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# ACCESS AND USE OF CREDIT IN UGANDA: Unlocking the Dilemma of Financing Small Holder Farmers



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## **ABSTRACT**

The study investigates the extent of access and use of credit by small holder farmers in Uganda. Despite several interventions in agricultural financing by government, access to credit by smallholder farmers has remained very low and stagnating over the years. In understanding the extent of the problem, the study uses information from the various agricultural financing initiatives government has implemented over the years including prosperity for all (PSA) of 2008, the national agricultural advisory services (2001), entandikwa scheme (1996), the recent agricultural credit facility (ACF) and microfinance support centre (MSCL), among others; it uses the Uganda Census of Agriculture dataset collected in 2008/09 to provide some insights on access to credit by agricultural households and examines two successful models of Centenary Rural Financing Scheme and Uganda Cooperative Alliance-Area Cooperative Enterprise (ACE) in promoting access to financial services to the rural poor. On the previous interventions by government in agricultural financing, the study observes that weak institutional framework for co-ordination, financing and implementation could have affected their impact. Insights from UCA (2008/09) data show that access to credit by agricultural households remain very low at 11.3 percent. This could be blamed on the policy failures of the various agricultural financing initiatives that government has implemented over the years, poor response of formal commercial banks to agricultural lending and weak regulation of the microfinance institutions at (Tier-4) to effectively deliver credit to small holder farmers. A critical review of two successful models in prompting access to financial services by small holder farmers suggests that if government is to succeed in promoting access to financial services by small holder farmers, there would need to have strong institutional framework for agricultural financing. Exploring the establishment of a rural or agricultural development bank could be a better option for Uganda.

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## **1.0 INTRODUCTION**

Financial markets in developing countries and particularly in Sub-Saharan Africa (SSA) are largely underdeveloped characterized by lacking depth, highly inefficient, concentrated in urban areas and dominated by a few, often foreign owned commercial banks. Credit, savings and insurance markets in the rural areas are generally non-existent, and those that do, many work imperfectly (Morduch, 1995). On the other hand given the agricultural dependence of the rural economies, the importance of financial markets that meet the peculiar requirements of the rural population cannot be emphasized. For example, agricultural production exhibits a great deal of correlations across farms such that bad weather may leave an entire village or a group of villages clamoring for insurance out (Ray, 1998).

Financial services are fundamental to the economic growth of a country. One school of thought by the celebrated economists such as Bagehot (1873) and Fry (1988) among others strongly contended that financial sector leads and promotes growth in the economy. Services such as banking, saving and investment, insurance and equity financing help the private sector to guard against credit risk and uncertainty, among others. On the other hand, financial credit enables businesses to start-up, expand, improve efficiency and compete favorably on the market. Among the poor segment of society, financial services not only reduce vulnerability, but also increase the ability of the poor to manage assets available to them hence leading to increased income levels.

The importance of rural credit services can be best understood by examining their potential contribution to the development of the agricultural sector. Despite the significant improvements in financial sector in Uganda, accesses to financial services by the rural households, who in case of Uganda constitute about 80 percent remain very poor (Okurut et. al (2004) and Kasirye (2007). This could be attributed to many factors ranging from policy, institutional, supply and demand factors.

In Uganda access to credit for farming remain very limited through the formal commercial banks. This is confirmed in Bank of Uganda report (2011) that since 2000, where less than 10 percent of total private sector credit has annually been allocated for agricultural production and produce marketing. Table 1 illustrates private sector distribution through commercial banks. Compared to services sector where annual allocation has been about 50 percent in the last 10 years, this is a smaller amount that cannot cause the transformation of the sector.



**Table 1: Percent Private Credit Distribution through Commercial Banks in Bln Shillings**

Sector/period	2003	2004	2005	2006	2007	2008	2009-11
Agriculture(production)	2.00	4.08	6.09	3.70	2.60	2.30	6.00
Agriculture (marketing)	5.00	6.51	3.93	1.60	1.90	2.00	3.00
Mining and quarrying	0.01	0.07	0.06	0.00	0.10	0.30	0.33
Manufacturing	23.00	20.22	20.08	9.10	10.60	9.30	13.00
Electricity and water	5.00	5.89	5.96	4.30	5.40	8.20	0.80
Building & construction	3.00	4.01	4.01	4.50	5.00	11.80	17.00
Whole sale and retail trade	50.00	59.23	69.23	47.50	48.82	66.10	40.30

*Source: Bank of Uganda (BoU) Monetary Statistics (2011)*

A number of agricultural financing initiatives have been initiated by GoU since 1990s, and complemented with NGOs and donor project programmes. The aim of these interventions was to improve access to agricultural financing. These include; the Cooperative Societies Programme (1992), the Poverty Eradication Action Plan (PEAP) 2004/5-2007/08, the Plan for Modernization of Agriculture (PMA), the National Agricultural Advisory Services (2001), the rural financial services programme (2005), the poverty alleviation fund (1996), entandikwa scheme (1996), the rural micro-finance support project (2003), the microfinance deposit taking institution programme (2003), the Plan for enhancement of sustainable financial services or microfinance outreach plan (2003) and prosperity for all (PSA) of 2005. While these interventions were well designed, they faced policy challenges including political interference and lack of institutional framework for funding, monitoring and implementation.

The paper documents the best practices and identifies policy options for improving access to financial services by small holder farmers in Uganda, amidst many government efforts to address the problem.

## 1.1 Objective of the Study

The ultimate objective of the paper is to document best practices and identify policy options for improving access to and use of financial services by small holder farmers in Uganda, amidst many government efforts to address the problem. Specifically the study seeks to;

- a) Document some key agricultural financing initiatives and their policy challenges to access to financial services by small holder farmers in Uganda;
- b) Provide insights on access and use of credit by agricultural households using the Uganda Census of Agriculture dataset;
- c) Examine some successful case study models in the provision of financial services to small holder farmers in Uganda, as learning examples for replication.

The major hypothesis for the study postulates that low access to credit by small holder farmers could be an institutional and policy failure that government has failed to address.

The significance of this study is that it informs policy makers on the extent of access and use credit by agricultural households in Uganda so that further interventions are made to improve a persistent problem of access to credit by small holder farmers despite several interventions by government.



