Vol. 12(10), pp. 285-293, 28 May, 2018
DOI: 10.5897/AJBM2018.8517
Article Number: 30FCF4B57153
ISSN 1993-8233

http://www.academicjournals.org/AJBM

African Journal of Business Management

Full Length Research Paper

Financing challenges of smallholder farmers: A study on members of agricultural cooperatives in Southwest Oromia Region, Ethiopia

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Received 5 February, 2018; Accepted 5 March, 2018

Smallholder agriculture plays a great role in food self-sufficiency, employment creation and economic growth. However, studies conducted in Ethiopia indicated that access to finance and input/output marketing are two of the critical problems affecting the productivity of smallholder agriculture in the country in general and in Oromia regional state in particular. The main objective of this study is to investigate how smallholder farmers in southwest Oromia zones finance their farming activities and examine problems associated to access to finance. To achieve this objective, 400 sample smallholder farmers who are members of agricultural cooperatives were selected from three zones (Jimma, Buno Bedele and Illu Aba Bora) and survey were conducted. Both structured and unstructured interview were made with farmers and officials of selected primary cooperatives operating in the three zones to scrutinize the issue in depth. The data collected were analyzed using descriptive statistical tools to come up with appropriate conclusions. The finding of the study showed that despite the expansion of cooperatives and MFIs to rural area, there is still a challenge to get credit from these formal financial sources. Some of the problems include: absence of interest free loan for Muslims, long lending procedures, problems related to repayment period. As a result of these, smallholder farmers tend to prefer informal sources such as credit from traders, family members, friends, and Iqube.

Key words: Access to finance, cooperatives, smallholder farmers, Southwest Oromia.

INTRODUCTION

Agriculture is still the major economic activity which creates job for most citizens in many African countries. Researchers estimate that agricultural productivity in Africa must increase by 50% to feed the 1.3 billion estimated populations by 2030. Currently, studies show that more than 25% Africans are undernourished out of which smallholder farmers comprise half of these people living in absolute poverty. The main reasons why Africa cannot feed itself though the majority of its population are engaged in farming is because farmers lack access to

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agricultural inputs and other agricultural technologies largely, because of lack of finance (Opportunity International, 2012).

Ethiopia has a land area of 1.1 million km^2 and population of more than 100 million which makes the country one of the largest in Africa. Its economy is largely based on agriculture that creates employment for 85% of the population, accounts for 37% of the GDP and brings about 90% of the export earnings (Central Statistical Authority (CSA), 2016). However, Ethiopian agricultural sector is also facing the same problems similar to its African brothers and sisters which forced the current government to make economic reforms. In 1992, the current government of Ethiopia has introduced a variety of economic policy changes aimed at enhancing macroeconomic stability, speedup economic growth, and reducing poverty (Tafesse and Ferede, 2004).

Central to all of the economic reforms of the country was Agricultural Development Led Industrialization policy (ADLI), enacted in the belief that agricultural sector can serve as the driving force for the rest of the economy. In ADLI, it is hoped that growth in agricultural sector ultimately leads to growth in the country cognizant of the fact that majority of the people resides in rural areas where agriculture is the main means of life. The policy aimed at exploiting the country's labour force and land with modernization of the agriculture sector thereby increasing agricultural productivity. It was believed that the surplus agricultural product would provide the industry a cheap source of raw material, while the demand for industrial goods would increase for agricultural inputs and consumption (Obo, 2009).

