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Access and Use of Credit in Uganda: Unlocking the Dilemma of Financing Small Holder Farmers

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Executive Statement

This policy brief is about access and use of credit in Uganda by small holder farmers. The brief uses the secondary data to shed light on the extent of the problem and further uses successful case studies in agricultural financing to demonstrate how improvements can be achieved. The major problem established from available information is that despite several agricultural financing initiatives and other reforms in the financial sector in the last 20 years, access to credit by small holder farmers in Uganda has remained very low in the region of about 10 percent. Examining the several agricultural financing initiatives since 1990s tends to suggest that the problem could largely be attributed to weak institutional framework and policy inconsistency on agricultural financing over the years, notwithstanding household demand factors. The key policy recommendation drawn from this assessment is that if agricultural financing is to improve, there is need to have strong institutional framework that focuses on financing frameworks, monitoring and implementation. A better option is for government to support the establishment of a rural or agricultural development bank that prioritises agricultural financing.



Agricultural Financing in Uganda

Agriculture finance generates controversy in many developing countries including Uganda. There is often an assumption that agriculture faces inherent difficulties in mobilizing credit and that this is a binding constraint on expanding agricultural output which justifies government intervention to provide or subsidise agricultural financing. There is no doubt that providing credit to small holder farmers involve large transaction costs and high risks for financial institutions, which means that most small holder are excluded from formal credit market. Formal financial

markets are subject to failures when serving small holder farmers, which in principle; provide grounds for Government intervention to promote financial inclusion¹.

In Uganda, access to agricultural credit by the rural community, where the majority, over 80 percent are smallholder farmers, has remained very low and stagnating in the range of 10-20 percent in the last ten years as revealed in the reports². The problem is attributed to supply³ as well as demand factors. Supply factors include weak institutional framework, policy inconsistencies on agricultural financing, high interest rates, and limited financial literacy. Demand side factors include lack of collateral, lack of bankable projects and high risk of agricultural credit to farmers.

Although the National Development Plan (NDP) and the MAAIF Development and Investment Strategy (DSIP) emphasize increased access to agricultural financing as a fundamental input to the sector transformation, this may not be achieved if the institutional and policy factors are not well streamlined along the credit market chain to solve the demand factors as given at household level. The institutional problem could be demonstrated from the level of credit allocation through the formal commercial banks to agriculture production which has remained in proportion of less than 10 percent of total credit allocation in the last 10 years⁴. The policy inconsistency argument is demonstrated from an unimpressive performance of a number of Agricultural

financing initiatives such as endandikwa, prosperity for all, agriculture credit facility (ACF), the medium term competitive strategy and rural financial services programme among others, have been implemented by Government since the 1990s (MFPED). Although the aim of these initiatives was to improve access and use of credit by farmers, and largely small holders, this has not been satisfactorily achieved due to lack of **“Effective Institutional Framework for Coordination, financing and Implementation”**.

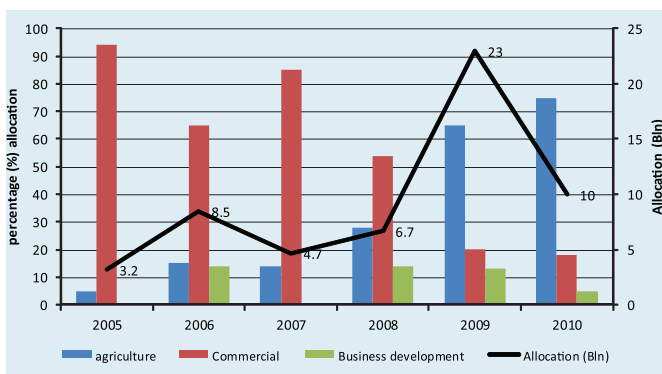
This policy brief provides a summary on access and use of credit by small holder farmers by looking at the nature of agricultural market structure, conduct and performance, using secondary data from existing documents and existing literature.

Growth of Credit to Small Holder farmer through MSCL

Although government undertook reforms in the financial sector to improve micro financing since 2005, the cumulative allocation through the Microfinance Support Centre (MFSC) of UGX 56 billion, has been insufficient to meet the requirements of rural financing including the small holder farming.

Fig. 1 illustrates trend growth in agricultural financing through the MFSC. Although in relative terms there was an improvement in microfinance allocation to agriculture from less than 10 percent in 2005 to 75 percent in 2010, of total microfinance through the Centre, this amount is far less than the actual credit demand for small holder farming and related activities along the value chains.