## **2.0 ANALYTICAL FRAMEWORK FOR AGRICULTURAL CREDIT MARKET IN UGANDA**

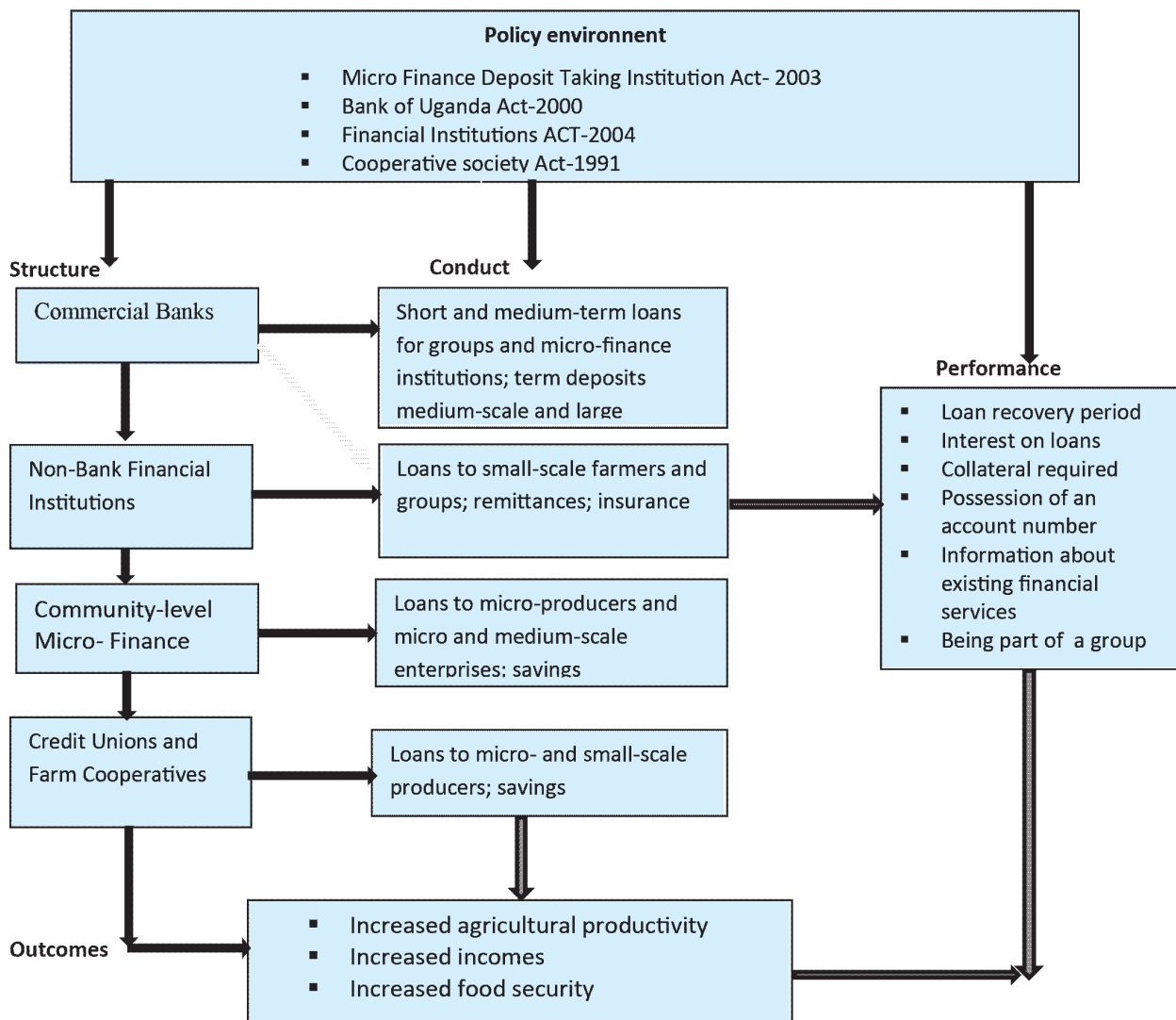
Examining Uganda's agricultural credit market is premised on the structure-conduct-performance paradigm (S-C-P) that has been employed to evaluate efficiency of credit markets in general in developing countries by Berger et al. (2002) among others. This analyzes the structure, conduct and the actual performance of the financial credit market in relation to delivery of and access to financial services by clients in this case Uganda farmers. The approach considers both supply side factors at institutional and financial intermediation levels as well as demand factors at enterprise level that affect market performance. In the context of this study, farmers are beneficiaries of credit and are assumed to access credit on demand basis.

Based on S-C-P paradigm and economic theory, a conceptual model for assessing access and use of credit by small holder farmers in Uganda is constructed and presented as Fig. 1. The financial credit model for small holder farmers is a sub-set of the entire national financial credit model and operates within the same framework.

The conceptual model uses the (SCP) framework to describe Uganda's agricultural credit market. At macro level, the government of Uganda has implemented financial sector reforms that allow bank and non-bank financial institutions to supply credit that is market determined. The commercial banks are regulated by BoU, while the microfinance institutions are regulated by the Microfinance Center. Using the model, the structure of the agricultural credit market identifies formal financial institutions such as commercial banks, non-bank financial institutions such as Micro-Deposit Institutions (MDIs), microfinance institutions (MFIs) and SACCOs as channels of agricultural finance in Uganda.

The institutional structure also comprises of informal as well as semi-formal financial groups that are channels of agricultural credit finance, such as self-help groups, money lenders and family friends. At market conduct level, the nature of loans, type of borrowers and type of activity that these financial institutions lend money are defined. At market performance level, both supply side and demand side factors that influence access and use credit at client level are examined. These include; loan recovery period, interest on loans, collateral required among others.

Figure1: Conceptual Model for Credit Markets



Source: Modification of Berger et. al S-C-P of 2002

### **3.0 REVIEW OF RELATED LITERATURE**

Limited access to financial services is an impediment to potential investments with good prospects where they are denied finance because of lack of collateral or network. The issues related to access to finance are due to transaction costs, agency costs and uncertainty according to Beck and de la Torre (2007) provided a theoretical framework that uses ‘access possibilities frontier’ to study supply and demand constraints. The financial market and institutions exist to deal with these costs and uncertainties. Therefore, the nature of the system affects the way institutions are able to deal with a lack of access.

#### **3.1 Demand Factors to Access to Financial Services**

Mpuga (2004), categorized demand side factor affecting access to financial services into two: the individual/household characteristics and the attributes of financial institutions. Individual characteristics factors include the level of income, sex, age, education and whether one has obtained credit before or not. Among the attributes of the financial institutions that may affect individual decision to demand for financial services from that source include interest rate, other terms of credit and distance from the provider.

Individual household’s characteristics which are of importance in influencing demand for financial services include age, gender, education and marital status (Mpuga, 2004). The lifecycle predicts that the young tend to invest in off-farm activities, which require large capital outlays, while old and retired, will tend to invest in farm activities. Therefore, the demand for financial services is expected to vary positively with age (Zeller, 1994). Gender, education level and marital status, depending on the levels of economic activity are also expected to have a positive influence on demand for financial services.