Most of the agricultural activities in Ethiopia are undertaken by smallholder farmers. Studies have shown that 94% of the food crops and 98% of the coffee are produced by smallholder farmers. Large private and state agricultural activities produce only 6% of food crops and 2% of the coffee grown (Gebre-Selassie and Bekele, 2013). From this, one can conclude to what extent smallholder farmers are the strategic candidates in enhancing the effort towards overall economic growth in Ethiopia. These days, smallholder farmers are recognized as key contributors to increasing the world food security. However, smallholder production in developing countries is fraught with a multitude of challenges, including low yields, low quality of crops, and lack of access to markets including credit markets. Access to finance is the most critical factor for the use of improved agricultural inputs and technologies. It provides funds for agricultural investments, enhances post-harvest practices, smooth household cash requirement and promotes better management of risks contributing to long term food security. But securing capital to purchase agricultural inputs, investing in farming machineries, and paying for transport to sell agricultural outputs is a challenge that smallholder farmers face in every harvest season. The authors have undertaken a survey on the topic "Financial and Marketing Challenges of Smallholder Farmers: A Study on Members of Agricultural Cooperatives in Southwest Oromia" in the academic year 2016/2017 under the sponsorship of Jimma University. The objective is to identify the bottle necks surrounding smallholder farmers in the region and provide appropriate suggestions. This article is part of the aforementioned study specifically aimed to identify challenges surrounding access to finance of smallholder farmers taking evidence from least developing country Ethiopia. Specifically, the evidence for the study is taken from small holder farmers in three zones in Southwest Oromia sub-region.

Research problem

In many rural regions of developing countries, large percentage of the population lives below poverty level. Hence, effort to improve their living standard highly depends on possibilities of enhancing agricultural productivity. However, smallholder agriculture is burdened with a multitude of challenges including lack of access to finance and markets. Securing capital to purchase agricultural inputs, invest in agricultural machineries, and pay for transport to sell agricultural outputs is a challenge that smallholder farmers encounter every harvest season. This issue has especial relevance to Ethiopia, where agriculture accounts for above 37% of the country's GDP and 85% of total employment (CSA, 2016). Majority of smallholder farmers in the country cannot use improved agricultural technologies out of their own funds. They need to get credit to finance agricultural input and use new farming technologies.

Access to agricultural credit makes conventional agriculture more productive through the purchase of modern agricultural machineries and other agricultural inputs. Credit can also be used as a mechanism for market stability in the economy. Smallholder farmers can enhance their bargaining power by having storage facilities for agricultural output and access to transport through credit. Credit plays a significant role in covering farm household consumption deficits. This would in turn help the smallholder farming family to work efficiently and effectively in its agriculture. Credit can further help as an income transfer means to remove the inequalities in income distribution among citizens. Access to various types of financial services is a significant challenge for smallholders, who constitute the vast majority of farmers in Ethiopia. Without access to finance and sufficient yearly earnings, many smallholder farmers give-up the majorities of their annual income in order to get quick access to cash to afford household expenses throughout the year. Before harvest season comes, smallholder farmers often face a challenge to pay for family necessities. Until their crops are ready to be sold, many farmers are forced to get credit from illegal moneylenders at high interest rates or sell their future harvest early at a reduced price to receive the cash they need to cover their expenditure for survival (Opportunity International, 2012). After harvesting crops during winter season, most smallholder farmers are busy selling their agricultural output in order to settle their earlier bills.

Since the majority of the farmers are bringing their output to local market at the same time, the price of crops goes down and they are unable to earn appropriate price for their harvest. This situation indicates to what extent smallholder farmers are exploited because of lack of awareness and absence of access to formal credit and proper marketing channel. Cooperatives in general and that of the agricultural cooperatives in particular are established to play significant role in improving access to credit, provide agricultural inputs and create market linkage of smallholder farmers.

Although, cooperatives are given such a central role in the country's rural development strategy, to our knowledge, there are limited studies on financing challenges of smallholder farmers especially in Southwest Oromia, Ethiopia. Hence, the focus of this study is to examine the financing practice of smallholder farmers and study the role of agricultural cooperatives in facilitating access to finance in South-Western Oromia sub-region.

Objectives of the study

The main objective of the study is to examine sources of finance for small holder farmers and identify the associated problems. Specifically, the study was carried out:

(1) To examine the extent of use of the different sources of finance by smallholder farmers in Southwest Oromia,
(2) To investigate the challenges for use of formal sources of finance by smallholder farmers,
(3) To evaluate the role of agricultural cooperatives in solving financing problems of smallholder farmers.

