

Giving credit to sesame

Sesame is an important export product of Ethiopia, on which the livelihood of hundreds of thousands of farmers depends. The way sesame is traded has been undergoing major changes since 2008, when the Ethiopian Commodity Exchange (ECX) was introduced.

By addressing asymmetric information and cutting post-production transaction costs, the ECX aims to link farmers more directly to international markets, guaranteeing them a better price for their produce. Yet – from land clearing to threshing – sesame production entails high operational costs. Timely availability of sufficient finance to pay for the necessary inputs is therefore important.

Unfortunately, most farmers do not have access to such finance, which affects their yields and profits. Based on fieldwork carried in Humera, Ethiopia's largest sesame producing area, this brief investigates the consequences of this shortcoming.

Credit is scarce

In 2009, there were ten commercial banks in Humera. However, none of the 1382 smallholders participating in our study received commercial credit. Lack of collateral is the major reason for this. Fieldwork revealed there are three alternative sources of credit: microfinance, the cooperatives' union, and moneylenders.

Microfinance institutions can provide immediate credit and request low interest rates; but the amounts are small and rarely sufficient. While rare for microfinance institutions in general, in Humera most do require a collateral. Farmers belonging to a cooperative can also obtain some additional working capital through the union. Although its interest rate is the most competitive, the amount of credit from the cooperatives' union is very small, and the timing is often unpredictable as well as lengthy. Frequently the farmers received the credit well after harvest. In this context, most smallholders need to borrow from a moneylender.

Moneylenders are officially illicit and demand interest rates of up to 240% per year. Farmers who participated in the 2009-2010 participatory rural appraisal borrowed between 1.000 and 14.000 Birr from moneylenders, usually through a shell arrangement: the provision of cash in exchange for a given amount of sesame at the end of the farming season. The issue of timely access to credit is not new to sesame farmers in Humera.

BoARD et al. (2002) report that, despite the presence of the Commercial Bank of Ethiopia and Wegagen Bank in Humera, the only source of credit available to farmers in the 2001 cropping season was informal credit. Amare (2009) found that financial constraints were one of the major challenges for sesame producers. The predominant source of farm credit in his study in 2006 is shell (43%), followed by cooperatives (38%) and Microfinance Institutes (14%).

Unleashing the potential of Ethiopian smallholders

Access to credit is especially important for sesame production in Ethiopia because it is remarkably capital intensive. Even the smallest smallholders require working capital for disking machinery, weeding, harvesting and threshing labour, and often pesticides. Farmers are well aware of the long term consequences caused by postponement of farming activities, and try to arrange credit and machinery well in advance. Obtaining these inputs is made more difficult by the yearly nature of sesame regional monocultures: disking tractors and machinery for example, are

Table 1: Characteristics of different credit types available to farmers in Humera in 2009-2010

	Microfinance	Moneylenders	Union
Maximum amount receivable (Birr*)	15.000	No limit	3.000
Received by farmers in study	500 to 10.000	1.000 to 14.000	500 to 3.000
Interest rate applied	18% in 9 months	15-20% per month	12% in 5 months
Annual Interest rate (conversion)	24%	225-240%	29%
Days for Searching & Info	1	1	1
Days for Bargaining credit amount	10-19	0-1	2-8
Days from application to receipt of credit	1	1	50

Source: fieldwork Cecchi

*at the time of this study 1 Euro = 22 Birr



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For quality of life:

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VC4PD Brief 14

VC4PD

needed only during a very small window of time. The absence of a tractor rental market makes finding one difficult: farmers need to search for individual tractor-owners or their co-workers in the entire district. This results in enormous transaction costs for smallholders. When farmers do not disk in time they will incur costs in terms of reduced yield. BoARD et al. (2002) confirm our findings that the machinery available for land preparation is inadequate to fulfil the requirements during peak periods.

Other non-marketing bottlenecks

Labour is another constraint faced during peak labour times (weeding, harvesting, threshing). When farmers have sufficient cash, they can hire labourers in a *Contratto* arrangement, which is based on performing a task on a given area for more days/weeks. However, when farmers do not have sufficient cash they have no other option than to conclude Per Diem (daily) agreements with labourers, which can cost up to twice as much as a *Contratto* arrangement.

According to different authors, farmers retain 70 to 80% of the market price of sesame (Demelash, 2004; Aysheshm, 2007), which is remarkably high in comparison to other agricultural markets. However, farmers who lack own capital or do not have access to sufficient and timely credit, have to accept disadvantageous pre-harvest agreements to sell sesame (shell). Likewise, farmers who obtain loans at high interest rates

from moneylenders need to repay these loans by selling their produce immediately upon harvest, and are therefore unable to store sesame anticipating possible benefits from price hikes later in the year.

Looking for solutions

To address this issue, the ECX aims to introduce the 'warehouse receipts' system. In this system, farmers are able to deposit their produce in an ECX warehouse and use the 'warehouse receipt' as bank collateral. This should reduce farmers' need to sell sesame for a low price immediately after harvest. While this measure would be a significant step forward – substantially abating the need of smallholders to sell immediately after harvest – it still does not satisfy sesame producers' need of credit at peak times well before harvesting time. If the issue of timely working capital is not addressed, Ethiopian sesame production will continue to incur major efficiency losses: Tefera (2010) calculates that farm output can increase by 13% if farmers' access to credit increases by 1%.

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