Like any other service or product, the demand for financial services is likely to be affected by their own price. In case of financial services, the price for savings/credit is the interest rate offered/charged. Holding other factors constant, the higher the interest rate charged, the lower the demand for credit. In addition to the high interest rate there are other charges such as commitment fee that may be imposed on the loan recipient. Availability of financial institution may improve demand for financial services. This background analysis tends to suggest that household characteristics and financial institution attributes are important in influencing demand for financial services. This demand structure affects different activities in the economy, at firm and household level. Agricultural credit which is the focus of this study is also influenced by this demand structure.

Studies done on Uganda by Okumu and Matovu (2006), Okurut et. al (2004) and Kasirye (2007), on the factors that influence access and use of credit by rural households, showed that the main factors constraining access to rural credit were lack of collateral, financial education, lack of organized farmer groups and location of financial institutions. These findings are in agreement with the study by Mpuga (2004). They however miss out on examining the policy and institutional factors that have an influence on the supply of credit along the credit market channel, which in turn has an influence of demand for credit. Assessing the access and use credit by small holders in Uganda, this paper focuses on the supply side factors of policy and institutional structure, conduct and performance that have an influence on the supply of credit. This is important because, beyond the household level in the utilization of credit, there are external factors of policy and institutional in nature that affect the supply of credit along the market chain, which this paper attempts to document.

### **3.2 Supply Factors affecting Access to Financial Services**

Supply side factors to access to financial services take the form of institutional attributes as well policy and regulatory framework. These include cost of credit, availability of financial institution, distribution network, and level of capitalization of the financial institution and policy and regulatory framework for the financial sector as in (Mpuga, 2004) and Frances and Javier (2006). The low level of access to credit, and to microfinance services in general, is attributable, first, to the regulation of the prices of microfinance services. Second, the scant reach of financial distribution networks does not allow mass access to financial services. Third, the use of inappropriate credit analysis methods prevents inclusion of the informal economy. Lastly, the inadequate regulatory and policy framework does nothing to solve the problems of supply. Regulations imposing maximum interest rates (usury rates) are one of the main factors that seem to be contributing to the lack of access to credit in Tunisia and Morocco. This apparently could be the situation across most SSA countries, including Uganda where more research is required to unlock the constraints to access to credit by small holder farmers.

In Morocco regulated financial institutions are subject to central bank-imposed interest rate caps, while microfinance associations are not (Frances and Javier, 2005). These associations lend at market rates (averaging 20 to 30 percent), which explains their growth, without this having diminished the demand for microcredit. In Tunisia, too, regulated financial institutions must respect interest rate caps imposed by the central bank. In Morocco, the interest rate at which microcredit associations are permitted to lend is capped at 5percent in Algeria and Egypt, by contrast, interest rates are unregulated. In Egypt, too, prices are liberalized; the average rate for loans by specialized microfinance institutions is currently around 30 percent. The second reason for lack of access to financial services in the countries under study is the scant reach of banking distribution networks. This deficiency of the banking networks is offset, however, by the density

of these countries' postal services networks. The large postal network is an inheritance from a shared French colonial past.

A study by AMIFU (2011), focused on supply side factors affecting the access to financial services by rural households along the key commodity value chains of coffee, apiary (bees), poultry, dairy, maize, pineapple in all regions of Uganda. The findings of the study shows that access to financial services by farmers is mainly affected by weak linkages of financial institutions from farmers up to formal financial institutions, the availability of the financial institution and the distribution network. The study recommends strengthening farmers groups to enhance access to financial services and accountability to the providers of credit.

In summary the literature tends to suggest that in order to increase access and use of agricultural credit financing, new approaches to identify financially excluded rural poor in Uganda should be developed. These would largely focus on access constraints such as lack collateral, weak farmer groups, financial literacy and improving the regulatory framework of the microfinance.

### **3.3 Challenges to Agricultural Financing in Developing Countries**

A study by Kimenye and Bombom (2009) on improving agricultural productivity in East Africa observes that investment in agricultural technologies by smallholders is often limited by financial constraints. Banks and other money lending institutions have always considered agriculture to be risky. Agricultural credit from commercial banks and other formal financial institutions is generally expensive. Smallholder farmer often lack the acceptable collateral needed to secure credit from these institutions. Inadequacies in farmers' ability to invest in agricultural technologies could be boosted by empowering them in groups and building their capacity through mobilization to enable them to own a micro-credit scheme that could cater for their financial needs.

Experience from other developing countries shows that there is evidence that credit provided to small-holder farmer is often too small to be used for the intended purposes such as buying healthy animals and this could lead to high default rates among farmers (Birdar and Jayasheela, 2000). This is further confirmed by, Banerjee, Duflo et al (2009), using a randomized trial, that micro credit has little impact on the investment practices and business income of those micro entrepreneurs that do not already possess a functioning business at the time of loan disbursement. Beck and Demirguk-Kunt (2008) argue that access to finance can directly be used to promote start-ups and small entrepreneurial skills. However, (Claessens et al., 2009) point to the supply side of financial services. They indicate that access and use of credit is greatly affected by the level of efficiency of the existing institutional framework that is in charge of availing financial services.

## **4.0 DATA AND METHODOLOGY**

This study used, both qualitative and quantitative secondary data. To analyse the data, both quantitative and qualitative methods were employed. Content and thematic analysis of qualitative information on the key agricultural financing initiatives government have implemented over the years; as well as on the two key successful models in the provision of financial services was adopted. In analysis of Uganda Census of Agriculture (UCA) data, descriptive statistics of access and use of credit was applied.

Data on the various agricultural financing initiatives since 1990 was collected from: Ministry of Finance, Ministry of Agriculture, Bank of Uganda-GiZ programme and PMA. Information and data about the good practices in the provision of the financial services to smallholder farmers was collected from the two successful cases: Uganda Cooperative Alliance-Area Based Cooperative Enterprise (UCA-ACE) Model and the Centenary Bank Agricultural Financing programme. From these two successful case studies, the best practices for improving access to financial services were identified. Currently the UCA-ACE model has been adopted by 66 farmer cooperatives with a total of about 64,346 farmer members, while the centenary bank agriculture financing programme works in almost all over the 40 bank branches across the country

This study also utilised data from the Uganda Census of Agriculture (UCA) of 2008/2009 to provide insights on access and use of credit by agricultural households. The census survey was conducted between the months of September 2008 to August 2009 covering 80 districts and focused on agricultural households. A two stage sampling technique was used to identify households. The first stage involved choosing 3,606 Enumeration Areas (EA) from the four geographical regions namely the Northern, Eastern, Central and Western Uganda. At the second stage 10 households were selected from each selected EAs translating into 31,340 households. Among others, the survey captured the responses to access and use of credit by agricultural households by institution and on uses in agriculture and related activities.