LITERATURE REVIEW

Finance is a broad concept that deals with the supply of fund to meet operating and investment expenditures of an economic activity. Rural finance is subdivisions of finance which comprises agricultural and non-agricultural finance. Rural credit specializes in the provision of credit for rural households. Agricultural credit is the most specialized division of rural credit, which provides credit service only to smallholder farmers (Komicha, 2007).

Rural credit institutions can be broadly classified into formal and informal institutions. Formal institutions are licensed and regulated by central bank or any relevant government agency. These institutions comprise of commercial banks, microfinance institutions, cooperatives, development banks, capital lease companies and insurance companies. Informal credit markets refer to those markets which are not licensed and regulated by government authority which include moneylenders, landlords, traders, friends, and relatives. The informal sector is not regulated by any formal institution and the lending conditions are often flexible. In the formal credit markets, institutions provide intermediation between depositors and lenders charge relatively low rates of interest that usually are government subsidized whereas in informal credit markets money is lent by private individuals. The formal sector depends on deposits while the informal sector relies more on its own funds. In between these two ends of the range are semi-formal financial nongovernment organizations including, Iqqub, Idhir, Mahiber, other self-help groups, nongovernmental and international organizations (Zewdie, 2015). Formal and informal credits are imperfect substitutes. In particular, formal credit helps to reduce informal borrowing, but does not completely eliminate it. Informal credit is used for consumption-smoothing purposes, while formal credit is used mostly for improving agricultural production. The informal financial sector in Ethiopia, as indicated earlier is neither regulated nor counted for in the country's financial intermediation process.

The sector, however, provides by far the greatest financial services to the bulk of the population on flexible terms. Though, the informal financial sector is important to most informal sector operators and the farming population, government support to the sector has been until recently very little. The establishment of formal credit financial institutions in developing countries some years ago was, among other reasons connected to the belief that local informal lenders such as merchants, landlords and shop owners exploit smallholder farmers by charging them very high interest rates (Manig, 1996). The banking sector in Ethiopia consists of one state-owned development bank (Development Bank of Ethiopia (DBE)), one state-owned commercial banks (Commercial Bank of Ethiopia (CBE), and 16 private commercial banks (NBE, 2017).

Despite the continuous increase in the capital base, the banking industry in Ethiopia is still very small compared to some big banks in Africa. Unlike its East African neighbours and other developing countries, Ethiopia is yet to open its banking sector to foreign investors, though it liberalized the sector for domestic participation in 1992. Further, the banking sector in Ethiopia emphasizes on relatively well to do businesses engaged in urban centers and mechanized agricultures to some extent and have totally ignored smallholder farmers (Zewdie, 2015). In response to the limited accessibility of the commercial banking system and the growing doubt about the effectiveness of NGO subsidized input supply loan programs, Ethiopian government introduced microfinance institutions in 1996 after formulating the required legal procedures. Growth in outreach and sustainability of microfinance institutions that reach a large number of rural and urban poor has been a prime objective of the new development strategy of the Ethiopian government (Zewdie, 2015). In Ethiopia, there are 35 microfinance institutions legally recognized by the National Bank of Ethiopia till 2017. These institutions deal directly with micro and small enterprises operators and individual farmers who fulfil the loan provision criteria set by their management. Though an absolute figure is not available, it has been believed that these microfinance institutions play an important role in narrowing the gap between the demand and supply of credit in rural areas. The advantage of these microfinance institutions is that farmers can get loan in cash and use it to purchase agricultural inputs (Zewdie, 2015).