Fig 1: Proportion of Agricultural Lending



Source MFSC, 2010

Performance of key some Agricultural Financing Initiatives and Some Policy Failures

Table summarizes the performance of some key agricultural financing initiatives looking at, objectives and policy failures.

One major drawback to these initiatives was lack of institutional framework for coordination, and implementation

Extent of Access to Credit in Uganda from UBoS Survey Data (2008/09)

Analysis of the Uganda Census of Agricultural survey data show that a national level, only 11.3 percent of total 3.9 million agricultural households accessed credit. Of this, 61 percent accessed credit through informal, 29 percent through semi-informal and 10 percent through formal financial institutions. With a higher percentage of the few farmers who accessing credit through informal sources, poses a high risk to agriculture. Informal sources have limited source of funding and may not satisfy the growing demand for farmers. This result is consistent with the 2005/06 and 2009/10 panel data which show that about 10 percent of the household accessed credit.

Regionally, Western Uganda had the highest proportion of households reporting access to financial institutions at about 16 percent followed by Eastern Uganda at about 11 percent, Central at about 9 percent and lastly Northern Uganda at only 7 percent. Most of the credit received was from the informal sources across all the regions with Eastern Uganda having the highest source of credit from the informal sources whereas Central Uganda had the highest source of credit from semi informal institutions. Access to credit from the formal institutions is almost uniformly low averaging about 10.5 percent.

Table 1: Proportion of households who have accessed credit in the past five years (%)

National	Categories of Credit institutions			
	All	Formal	Semi-formal	Informal
Uganda	11.3	9.6	29.4	61
Central	9.4	10.4	34.1	55.5
Eastern	10.6	10.9	21.9	67.1
Northern	7.3	10.6	29.4	59.9
Western	15.9	8.1	32.7	59.1
South-Western	14.8	7.1	32.8	60.3

Among the factors that could be limiting access and use of credit by small holder farmers include lack of collateral being demanded from both the formal and informal financial institutions from 90 percent and of the farmers as well as lo repayment period of less than one year reported by about 78 percent of the farmers.

Table 2: Key Agricultural Financing Initiatives and Policy Failures

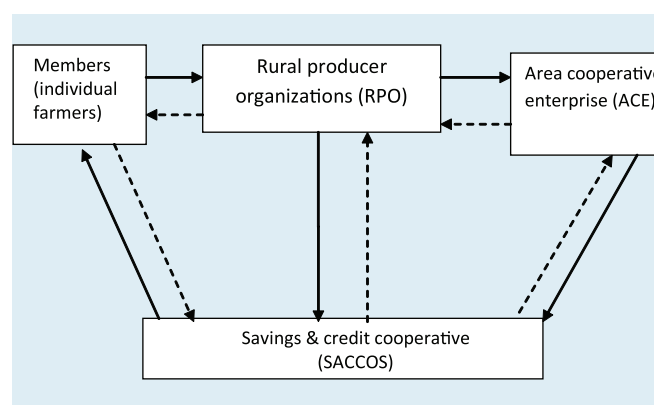
Initiative	Objective	Policy Failures
Endandikwa-1996	<ul style="list-style-type: none"> Increase access to rural credit by farmers 	<ul style="list-style-type: none"> Weak institutional framework For implementation
The medium term competitive and Investment strategy (CICS)	<ul style="list-style-type: none"> To support the private sector to become a powerful engine of growth and a central pillar for increasing incomes and consequently poverty reduction on sustainable basis; through strengthening the financial sector and improving access 	<ul style="list-style-type: none"> Inadequate financing Narrow outreach Weak institutional framework for coordination and implementation
Rural financial services programme of 2005-2008	<ul style="list-style-type: none"> Increase financial services outreach 	<ul style="list-style-type: none"> Weak regulatory framework for MFIs and SACCOS
Prosperity for all (PSA)-2008	<ul style="list-style-type: none"> Empowering the household to earn annual income of 20 million through increased access to financial services and remunerative markets. 	<ul style="list-style-type: none"> Limited access Government failure to allocate resources in time Political interference
The National Agricultural Advisory Services (NAADS)-2001	<ul style="list-style-type: none"> To increase farmers' productivity and household incomes through enhanced provision of extension services and support to the provision of financial services 	<ul style="list-style-type: none"> Weak institutional framework for coordination, financing and implementation Inadequate financing to cover a good number of farmers
The Microfinance Support Centre (MSCL)-2005	<ul style="list-style-type: none"> Improved access of credit for farming by farmers at a lower interest rate of 9 percent as well commercial credit at 13 percent per annum 	<ul style="list-style-type: none"> Loans not equitably distributed in all zones The MFIs and SACCOS shifted from the initial objective of low credit provision to purely trade credit at rates competing with commercial banks and some times higher Lack of effective regulation, monitoring and supervision
Agricultural Credit Facility (ACF)-2009	<ul style="list-style-type: none"> Improving access to finance for agricultural equipment for value addition and processing for commercial farmers at an interest rate of 10 percent. 	<ul style="list-style-type: none"> It's a biased credit facility to agro processing and value addition for medium and large scale farmers It does not cover production inputs such as fertilisers, fungicides and pesticides which are important for small holder productivity gains The facility is blamed for being credit market distorting