## **5.0 RESULTS AND DISCUSSIONS**

### **5.1 A critical review of Agricultural Financing Initiatives by Government of Uganda**

Government of Uganda has initiated and implemented a number of policies specifically aimed at improving rural finance intermediation with a sole objective of reducing poverty in the rural areas. Critical analysis on the main objectives, strategies to implement and what actually went wrong in implementing the programmes has been evaluated. Among the key government programmes that are analyzed include the prosperity for all (PSA) of 2008, the national agricultural advisory services (2001), entandikwa scheme (1996), the recent agricultural credit facility (ACF) and microfinance support centre (MSCL). The information is drawn from recent PMA and GiZ reports and a few other studies reports on bottlenecks agricultural financing in Uganda.

Despite investment of sufficient resources in these initiatives since 1990s, these reports concur that the impact to improving access to agricultural financing by the majority of the rural poor has not improved over the years. While demand side factors to access and use of credit by farmers are known, there seem to be a missing link on critical analysis of the policy and institutional factors that could be contributing to low access to financial services that require further investigation. By examining these initiatives and drawing from successful case studies in the provision of financial services to farmers, this study identifies the policy and institutional gaps that are supply side constraints that could be inherently affecting access to financial services to the rural poor, majority of whom are small holder farmers. A critical examination of these initiatives is important to inform further policy reforms to improve access to financial services by the majority of small holder farmers.

#### **5.1.1 The prosperity for all (PSA)**

The programme was launched in 2008 with the main objective of empowering households to meet the basic needs and attain target gross income of at least Ush.20 million per year. This objective was to be attained through improved agricultural productivity, increased access to financial services and remunerative markets, coupled with value addition. Policy actions of PFA entailed selecting six demonstration farmers per parish and loaning the farm inputs such as stocking material and farm tools. This policy was supposed to support the formation of SACCOs. Of recent this policy seems to have faced problems of implementation and financing.

#### **5.1.2 The medium term competitive and investment strategy (CICS)**

The main objective of CICS support the private sector to become an engine of growth and a central pillar for increasing incomes and consequently poverty reduction on a sustainable bass. CICS interventions entail increasing productivity and profitability at firm level reducing the cost of



doing business and creating an environment where private sector is viable. Among the key priority areas include strengthening the financial sector and improving access to credit and maintaining a market-determined interest rate for financial services. The programme has however got some challenges including weak institutional framework for coordination and implementation and inadequate financing of key strategies.

### **5.1.3 The rural financial services scheme of 2005**

The programme initiated to increase financial services and outreach in rural areas. Its actions included providing support to communities to start SACCOs in Sub-Counties, provide a source of accessible and affordable wholesale funds to supplement SACCOs' deposit liabilities and to enact the requisite regulatory framework for licensing of SACCOs and supervision of their activities, as well as activities of non-regulated financial institutions. Some of the key challenges include weak regulatory framework for MFIs and SACCOs and inadequate financing to roll out the SACCOs.

### **5.1.4 The national agricultural advisory services (NAADS)**

The programme was launched with NAADS Act of 2001. It has been implemented through local governments. Currently the programme is executed in almost all the districts of Uganda. NAADS has been providing an in-kind support to farmers through registered farmers groups. Farmers support has been at 30 percent subsidy and the recipient is required to pay 70 percent of the initial value of the input package received. This approach of subsidized input credit access has not worked successfully. In most of the districts, it has been manipulated by local leadership and has not achieved the intended objective of improving farmers' productivity. Within the same NAADS arrangement, it has not been clear about the selection criteria of farmers and farmers groups. Because of the failures of NAADS in addressing access to agricultural credit whether in kind or cash, government has been prompted to review the programme with a view of separating extension and provision of agricultural credit finance services.

### **5.1.5 Micro finance support centre limited (MSCL)**

Government through MSCL aimed at providing financial support to SACCOs that meet minimum requirement like having at least 300 members. The targets were agricultural and commercial sectors with different rates on the loans. The agricultural loans were to attract a 9 percent interest rate while the commercial and trade, and business development loan attract 13 percent interest on accessed loans. The programme has been operating in 11 zonal offices with Kampala hosting the Headquarters.

**Table 2: Percent Loan Distribution by Sector and Region through the MSCL**

	2005	2006	2007	2008	2009	2010
Agriculture-Northern	4.1	1.6	3.8	1.4	16.6	6.7
Agriculture-Western	1.9	3.6	7.9	21.8	30.6	38.9
Agriculture-Central	0.0	12.9	1.3	7.1	16.1	24.2
Agriculture-Eastern	0.0	1.2	0.9	0.9	3.0	5.7
Commerce and Trade-Northern	16.5	1.3	4.9	6.6	1.5	0.5
Commerce and Trade- Western	20.9	8.5	30.6	20.1	3.8	4.7
Commerce and Trade-central	50.8	49.8	40.6	23.1	12.8	12.0
commerce and Trade- Eastern	5.8	6.5	10.0	4.0	2.7	2.4
Business Development-Northern	0.0	1.0	0.0	0.0	0.8	0.0
Business Development-Western	0.0	5.0	0.1	0.0	4.1	1.6
Business Development- Central	0.0	4.6	0.0	15.0	4.3	1.6
Business Development- Eastern	0.0	3.9	0.0	0.0	3.7	1.7
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

*Source: Microfinance Support Centre, 2010*

However regional distribution of loans through the system from 2005 to 2010 by sector, show wide inequalities of the loans (table 2). The western and central regions continued to dominate in receiving support. The western region received over 8.9 billion, followed by 7.6 billion for the central region, 4.3 billion for the Northern region and 2.1 billion for the eastern region. In total about Ush.60 billion had been disbursed by MSCL. This is however insufficient for the implied demand for rural financing. Further analysis of the data shows that funds disbursed for agricultural development across regions were less than 20 percent over the years, apart from the western region that received substantive amounts between 2008 and 2010.

Although there is evidence of increase in growth of agricultural financing through the MSCL, the amount of funds allocated has remained small in the range of 2 billion to 6 billion to meet the actual and potential demand for farmers. In additions the microfinance institutions and the savings and credit cooperatives, which are the beneficiaries of the MSCL remain weak and unregulated. This poses a risk to savings and access to credit through these institutions by small holder farmers.

Further, in spite of having attracted formation of over 600 SACCOS throughout the country, the weak regulation of the (Tier- 4) microfinance institutions have created briefcase SACCOS that have taken advantage of ignorance of rural community to cheat them. There is also evidence that even the SACCOS which benefited from MSCL have moved away from the initial target of providing affordable loans to the rural communities, but charging even higher than the commercial banks making harder

for the rural farmers to access credit. This institutional distortion has further complicated generally the rural communities to access loans not only for micro enterprises but also for agriculture.

