Transaction costs for Ethiopian sesame farmers

Ethiopia, like many other African countries, places high priority on accelerating agricultural growth through the marketing of smallholder production. This is not an easy task. Marketing relatively small amounts of agricultural produce, sold by thousands of smallholder farmers is costly. These costs are often referred to as 'transaction costs'. Transaction costs include the costs associated with finding a partner to trade with, delivering the commodity, negotiating a contract, or enforcing the agreement (for example, Bernard et al., 2010; Eaton et al., 2008; Gabre-Madhin, 2001; Pingali et al., 2005). Smallholders typically face proportionally higher transaction costs than large farmers because of the small size of each transaction. Therefore, to promote participation of poor farmers in competitive markets, it is necessary to reduce these transaction risks and costs. Our case study on sesame farming in Humera , the heart of sesame production in Ethiopia, examined whether these risks and costs can be decreased through contract farming arrangements.

Low marketing transaction costs

Sesame is mostly traded at village or nearby city markets. Farmers, traders and brokers are all in the same physical space. Brokers, who mediate large scale sales, play a vital role in spreading information on buyers and prices to the farmers. In Humera, competition between traders is generally high and therefore farmers will usually obtain a relatively high price. Farmers in Humera thus receive a large share (70 – 80%) of the export price and make a large profit compared to other actors in the value chain .

High inputs transaction costs

On the input side, the situation is quite different. Here smallholder farmers struggle to secure inputs such as working capital, labour, tractor services, etc. See the figure below for an overview of the transaction costs farmers bear when securing their inputs. One of the most stringent constraints farmers face is finance. It takes smallholders many days to obtain small and insufficient amounts of credit. Farmers, who understand the positive impact of timely land preparation, sowing, weeding and harvesting, have to revert to moneylenders for their working capital. Timely availability of sufficient finance to pay for the necessary inputs is therefore crucial to obtain high yields and profits. Usually, the loans are paid back in kind (sesame). The number of sesame bags that farmers have to pay is set at the time the loan is given. It is based on a much lower price than the price farmers would have received if they had sold their crop on the market.

Can contract farming reduce the struggle for inputs without lowering the ease of marketing?

Contract farming refers to pre-agreed supply agreements between farmers and buyers. Usually local farmers grow and deliver agricultural produce for specified quantity and quality at an agreed date. In exchange, the company agrees to buy the produce supplied, usually at a specified price. Moreover, the company can provide upfront inputs, such as credit, seeds fertilisers, pesticides and technical advice to the contract farmers, all of which may be charged against the final purchase price, as is illustrated by Selet Hulling in Humera. Other studies on contract farming demonstrate that contract farmers benefit from reduced transaction costs in the input market and that farmers gain access to inputs and new technology. These studies also show that contract farming helps farmers to meet market requirements and increase their yield and income. Buyers benefit from contract farming because they will receive constant and improved quality products. This is confirmed by the 2009 World Investment Report (UNCTAD, 2009) and the 2011 Agribusiness for Africa's Prosperity report by UNIDO that give considerable attention to contract farming as an option to solve supply-side constraints.

Contract farming can create dependency of smallholders on the contracting firm. Although such considerations are certainly important, it may be less applicable to sesame farmers in Ethiopia because farmers generally have good access to price information. This has improved with the introduction of the ECX. This minimises the risk that contract firms will disadvantage sesame producers.