Other sources of rural finance are the different types of cooperatives that are established in rural area. In Ethiopia, cooperatives are playing a crucial role in the country's past and current development strategy. As of 2015, there were 56,044 primary cooperatives, both agricultural and non-agricultural having nine million members throughout the country. Of these, 8,435 primary cooperatives are organized in 309 unions. Agricultural cooperatives, however, only account for about one-fourth of cooperatives in the country. In Oromoia region alone there are above 15,492 primary cooperatives, more than 124 cooperative unions and two cooperative federations. One of the objectives of cooperatives specifically agricultural cooperatives is providing or facilitating credit service to their members. Instead of borrowing money and purchase farm equipment, such as tractor and combiner or even complete farm and harvesting equipment; it is sometimes possible to acquire them through lease agreement. Lease is an agreement of giving to another party the right to use an asset for a specified period, in exchange for a periodic lease payment. In other words, just like liquid money, productive assets can be borrowed through leasing. These assets are however contained in the balance sheet of the lessor and not in the balance sheet of the borrowing firm, the lessee. Therefore, leasing essentially represents a form of off-balance sheet financing. This aspect may be important in situations in which a farmer prefers to maintain a certain debt-equity ratio or is not in a position to further increase its debts (Peterson and Fabozzi, 2003).

The basic challenges in providing credit to poor people, as formal financial institutions tend to see it is the high risks and the high transaction costs involved. In Ethiopia, where the majority of the rural population live in very poor conditions, people have to find a way of survival. Hence, semi-formal financial institutions have become a high priority especially among the poorest segments of the rural population. Such traditions have existed for a long years, and continue to the present day, mainly because they have been successful in achieving their objectives. There are a number of community based indigenous savings and credit groups. One of the traditional community based institutions is known as Iqqub. It is an informal type of cooperative society established by members for the purpose of bringing their savings in accordance with rules established by the members. Group members agree to deposit monthly or weekly contributions of a fixed sum with an elected treasurer among themselves. Lottery is drawn weekly or monthly by turns and any member can get the fund by chance (Aredo, 1993).

With respect to formal financial institutions, it is only 1% of rural households that have their own bank accounts. Thus the traditional informal financial institutions are the most important sources of rural finance and accounts for about 78% of total agricultural credit. The major sources of finance according to Aredo (1993), are relatives and friends (66%), and moneylenders (15%). Informal moneylenders are preferred by the majority of the smallholder farmers because they are quick, simple, convenient and flexible albeit charging at an annual rate of interest as high as 245% (Aredo, 1993).

Generally, the formal financial sector is challenged to deliver efficient and effective financial services in rural areas where a huge demand supply gap exists. The reasons include: high transaction costs due to small loan size, lumpy cash flows, and high covariant risks across borrowers and clients live dispersed and suffer from a lack of adequate infrastructure, skill gap in the banking sector; especially lack of knowledge of the agribusiness sector and poor risk management skills, low product quality in savings, loans, insurance and payment services. This covers limited credit for input financing, for inventory and export financing, for long term loans, for cash flow based lending and deposit products, high collateral requirements and the inability to use land as collateral lead to the use of illiquid and perishable collateral, lack of a dedicated regulatory framework for cooperatives (Zewdie, 2015).

Developing the agricultural sector is critical to achieve the Millennium Development Goal of reducing poverty and hunger in the world. With a rising world population, it is expected that the demand for food will continue to increase. At the same time, the food price rise in recent years has increased global concerns about current levels of agricultural production. These requires giving due attention to financial institutions in increasing agricultural producers' access to finance (International Financial Corporation (IFC), 2014).

According to IFC (2014), of the 75% of the world's poor that lives in rural areas, 80% depend on farming as their main source of livelihood. Thus, smallholder farmers play a key role in increasing food supply in poor countries. Despite their socioeconomic importance, smallholders have no access to formal credit, which limits their capacity to invest in modern technologies and use of agricultural inputs that increase their yields and incomes and reduce hunger and poverty (International Financial Corporation (IFC), 2014).

Many factors that emanate both from the demand and supply side make rural households not to access financial services. The first is the high transaction costs due to inadequate communication and information technology and the remoteness of the local areas.