#### **5.1.6 The agricultural credit facility (ACF)**

The Agricultural Credit Facility (ACF) was introduced in 2009 with the objective of improving access to finance for agricultural equipment for value addition and processing for commercial farmers at an interest rate of 10 percent. It is being administered through BoU in partnership with few commercial banks. Initially, government allocated Ush. 30 billion and participating banks counter funded with Ushs. 30 billion but subsequently banks' counterpart funding increased to 60 billion in 2010 and 2011. The ACF does not require collateral. Under this facility, funds are provided to participating commercial banks at zero interest rate backed by a 50 percent guarantee for the principal amount of loan. Following the increased contribution by participating commercial banks, the ACF was modified in 2010/11 to allow for an increase in the interest rate to 12 percent p.a. to the final borrower.

One major drawback of this facility as observed by GiZ (2010) and Uganda Debt Net Work (2010), among others, is that ACF cannot be used for agricultural inputs, production and marketing which are key to growth in agricultural productivity. Further, the facility targets a few large scale farmers on a first come first serve basis. Because of such unfavorable terms, accessing the loan becomes rather distortionary to an efficient agricultural credit finance market. Further analysis of the performance of this facility is that it is not a popular initiative by some banks that signed to participate (particularly the MDIs) as reported in the GiZ report of 2010. Stake holders note that the ACF is not the only way and may in fact, not be the most suitable way for government to promote lending to the agricultural sector. It is generally observed that the ACF would have been more productive if it had incorporated in mechanisms for small scale farmers as groups or individuals. Small scale farmers constitute about 85 percent of Uganda's farming community and any credit arrangement that leaves them out may not cause any significant growth of the sector. Other key initiatives that had a focus on increasing access to financial services by farmers include plan for modernization of agriculture (PMA), the plan for enhancement of sustainable financial services or microfinance outreach plan (MOP) of 2003 and the piece and recovery and development plan for northern Uganda (PRDP) and the microcredit deposit taking institution (MDIs) act of 2003. All these initiatives had policy failures with regard to institutional framework for coordination, financing and implementation.

#### **5.1.7: Policy effectiveness of agricultural financing initiatives**

Assessment of the various reports from PMA, GiZ and a few studies point out that the impact of these agricultural financing initiatives to access to financial services by the majority small holder farmers has been dismal or mixed. This information was confirmed by reports from key

officials from PMA, GiZ, Farmers Federation, Uganda Coffee Farmers Federation, among other stakeholders consulted. In the reports, although it is observed that there has been progress in rural penetration by the financial intermediaries following the reforms, this has not improved access to rural financial services that has remained less than 20 percent (Kasirye, 2007 and PMA, 2006). FinScope (2009) access to formal financial services for all Uganda adults stood at 29 percent, with 22 percent of adults aged 18 years and above reporting as banked, while 7 percent have access to other formal financial sources such as MFIs and SACCOs and insurance companies. This situation would confirm the low access to financial services through the formal and other formal institutions which are key to financial intermediation in the country.

The overarching characteristic of these initiatives which is observed in this study is weak implementation framework for coordination, financing and implementation. These interventions have been scattered across ministries and departments (Ministry of Agriculture, Animal Industry and Fisheries (MAAIF), Office of the Prime Minister (OPM), Ministry of Finance, Planning and Economic Development, Bank of Uganda, other). With this scattered approach, it is very difficult to monitor progress and assess impact. Lack of effective regulatory framework seems to have also constrained the success of these programmes. Lack of effective regulatory framework could also be constraining the success of these projects. The MFIs and SACCOs, NGOs are tier 4 have stayed unregulated for years and this has a negative impact to access and recovery of loans in the rural sector. This could explain why government policy of recent has shifted to regulating and monitoring the institutions at tier 4. If a law is put in place to regulate the lower level microfinance institutions, probably commercial banks will respond to increase the supply of credit to rural area and invest in support financial services to improve access to the rural community. The paper adds voice to the previous papers that the speed of the reforms since 2005 have been adequate, what is important is to address existing policy institutional failures that seem to have affected the success these initiatives. These seem to be major external supply factors which are key to access and use of credit, notwithstanding demand factors which are household specific and unless supply factor are addressed, these may not change.

## **5.2 Insights from the Uganda Census of Agriculture Data**

### **5.2.1 Access to agricultural credit by source**

Table 3 presents the extent of access to credit by agricultural households by source using the Uganda Census of Agriculture data set collected in 2008/09. At National level, only 11.3 percent of the households received credit in the past five years. Of this percentage, 61 percent had received from informal credit institutions, about 29 percent from semi-formal institutions and only about 10 percent from formal institutions. This shows that the majority of the farmers are financially excluded from the formal banks. Banks are well capitalized and could be sustainable source of credit to farmers. Exploring this channel as a source of credit to farmers very important if Uganda is to achieve agricultural transformation.

**Table 3: 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
<i>Sub regions</i>				
<b>Central</b>	9.4	10.4	34.1	55.5
Kampala	3.5	5.5	8.2	12.4
Central 1	20.9	9.9	40	50.1
Central 2	8.5	11.1	24.5	64.4
<b>Eastern</b>	10.6	10.9	21.9	67.1
East Central	11.6	8.5	28.2	63.2
Mid Eastern	10	12.5	17.7	69.8
<b>Northern</b>	7.3	10.6	29.4	59.9
Mid-North	5.4	15	31.9	53
North East	2.6	3.1	9.9	87.7
West Nile	12	7.7	28.7	63.5
<b>Western</b>	15.9	8.1	32.7	59.1
Mid-West	17.2	9	32.6	58.3
South- Western	14.8	7.1	32.8	60.3

*Source: Authors calculation based on UCA 2008/09*

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.

Access to credit by agricultural households remains low even in the presence of several government and private initiatives sprouting to provide credit to the rural areas. Contrasting with the findings by Kasirye (2007) who used the Uganda household survey of 2005/06, access to credit had increased slightly but overall it remained low. The findings showed that that only 1.8 percent of rural households had accessed credit from formal institutions, 4.4 percent from informal institutions and 23.4 from informal institutions. In addition, only 6 percent of the rural communities had access to a bank and 21 percent of rural household had access to an MFI located within their locality. Given this shortcoming, most rural households majority of whom rely on agriculture are forced to embark to borrowing from informal sources.

## 5.2.2 Loan period and collateral requirement

Most sources of agricultural loans are associated with a repayment period of less than a year. Table 4 shows the response to loan repayment by source. It is evident that majority of formal institutions demand loan repayment in less than year. This could be prohibitive to access agricultural credit given the seasonality and risks prone to farming.