Source: Agricultural Finance Year Book (2010).

Success Models in Agricultural Credit Supply

One the registered success model in promoting agricultural financing to small holders is the Uganda Cooperative Alliance model⁵. The model was conceived in 1998 with a view of addressing three critical areas: 1) production 2) productivity and 3) value addition and marketing, through access to rural finance. This framework draws its success from initially organizing individual farmers into producer organizations (POs). These POs form the area cooperative (ACEs) which operate savings and credit cooperatives as a source of loans to farmers. Through the model 66 farmer cooperatives in Jinja, Kyenjojo, Mbale, Mbarara, Mukono and a few others, have been mobilised. Through this model, financing of value chains including maize, coffee, rice, livestock, cotton, banana, apiary and pineapples has been achieved. Through linking farmers to the market, the out-turn sales through the cooperatives has improved from less than 500 million in 2004 to about 16 billion shillings, with member ownership of about 64, 346 by 2010/11. Fig. 2 illustrates the linkages.

Fig 2: Structural linkages between, RPOs, ACES and SACCOS based on the ACE framework



Source: UCA (2010/11).

The second success model is the **Centenary Rural Development Bank (CERUDEB)**. It began its operations in 1985 with a main objective of serving the rural poor and contributing to the overall economic development of the country. The objective of the bank is quite different from other commercial banks whose objective is profit maximization. Today Centenary Bank is the leading Commercial bank in Uganda serving over 1,000,000 customers and putting emphasis on agricultural financing throughout the 40 branches in the country.

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The strength of delivery mechanism to agricultural financing is by establishing a department of agricultural credit throughout its branch and the introduction of innovative approaches different from other commercial banks that has led to growth in demand and use of agricultural credit by farmers. These approaches include: focusing on commercially oriented farmers irrespective of the size of their operation, introduction of self-liquidating loans, having appropriate loan products such as micro agricultural business loans for financing production inputs agricultural loans for small and medium enterprises and new agricultural loan products for farm equipment such as ox plough, tractors and other farm equipment; this has greatly contributed to the success of the bank in agricultural lending.

Conclusion and Policy Recommendations

There is evidence that despite financial sector liberalization in Uganda and initiation of agricultural financing initiatives, access and use of credit by farmers has remained very low. Given the importance of agriculture to Uganda's economy and employment, there is need for government to undertake appropriate policy actions to reverse the current trend. These policy actions would include:

- Transform all the various agricultural financing initiatives (Agricultural Credit Facility, Micro financing through the MicroFinance Support Centre), others) into a **Rural or An Agricultural Development Bank**, that prioritises agricultural financing. This bank should be privately run on the standard banking best practices.
- There is need to support commodity cooperatives and farmer associations along the value chains. These farmer organizations could be important in intermediating credit.
- There is need to build capacity of rural credit cooperatives by scaling up successful models such as the Area Cooperative Enterprise (ACE) of the Uganda Cooperative Alliance (UCA) which has demonstrated success in increasing access to agricultural finance by small holder farmers along key commodity value chains such as maize, coffee, rice, livestock, cotton, banana, apiary and pineapples.
- There is also need for government to leverage agricultural financing through the existing commercial banks by helping the banks develop and diversify their portfolio on agricultural financing that create demand for the products and services.

Endnotes:

- 1 Mutebile, E. (2012). Challenges which will Face Agriculture in an Oil Economy at CEO Summit, Kampala
- 2 Kasirye, I. (2007). Rural Credit Markets in Uganda: Evidence from the 2005/6 National Household Survey
- 3 Association of Microfinance Institutions (AMIFU), 2011. Agricultural Financing in Uganda: Needs and Financing Options Along the Value Chain.
- 4 Bank of Uganda (2011). Monetary Survey Reports.
- 5 Uganda Cooperative Alliance (UCA) (2010/11). Annual Report.

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