The second is credit risks which are higher in rural area since the incomes of the rural households are highly exposed to natural disasters including: flood, drought, plant diseases, and fluctuating weather. Further, rural households mostly depend on few sources of income and thereby increasing the risks of financial intermediation. Loans can be secured with fixed assets backed by a clear legal ownership. Credit institutions often require land or other fixed assets as collateral for agricultural loans, thus excluding a large percentage of agricultural producers from access to finance. This is because many households either entirely lack collateral or do not have the legal title to land which negatively affect access to finance. The last reason in most developing countries is high illiteracy rate in rural areas which has multifaceted effect. Poorly educated households find it increasingly difficult to assess the financial service (International Financial Corporation (IFC), 2014).

RESEARCH METHODOLOGY

This study is designed to describe the financing challenges of smallholder farmers and the role of agricultural cooperatives in alleviating these challenges. Thus, a descriptive method is viewed as an appropriate research design for the study. The researchers used both quantitative and qualitative approaches to collect and analyze data. This study is based on a sample of smallholder farmers who are members of cooperatives selected from the three zones in south western Oromia regional states.

According to the information from Jimma, Illu Ababa Bora and Buno Bedele zones cooperative agencies, there are above 1,000 primary cooperatives in the three zones. A multi stages quota sampling procedure was adopted to select 400 sample respondents for the study. First, eight administrative districts which have sufficient number of cooperatives were purposely selected. The districts selected include four from Jimma zone, two from Buno Bedele Zone and two from Illu Aba Bora zone. Second, two primary agricultural cooperatives from each districts were randomly selected and finally 25 smallholder farmers were randomly taken from each agricultural cooperatives for structured interview. Both primary and secondary data were collected and used in the study. Survey instrument was designed and used considering the limited level of education of the respondents. The interview questionnaire includes information on access to finance and household and farm characteristics such as age, gender, education, family composition and farm size, agricultural yields, household income, loans and credit provisions. The questionnaire was prepared considering all the variables to be analyzed and using questionnaires of similar researches conducted in other parts of the country.

Additional primary data were collected using semi structured interview with leaders of the selected primary cooperatives (16 interviewees) and government officials in cooperative promotion agencies of the selected zones and districts (8+3 = 11 interviewees). A total of 27 officials were contacted for semi structured interview. The main objectives of conducting the interview is to support the data collected with interview questionnaire from smallholder farmers. The results of the interview were therefore incorporated in the discussion part whenever it is appropriate. In addition to primary data, secondary data pertaining to the study were collected from CSA, regional, zonal and district cooperatives promotion agencies. These include population statistics, list of members of the selected primary cooperative agencies, rules, regulations and working procedures related to cooperatives in the region. After collecting primary and secondary data, descriptive statistical tools were used for analysis purpose. Some of the descriptive statistical tools used in this study are: averages, frequency distributions, percentage distributions, tabulations and cross tabulations, graphs, etc.

RESULTS AND DISCUSSION

Before going to the main points of discussion it will be good to describe the nature of the respondents. Table 1 shows the sex composition, religion, age and educational background of head of the household who responded to the interview questionnaire. As shown in Table 1, the majority of the heads of household who responded to the questionnaire are males and Muslims. Table 1 further shows that the majorities of the respondents are in the age interval between 36 and 60 years which are considered as adults and about 78.3% are literate who have some sort of schooling and 14.8% are illiterate.