**Table 4: Proportion of loan periods and collateral requirement by loan source (%)**

	Loan sources			
	Formal institutions	Semi informal institutions	Informal institutions	All
<b>Loan Period codes</b>				
less than 1 year	55.4	74.3	84.2	78.6
1-3 years	34.6	16.5	7.9	13
More than 3 years	5.8	2.2	1.4	2.1
Others (Don't remember)	4.2	6.9	6.4	6.3
<b>Type of Security required</b>				
Land title	28.8	34.9	14.2	21.7
Crops	8.4	11.4	15.4	13.5
Livestock	15.1	16	11.3	13
Character	7.7	14	24.8	19.7
Salary	40.2	7.7	2.8	7.9
Others (Don't remember)	5.7	11.4	8.3	9

*Source: Authors calculation based on UCA 2008/09*

Such short repayment periods do not give adequate time for farmers to invest the acquired loans and increases the chances of defaulting. This explains why credit access by the majority of rural farmers who are small scale remain very low in Uganda. Although having a land title seems to be the most preferred collateral by all the loan sources, formal institutions are associated with using salary most as security (40 percent), followed by the land title (29 percent) and lastly the character (7.7 percent). For semi informal credit sources, the land title is very important (35 percent) and salary is least used as collateral. For informal institutions, character seems to override even the land title as security.

On average, the loans received from the formal institutions are higher than those from semi informal and informal institutions (table 5). Formal institutions on average had the loans ranging from one million to one million, eight hundred twenty nine thousand shillings only while semi informal institutions had their loans ranging from sixty five thousand to one million four hundred and forty thousand. On the other hand the loan ranges for informal institutions were from as low as thirty six thousand to three hundred thousand shillings only. This is evident that it from the formal and semi-informal institutions that sufficient amounts can be accessed. The smaller amounts through the informal groups may not be sufficient to improve farmers yields.

**Table 5: Average Amount of loans received by households**

<b>National</b>	<b>Formal</b>	<b>Semi- informal</b>	<b>Informal</b>
Uganda	1,337,633	601,265	200,534
<b>Sub regions</b>			
<b>Central</b>	1,401,845	657,117	266,274
Kampala	1,000,000	1,446,452	300,000
Central 1	1,682,614	646,799	284,350
Central 2	1,069,912	592026	247,035
<b>Eastern</b>	1,157,494	695,894	151,833
East Central	1,090,966	795087	168,760
Eastern	1,188,068	589604	141, 492
<b>Northern</b>	1,224,229	620,933	230,201
Mid- North	1,32,582	1,007,929	369,088
North East	1,000,00	65,637	36,568
West Nile	1,217,516	300,830	162,514
<b>Western</b>	1,516,148	529,532	204, 432
Mid-West	1,829,406	527,225	227,177
South- Western	1,103,121	531,932	181,365

*Source: Authors calculation based on UCA 2008/09*

### 5.2.3 Utilization of agricultural loans

Most of the loans received from either formal, semi informal or formal institutions are mainly used for trading in agriculture produce and agriculture labor. Loans borrowed from semi informal institutions may also be used for buying seeds and livestock whereas loans borrowed from formal institutions may also be used in other agricultural activities.



**Table 6: Proportion of the loan accessed to the different agriculture activities (Percentages)**

Loan Purpose	Categories of lending institutions (Percentages)			
	Formal	Semi informal	Formal	All
Agriculture labor	25	24	29.2	27.3
Seeds	3.5	14.8	2	16.6
Fertilizer	1.6	3.9	3	3.1
Agro-chemicals	1.2	1.2	2.3	1.9
Farm implements and machinery	4.3	2.6	3.3	3.2
Irrigation structures	0.3	0.1	0.2	0.2
Livestock	10.5	11.1	7.2	8.7
Aquaculture	0	0.5	0.2	0.3
Apiculture	0	0.4	0.3	0.3
Trading agriculture produce	28.1	29.4	18.7	22.8
Other agriculture activities	21.4	9.9	14.5	13.8
Don't remember	4.1	1.9	1.5	1.9

*Source: Authors calculation based on UCA 2008/09*

### ***Characteristics of households receiving loans by credit source***

Table 7 presents the structure of HH loan access by sex of the head, education level, marital status, and infrastructure access. Majority of the households accessing loans in either formal, semi informal and informal institutions are from male headed households with the age range between 43 to 45 years and majority of them have completed some primary. In addition households far away from extension services and the district produce are more likely to borrow from semi informal and informal institutions.

**Table 7: Household characteristics by loan source (Percentages)**

	Loan sources		
	Formal	Semiformal	Informal
<b>Household head characteristics</b>			
% Males	86.7	85.4	82.7
Age	43.9	44.9	43.2
<b>Education levels (%)</b>			
No education	0.2	0.5	12.9
Some primary education	55.9	43	45.2
Completed primary	10.7	19.3	21.2
Some secondary	22.2	28.1	19.1
A level and higher	8.2	3.8	1.6
<b>Marital status (%)</b>			
Never married	4.7	1.6	2.3
Married	84.5	85.1	79.8
Widowed and not remarried	4.7	8	12.1
Divorced and not remarried	2	2.4	3
Married but separated	4.1	2.8	2.8
<b>Infrastructural access</b>			
Average distance (Km)			
District produce market	16.6	17.6	20.7
Input shop	6.6	6.6	6.4
Extension	7.1	7.2	8.6
Feeder road	1.8	2	2
All year gravel road	3	3.9	3.5

**Source:** Authors calculation based on UCA 2008/09

#### 5.2.4 Household information source on credit use

The major information sources for all credit sources were radio and farmer to farmer methods are given in table 8. For formal financial sources, extension services and the presence of NAADS followed as major sources of information for this loan source. For semi-formal and informal sources of credit, other sources of information such as the use newspapers and NAADS follow as major sources of information on credit provision by this institution. Farmer to farmer communication can be strengthened by organizing farmers to form groups whose capacity to save and borrow is enhanced through appropriate trainings on loan schemes.

**Table 8: Household Information source on credit access**

Information source	Loan sources			Total Households
	Formal	Semi informal	Informal	
Radio	13,371	39,878	68,691	121,940
Modern ICT	1,030	1,341	434	2,805
Extension worker	2,669	5,661	7,121	15,451
Farmer to farmer	8,936	32,735	98,483	140,154
NAADS	2,241	7,048	13,147	22,436
Others	2,374	7,923	11,321	21, 618

*Source: Authors calculation based on UCA 2008/09*

### 5.2.5 Reasons for taking up the loans

Various reasons were given for non-use of loans in the past five years as presented in table 9. Most of the reasons were attributed to supply side constraints such as the high interest rates at 24.2 percent and the lack of collateral. About 12 percent of the respondents did not apply for the loans following the negative past experience while about 13 percent were just ignorant of the availability of credit services in their vicinity. Otherwise, 14 percent were credit unconstrained households that did not require loan services.