Contact

e jennie.vandermheen-sluijer@wur.nl

t +31 317 48 40 47

i http://www.dgis.wur.nl

Development Cooperation
Ministry of Foreign Affairs

WAGENINGEN UR
For quality of life

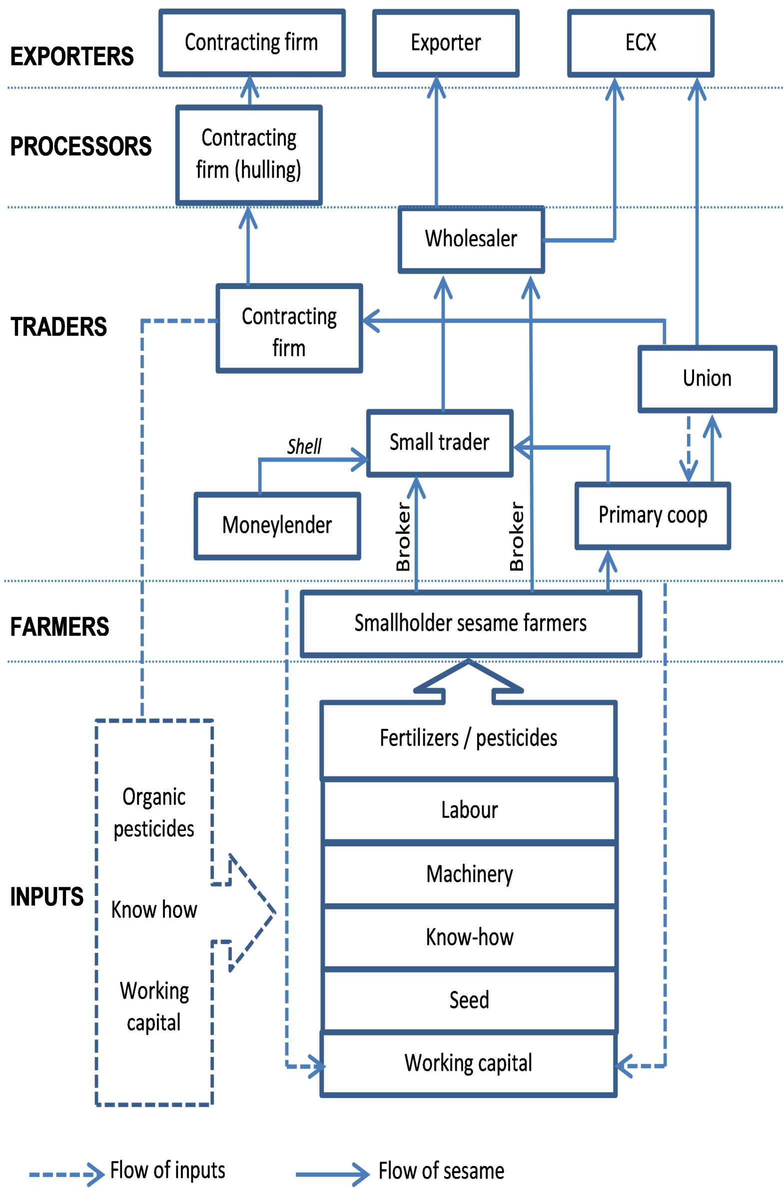
Transaction costs for Ethiopian sesame farmers

Jennie van der Mheen-Sluijer
Francesco Cecchi

September 2011

VC4PD Brief 15

Simplified domestic sesame value chain and transaction costs borne by smallholder farmers in Humera, Ethiopia



Overview of transaction costs borne by smallholder sesame farmers in Humera,

Farmers hardly face costs when selling their sesame. They measure price discussions, inspection of crop, and receipt of payments in minutes.

No soil fertility management; only rotation with sorghum => declining soil fertility Pre- and post-harvest chemicals hardly used; seed bug can cause significant losses

Farmers lacking finance to pay labourers for weeding, harvesting and threshing time have to revert to time consuming recruitment of daily workers for twice the costs

Race to secure tractor takes circa 8 days. Late land preparation leads to reduced yield

Hardly any extension service available for sesame farmers

No improved sesame seed available. Farmers use own crop as next year's seed.

Most farmers had to go to moneylender for sufficient and timely access to credit. Annual interest rate varied from 225 – 240%. Other sources: small amount; takes 2 – 19 days

This brief is a result of the research program Value Chains for Pro-poor Development (VC4PD), implemented in collaboration with Agriterra and AgriProfocus, under the Partnership Programme between the Netherlands' Ministry of Foreign Affairs and Wageningen UR. In Ethiopia, the VC4PD program supported EPOSPEA and the PPP on Oilseeds, and collaborated with EIAR, FFARM and SNV. The views expressed in this brief are the author's only.

.