Microfinance institutions and cooperatives are formal financial sources that reach rural poor population who are not served by the conventional commercial banks. Especially, MFIs that are operating in the study area include Oromia Credit and Saving Share Company (OCSSCO), Harbu Microfinance Share Company, Eshet Microfinance Share Company, etc. Respondents were requested to mention their source of finance when they start agriculture for the first time. Smallholder farmers (72.5 and 27.50%) replied that they use previous saving and inheritance from family as initial source of capital for starting agriculture, respectively. The survey further indicates that smallholder farmers rarely use bank loan and machine lease as a source of initial capital. This goes with the reality that most family members in Ethiopia are engaged in the same activity that their parents have been doing. After starting agricultural activity, farmers need source of finance for purchase of agricultural inputs and for further expansion of their agricultural activity. These sources of finance include credit from cooperatives and microfinance institutions. Specifically, interview with zonal cooperative promotion officers indicate that cooperatives can grant the following three types of credit to their members at least in principle. A short term credit of maximum amount Br.1,500 that should be repaid within a year, a medium term credit of maximum amount Br. 5,000 that should be repaid within three years and a long term credit of maximum amount of Br.7,000 that should be repaid within five years. Each of these credits should be used for short, medium and

Table 1. Demographic characteristics.

Sex of the respondents	%	Religion of the respondents	%
Male	90.0	Christian	24.0
Female	3.0	Muslim	69
Missing	7.0	Missing	7.0
Total	100	Total	100
Age of the respondents		**Educational background**	
<36	27.0	Illiterate	14.7
36 - 60	57.7	Elementary	65.0
>60	7.8	High School	13.3
Missing	7.5	Missing	7.0
Total	100	Total	100

Table 2. Use of credit and sources of information.

Use of the credit	%	Sources of information	%
Purchase of farm inputs	41.25	Extension agents	57.00
Purchase of farm oxen	28.25	Cooperative Leaders	52.00
Payment for daily labourer	2.50	Local administrators	19.50
Purchase of fixed asset	1.50	Microfinance officers	18.25
Payment for daily consumption	0.75	Friends and relatives	2.25

Source: Survey Data.

long term investment, respectively so that borrowers will payback within the specified time period. Respondents were also requested whether they have obtained any credit from cooperatives or microfinance institutions after starting agriculture and the survey result revealed that only 31.5 and 25.5% of respondents have requested and succeeded in getting credit from cooperatives and MFIs, respectively. Further questions were raised for what purpose they have used the credit and to mention the source of information about the availability of such credit.

Table 2 shows the result of the survey. As shown in Table 2, smallholder farmers used the credit obtained from cooperatives and MFIs mainly for purchase of farm inputs and agricultural oxen. The use of credit from formal source for consumption, purchase of farm equipment and payment to daily labourers is very rare. Specifically, cooperatives play a more significant role in providing agricultural inputs on credit. This result is similar with the finding by Zewdie (2015), in which informal credit is mainly used for consumption-smoothing purposes while formal credit is mainly used to purchase agricultural inputs.

The result further shows that the information about the availability of credit services from cooperatives and MFIs is obtained mainly from agriculture extension workers and cooperative leaders. Interview with district cooperative promotion agency officers indicates that currently, three extension workers are assigned in each peasant association in different disciplines including plant science, animal science and natural resource management. Hence, farmers have high possibility of contacting either of these agricultural workers.

Farmers who have a frequent contact with extension agents in rural area have more information that will influence their demand for credit from the formal sources including cooperatives and MFIs. If a farmer participates in extension package, then he/she has the chance to get credit for the purchase of farm inputs or technologies. The survey result further shows that about 69 and 72.5% of the respondents either did not requested or requested but not succeeded credit from cooperatives or MFIs, respectively. The reasons for not requesting at all or requested the credit but not succeeded in getting credit from cooperatives and microfinance institutions are shown in Table 3.

A number of factors explain why certain borrowers do not prefer to use formal credit from cooperatives and MFIs. Table 3 clearly shows that lack of interest for loan, long loan procedure and fear of asset risk are the main reasons for not taking credit from cooperatives. Whereas high interest rate, religion, long loan procedure and inconvenient loan repayment period are the main reasons for not taking credit from MFIs. The study by Yehuala (2008), in his survey in Metema district of Amhara region

Table 3. Reasons for not taking credit.