**Table 9: Reasons for non-use of loans in the past five years from 2008**

Reason for nonuse of loan	Proportion
No need for a loan	14.6
Unavailability of lending facilities	9.7
Lack of collateral	18.6
Interest high	24.0
Not profitable	11.5
Ignorance	13.0
Negative past experience	11.6
Other specify	1.7

*Source: Authors calculation based on UCA 2008/09*

### 5.3 Success Models in Promoting Access to Financial Services by Small Holder Farmers

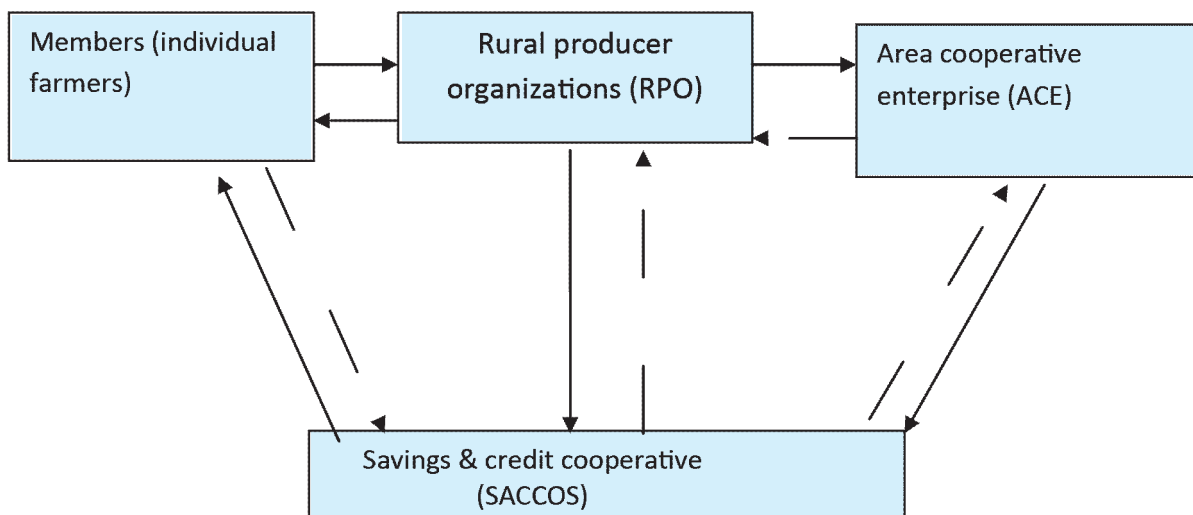
In order to learn from the best practices in the provision of agricultural credit financial services to small holder farmers in Uganda, two successful programmes have been analyzed. The approaches used by these programmes provide a learning lesson for scaling up provision of agricultural credit financing to small holder farmers through the formal banks and other institutions at grass root level .These include; the area cooperative enterprise programme (ACE) which is implemented by the Uganda cooperative alliance (UCA) and the Centenary Development Bank Agricultural

Financing Programme The ACE, programme has been in operation since 2000. It is being implemented in 66 farmers groups located in the regions of; Western, Eastern and Central, in about 25 districts (UCA, 2010). In total membership is about 64,346 individual farmers organized in an area cooperative enterprise (ACE) which is linked to a SACCO and a quasi warehouse facility as a credit insurance mechanism. The CERUDEB agricultural financing Programme is being implemented in all the branches in the country.

### 5.3.1 The area cooperative enterprise (ACE) programme

The area cooperative enterprise programme is implemented based on the area cooperative enterprise model. The main objective of the model was to develop a strategy that would be used to address the critical challenges faced by a small holder farmer such as lack of access to affordable equipment for production, limited access to equipment for value addition, and exploitation by middle men through low farm-gate prices. The model was designed in such a way that the value chain framework was used to bring about collaborative linkages among member groups. The ACE framework is designed in such a way that individual farmers are organized into small groups which are referred to as the rural producer organizations (RPOs). These are further organized and linked to an Area Cooperative Enterprise (ACE) to handle value addition and marketing and later into a Savings and Credit Cooperative to provide financial services (see figure 1). The key value chains farmers are engaged in include maize, coffee, rice, livestock, cotton, banana, apiary and pineapples.

**Fig. 2 Structural linkages between, RPOs, ACES and SACCOs based on the ACE framework**



Source: UCA (2010/11)

The ACE programme is conducted in such a way that, the rural producer organizations (RPO) organize extension services and marketing services for farmers as groups, the ACE provides marketing and value addition services to RPOs, the SACCO provides financial services to RPOs, ACEs and individual farmers. The RPO usually has 30 to 200 farmers and a mini storage facility to handle bulking of produce at that level. At the ACE level there is a central storage facility for all the RPOs that act as a quasi-warehouse receipt system to ensure against access to loans for RPOs from the SACCOs. The SACCOs, provide agricultural credit to a level of up to 60 percent of the value of the total produce from RPOs through the ACEs at the prevailing market prices.

In terms of performance, farmers have not only developed their produce capacity, but also they have strengthened their linkage to the markets and financial institutions. To date, there are over 66 ACEs linked to SACCOs with a total membership of about 64,346 individual members with annual outturn produce sales of UGX 16 billion. In terms of access to financial services, farmers, through their RPOs and ACEs have managed to mobilize the threshold capital requirement for their borrowing. On average the level of capitalization is about 400 million to about 1 billion (UCA, 2010/11). Furthermore, the programme has been able to attract donor support from USAID in providing initial support to farmers as startup capital for SACCOs on a gradual recovery basis at a lower interest rate. Notably, the key services provided by the ACEs include provision of market information, input delivery through bulk purchase at reduced prices, commodity bulking and warehousing, linking farmers to markets, quality assurance, value addition and linkage to financial services through SACCOs.

The lessons drawn from this programme posts to that the strength of having organized farmer groups that are linked to the markets and financial institutions would be a better effective and sustainable way of improving access to financial services by small holder farmers in Uganda.

#### ***Future outlook and sustainability of the model***

When the achievements of the model in the last 10 years are examined, the future is promising in improving farmers' productivity, output and income as well as providing financial services to small holder farmers. UCA will continue to farmer groups to form cooperatives and SACCOs. The continued savings mobilization of farmers groups for SACCO formation will ensure enhanced access to financial services Other innovations for sustainability include linkage of farmer groups to markets through value addition and warehouse receipt system (UCA,2011).

#### **5.3.4 Centenary Rural Development Bank agricultural financing initiative**

Centenary Rural Development Bank started as an initiative of the Uganda National Lay Apostolate in 1983 as a credit trust and it began 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. In 1993 Centenary Rural Development Bank Ltd was registered as a full service commercial bank. Today Centenary Bank is the leading Commercial bank in Uganda serving over 1,000,000 customers. The bank now has 40 Full Service Branches and 80 ATMs network countrywide.

