the depletion of the stock of fish;
- Poor access roads to the landing sites;
- Poor sanitation at the landing sites;
- Fish plants behave as monopolies;
- The fishermen are price takers and never get to know the fluctuations on the international market;
- It is feared that industrial waste disposal has an impact on the stock of fish as some of the wastes might be poisonous to the fish. This in a way is also related to the environmental management system;
- High trading license fees by the district authorities; and
- High taxes and related payments though exports are not supposed to be taxed.

Hides and Skins:

The main issues for this sector are:
- Poor quality raw hides and skins;
- Competition with tax evaders in the export sector;
- Provision of low prices by exporters; and
- The closure of livestock markets as a result of foot and mouth disease which led to decreased volume of hides and skins.

Maize:

The main issues with respect to maize are:
- Increasing price of inputs;
- Decreasing soil fertility;
- Lack of access to machinery and equipment;
• Insufficient manpower;
• Unfavourable weather;
• Price and demand fluctuations;
• Poor loading conditions;
• Theft of produce;
• Poor quality of grain from farmers.

TEA:
The main issues with respect to tea are:
• High costs of agricultural inputs and processing machinery;
• Low price of green leaf;
• Shortage of labour for green leaf plucking. A reason for shortage of labour is lack of funds to meet the salaries required by the workers.
• Limited Research in the development of Tea.

TOURISM:
The main problems reported are at the level of hotels. These include:
• Price increases in food and all other major items.
• In addition to the VAT, the hotel service taxes have been introduced forcing the industry to pass over the increase to the clients. This might jeopardize the competitiveness of the industry.

VANILLA:
The main constraints to the vanilla sector are:
• Lack of market information for their vanilla;
• Lack of buyers;
• Low prices for vanilla.

EDUCATION:
The main constraints are:
• High loan interest rates.

It is, however, recognized that the Plan for Modernisation of Agriculture (PMA), the Government’s strategic framework for eradicating poverty through multispectral interventions, is already addressing most of the issues raised by the participants in the export market, in collaboration with the private sector. What would mainly be required to fully address the concerns of the participants in the market is an intensification of the services being provided under the PMA.

Among others the PMA is addressing the following issues:

i. National Agricultural Advisory Services (NAADS) has been created to coordinate service provision to subsistence farmers. Beyond the traditional advice on productivity enhancing technologies and soil conservation, knowledge and skills development, marketing, storage and agro-processing are part of the content of advisory services.

ii. Government has put in place a policy and regulatory framework for supporting the micro-financial services.

iii. Several barriers to producing, processing and marketing of agricultural products have been removed through among other measures liberalization of these processes, as well as liberalisation of foreign exchange markets.

iv. Government is supporting rural electrification in support of agro-processing and manufacturing in rural areas, by supporting the private sector through the Rural Electrification Fund.

v. Efforts are being made towards construction and maintenance of roads, particularly rural feeder roads. This should open rural areas to wider markets for their products and access to production inputs, create opportunities for competition, incentives for new innovation, reduced transaction costs, increased efficiency and improved quality of services. These would reduce costs of production, increase productivity, permit higher farm gate prices and increase profitability at farm level.

Table 1.1: DRC Ratios for Commodities - 1998/99, 2005/06, 2006/07 and 2007/08

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2/ The results are based on 2007 data. Data is based on two schools. The sample and income group can vary by year.