Reasons for not taking credit from coop	%	Reasons for not taking credit from MFIs	%
I do not need loan	32.25	High interest rate charged by MFIs	23.75
Long Loan processing time	7.75	Because of my religion	17.50
I do not want to put my asset at risk	7.75	Long Loan Procedure	14.50
Fear of inability to repay	6.50	Inconvenient Loan repayment period	11.25
Inconvenient repayment period	5.75	No awareness about MFIs services	3.25
High interest rate charged	5.50	Forced Saving required by MFIs	2.25
I do not have saving in the cooperative	2.50	Lack of guarantee for taking Loan	0.50
Long distance from the cooperative	1.00	-	-

Table 4. Credit taking and loan repayment seasons.

Credit taking seasons	%	Loan repayment seasons	%
Spring season	63.00	Autumn season	64.75
Summer season	32.00	Winter season	27.25
Autumn season	5.75	Summer season	1.50
Winter season	2.00	Spring season	0.25
Anytime	1.25	Anytime	0.00

Source: Survey data.

also came up with similar factors that hinder smallholder farmers from accessing formal credit sources. As earlier shown, long loan procedures and inconvenient loan repayment period are two of the common reasons for not taking credit from both cooperatives and MFIs. Specifically, MFIs force smallholders to be organized in groups and agree to the joint liability pressure for repayments of the credits. However, this is not a limit for MFIs but rather an enforcement of property which instead guarantee the viability of the microfinance formula. Smallholder farmers will take credit during active farming season and repay their loan by selling their agricultural output. Therefore, the need for sources of finance and the time at which they will have liquid cash to repay credit is seasonal in nature. In this connection, respondents were requested to mention which season they wish to take credit and indicate the convenient seasons for repaying the loan. Table 4 shows the result of the survey.

As shown in Table 4, majority of the respondents prefer to take credit during spring or summer seasons. This might be because spring and summer seasons are periods in which most agricultural activities takes place in southwest Oromia. During these seasons, farmers need to purchase agricultural inputs including fertilizer, selected seed and pesticide and need cash for the payment of daily labourers. On the other hand, farmers wish to repay the loan they have taken in autumn and winter seasons. This is because these two seasons are harvest seasons in which farmers can take their crops to market. During these seasons, farmers can have liquid cash that enable them to settle their previous bills.

The discussion is related to formal way of financing smallholder farmers. In addition to the formal method of financing, other informal financing mechanism are common among smallholder farmers in Ethiopia. Mobilizing Iqqub is one of the informal financing mechanisms used by smallholder farmers. Out of the total respondents, one-fourth of the smallholder farmers have used Iqqub to mobilize capital. Respondents have mentioned the reasons for preferring Iqqub as a financing mechanism. Increasing cooperation among them (26%), absence of interest payment requirement (24%) and local availability (12.5%) are some of the reasons for using Iqqub as informal financing source. Informal credit is another main source of finance for smallholder farmers. It refers to loans that suppliers extend to their customers upon product purchase or any credit from local friends, trade man, landlords, etc. Respondents were asked whether they have taken any credit from these informal sources and the associated reasons for doing so. Table 5 shows the result of the survey.

As shown in Table 5, significant percentage of smallholder farmers takes credit from informal creditors at least sometimes. The source of credit consists of relatively rich farmers, tradesmen, and sometimes government employees. The transactions are creditors provide cash in advance before the crops are harvested and borrowers are then expected to repay in kind based on previous commitment made with the lender. A very common example is in coffee and chat grower farmers; where the anticipated value during the harvest is advanced to the smallholder farmer and collection is

Table 5. Taking credit from informal sources and the associated reasons.

Have you taken credit from informal creditors?	%	Reasons for taking informal credit	%
Yes always	0.75	Willingness to grant credit	7.61
Yes sometimes	45.25	Easy to obtain	58.15
Not at all	39.75	My Being regular client	3.26
-		No collateral is required	23.91

Source: Survey Data.

made in kind by the creditor at the time of harvesting the crops, and the majorities who make the advances are often coffee or chat traders in the nearby towns. At the time of borrowing, the smallholder farmers usually sign a loan contract in order to avoid default and conflict at the time of harvest. Informal market loans are believed to carry hidden interest over and above the explicit interest or may require the borrower to repay loans taken in kind in terms of a higher quality product which fetches higher price.