Within the bank, the micro credit department deals with agriculture loans. For example the department dealt with about 100 billion of agriculture loan portfolio and was projected to growth in the coming years. This amount of fund was over and above the Ush. 60 billion that government had cumulatively supported through the microfinance system (MFPED, 2010). Additionally, the agricultural loan portfolio is managed by highly qualified staff in the field of agriculture equipped with the necessary tools to perform efficiently. The success of the bank provides a learning case for other banks to prioritise agriculture financing.

### ***Approaches employed in the provision of agricultural financing***

The success of agricultural lending in centenary bank as explained by the agricultural department and from the various reports is attributed to the innovative approaches and having an appropriate lending methodology that enables it lend to small holder farmers. Agricultural lending was first piloted in Mbale district through the Mbale branch targeting a number of crops grown in the mountain areas and also cereals on the flat plan. This pilot faced a challenge on low prices especially on vegetables due to bumper harvest that resulted in high default rate which stood at about 50 percent. Some of the causes documented included inexperienced loans officers and rough terrain hindered the new officers to effectively screen their clientele very well and poor credit culture.

To mitigate against potential defaults, in the second year of piloting, the bank introduced tough recovery measures which sent a warning signal to prospective clients that the loans were not gifts or handouts from government or donors. The bank also employed more qualified agricultural loans officers to participate in sensitizing farmers and in the assessment and recovery of the loans. In the subsequent years of implementation, due to the tough measures adopted by the bank, with increased sensitization of farmers, agricultural lending is operational in all branches in the country and largely focusing agricultural activities. Focusing on agriculture is reported to have made Centenary Bank more profitable and self-sustaining even in remote areas like Kapchorwa, which were traditionally unbanked. The success of Centenary Bank in depositor confidence and expansion is attributed to having lowest ledger fees and payment of interest rates on savings accounts. For example, its microloans are charged a monthly interest of 1.58 percent on reducing balance on principle, making it even much cheaper than most Ugandan MFIS and SACCOS, more flexible repayment schedules and geared to expected cash flow.

Since inception in 1998 with an aim of extending financial services to the rural poor, where majority are smallholder farmers, agriculture lending is one of the major sectors financed in the bank.. The target for the bank is to have 20 percent of the total loan portfolio for agricultural lending from the current 15.3 percent, worth of Ush.95.8 of total credit portfolio. Furthermore, microfinance loans to small and medium enterprises (SME) continue to dominate the bank's loan portfolio. Furthermore, the bank has established success of the bank in agricultural lending is also attributed to several innovative approaches including; 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.

Finally as a way of ensuring sustainability of the agricultural loan initiative, Centenary Bank is exploring other innovations such as structured financing and direct credit of loan proceeds to service providers to reduce exposure to the risk of diversionary funds. The bank is also investigating crop insurance against weather, pests and diseases and crop failure. All these innovations of the banks provide learning lessons for other commercial banks to prioritize agricultural financing in their loan portfolios



## **6.0 CONCLUSIONS AND KEY POLICY RECOMMENDATIONS**

### **6.1 Conclusions**

The study evaluates the level of access and use of agricultural credit finance services by small holder farmers in Uganda. It attempts to look at key agricultural financing initiatives government has implemented since 1990s, provides insights from UBOS data to describe the national outlook on access and use of credit by agricultural householders and also analyses the performance of two successful case study models the provision of financial services to small holder farmers as learning lessons.

The study shows that although there has been several government initiatives on agricultural financing 1990, agricultural financing has not improved over the years. This is largely blamed on weak institutional and regulatory framework for coordination and implementation (PMA, 2009). Another major challenge has been lack of appropriate agricultural financial products and services that are accessible to farmers (Agriculture Finance Year Book, 2011). This seems to have been aggravated by absence of a designated institutional home fully mandated to handle agricultural finance policy. Fortunately there is increasing recognition of these key issues, not only for Uganda but also for Africa as a whole.

Insights from UBOS data show that access to credit by agricultural households remain at 11.3 percent. Of the total agricultural households estimated at 3.9 million in Uganda (UBOS, 2008/09), this is a smaller number of farmers to impact on agricultural sector transformation. Of the few farmers who access loans, over 70 percent access loans through the informal sources, which are weaker sources of credit.

The formal financing institutions do not adequately cover agricultural households, who are important for future growth of the economy. Commercial banks which would be the major channel of agricultural credit finance to small holders have not taken a deliberate effort to understand small holder farming and the type of financial products they require to improve access.

The micro-finance systems through the SACCOs arrangement seem to have failed to promote access to agricultural credit by the rural farmers in almost all regions. In a few regions where there is reported improvement, the amounts accessed remain very small in the majority of the households to cause transformation of agriculture.

Finally, this paper takes the view that sufficient attention has not been given to interventions that improve access to small holder farmers through reducing risks in the rural financial environment. Small holder farmer borrowers are not attractive to commercial banks as they are perceived as high risk borrowers. It is observed that their chances of accessing financial credit can be

improved with interventions that provide those opportunities to manage and reduce the risks to which they are exposed. Using success farmer groups projects, it is evident farmers groups who organized around a common enterprise value chain such as coffee, maize, etc, that are market linked are more likely to succeed in improving access to financial; services than individual farmers. This requires that farmer group membership is enhanced and their capacity built to borrow and lend to their members. A study by Adong et al. (2011) found that farmer group membership in Uganda was still low at only 16 percent membership by households.

## **6.2 Policy Recommendations**

Given the policy failures with piece meal interventions by government and testing from the various government agricultural financing initiatives and recent agricultural credit facility, it is important that government undertakes further policy reforms to improve agricultural credit financing as follows:

- Review the agricultural credit facility (ACF) to cover production financing other than looking at equipment for agro processing and value addition accessed by a few who may have the ability to access commercial credit on their own.
- Borrowing from success case studies in the country in the provision of financial services and consolidate the Uganda Cooperative Alliance, area cooperative enterprise model (ACE) as farmers driven framework for sustainable agricultural financing to small holder farmers.
- There is need for government to consider transforming the Microfinance Finance Support Centre (MSCL) programme and other scattered agricultural financing initiatives in government programmes such as NAADS, PMA, CICS, among others into a rural or agricultural development bank, managed under PPP framework and regulated by the central bank. Rural development banks have become an approach to rural transformation in a few developing countries in Latin America and Asia. Africa seems to be lagging behind in adopting this approach.
- Lessons learnt from other developing countries (Bangladesh, Singapore, e.tc.) show that there is need for the government to leverage agricultural financing through support to credit guarantee crop insurance schemes through partnering with the banks. This would make agricultural credit affordable.
- There is also need for government to encourage companies to support contract farming of along the value chains as avenues for promoting access to agricultural credit by farmers as groups.
- In order to generate more information on the progress on status and access and use of credit by small holder farmers, more insights from UBoS UNHS panel surveys as well data on other successful cased studies that have not be covered in this study.

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