There are at least four reasons to take trade credit by smallholder farmers in this arrangement: (i) Ease to obtain credit from the supplier; (ii) Being regular client of the supplier which means regular buyers may establish trust, which increases their chance of getting suppliers credit; (iii) No collateral was required to back up the loans and finally; (vi) Loans from informal sources have no obligations as to how and for what purpose(s) they should be used. The survey respondents vividly indicated that they have never taken credit from local private money lenders who grant credit for the sake of getting high interest because of the harsh major taken by the government on individuals doing such type of business. In Ethiopia, the right to give loan anticipating interest in the future is given to banks and MFIs and it is illegal for individuals to engage in such type of business.

Conclusion

One of the roles of cooperatives is to provide credit to smallholder farmers. The study found that only one-third of the members have taken credit from cooperatives in the last three years. There are a number of reasons for not taking credit from cooperatives by smallholder farmers. Lack of interest for loan, complex loan procedure and fear of asset risk are the main reasons for not taking credit from cooperatives. Though cooperatives are established to provide credit, they are currently very weak to give the required services to their members. This is associated to lack of stability of the cooperatives themselves and absence of commitment of cooperative leaders and members. Cooperatives are organized and reorganized again and again and this has created instability in the members and cooperatives leaders. This will in turn discourage those who are already a member and those who are planning to join them. Microfinance institutions are formal financial sources that are supposed to reach a large number of rural poor who are not served by the conventional commercial banks. Oromia Credit and Saving Share Company (OCSSCO) is the major state owned financial institutions operating in the study area. The study found that smallholder farmers have less culture of taking credit from MFIs. Some of the reasons for not using MFIs include: high interest rate charged by MFIs, religion, complex loan procedure and inconvenient loan repayment period. This implies that although the government is taking action to support smallholder farmers by expanding MFIs to rural area, still our peasants are not using the alternatives available to them because of the above reasons. The administrative procedure of MFIs is a serious burden to the rural household. Potential borrowers need to form group, hand in application forms, farming plans, and guarantee evidence. These procedures may be too difficult for less educated rural households. Some smallholder farmers have also raised existence of corruption by customer service officers of MFIs. Some customer service officers will request bribe from the borrower smallholder farmers under the pretext of shortening the time to get the loan. Still significant percentage of smallholder farmers takes credit from informal creditors. The source of credit consists of those farmers who are better-off, tradesmen, and sometimes government employees. Creditors provide cash advance before the crop is harvested and borrowers are then expected to repay in kind when harvest time is coming based on previous commitment made with the lender. A very common example is in coffee and Khatt grower farmers; where the anticipated value during the harvest is advanced to the smallholder farmer and collection is made in kind by the creditor at the time of harvesting the crops, and the majorities who make the advances are often coffee or Khatt traders in nearby town. At the time of borrowing, the smallholder farmers usually sign a loan contract in order to avoid default and conflict at the time of harvest. These types of loans are typically short term, characterized with higher profit margin for the lender. This implies that Informal credits play vital role in the life of peasant farmers and any rural development and credit programs should take this reality into account. This indicates that there is much to be done if the rural smallholder farmers in Ethiopia are going to access and fully utilize agricultural credit.

The majority of smallholder farmers will use trade credit as alternative financing means from suppliers. This may require designing a programme such that financial institutions provide credit to large suppliers of agricultural inputs which in turn would lend it on to smallholder farmers in the form of credit, thereby bypassing the problem posed by the high risk and transaction costs that make them unattractive clients to financial institutions. It may also be used to help smallholder farmers improve their product quality by improving access to modern agricultural tools for mechanized farming.

CONFLICT OF INTERESTS

The authors have not declared any conflict of interests.

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