International Journal of Management and Commerce Innovations ISSN 2348-7585 (Online)
Vol. 7, Issue 2, pp: (1392-1397), Month: October 2019 - March 2020, Available at: www.researchpublish.com

INFLUENCE OF VALUE CHAIN FINANCE ON FINANCIAL PERFORMANCE OF TEA FACTORY UNDER KENYA TEA DEVELOPMENT AGENCY, AN EMPIRICAL REVIEW

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Abstract: **The purpose of these study was to investigate influence of agricultural value chain finance on financial performance of Tea Factory under Kenya Tea Development Agency. The aim of a systematic review is to identify all empirical evidence that fits the pre-specified inclusion criteria to answer a particular research question or hypothesis. The study targeted all studies that focused on the influence of agricultural value chain financing on performance both locally and internationally. Empirical studies on agricultural value chain financing from 2000 to 2019 was considered. From the findings, only one of the study failed to indicate significant relationship between agricultural value chain financing and performance whereas other reviewed studies indicated that agricultural value chain financing has significant influence on financial performance. Nonetheless, none of the study focused on tea subsector implying that there is need for an empirical studies to investigate relationship between agricultural financing and financial performance of tea factory under Kenya Tea Development Agency.**

Keywords: **Agricultural Value Chain Finance, Financial Performance, Value chain Finance.**

I. INTRODUCTION

Agriculture in developing countries, all over the world, is experiencing profound, fast-moving changes. Agriculture is the backbone of the Kenyan economy directly contributing 24% of the GDP valued approximately at KSh342 billion in the year 2009 and another 27% indirectly, valued at KSsh.385 billion (Kenya National Bureau of Statistics, 2013; 2012). In 2008, the sector contributed 21% of real GDP. Dairy farming contributes makes up 3% of this GDP. The resulting processes of structural change entail profound consequences for employment, income generation, risk management, poverty alleviation, and the well-being of rural households in these countries. Despite the fact that Kenya's and Africa's economic mainstay is Agriculture, financial institutions are not lending to this sector (Kariuki, 2016).

The subsistence nature of production, and the corresponding low level of savings, has resulted in inadequate funding for farming operations in Kenya. In addition, high interest rates and transactions costs prevent most smallholder farmers from accessing formal financial services. Although cooperatives and savings and credit groups run by rural communities, organized farmers groups, and some NGOs are providing credit to farmers and rural entrepreneurs, these institutions generally lack sufficient capital to cater even to the needs of their members, and therefore have very limited potential to expand their scope or services in a financially sustainable manner. On the other hand, many MFIs provide loans to clients who rely primarily on agriculture as a livelihood strategy: however, since these loans are rarely tailored to the agricultural sector and are not accompanied by embedded technical services, and since the MFIs are rarely interested in the type or potential of the crop being grown by the client, they have limited potential to bolster commercial agricultural value chains, although they will remain an important resource for low-income rural families (Conway & Barbier, 2013).

It is now increasingly recognized that some of the constraints that farmers face in their transition towards commercial agriculture can be alleviated through the value chain approach that brings together different chain actors (including farmers, aggregators, traders, processors and financial institutions) to gain control over the processes of production, marketing, processing and distribution in order to realise scale economies, reduce transaction costs, and minimise uncertainties in supplies and quality of inputs, outputs and services (Trienekens, 2011).

As opposed to conventional financing of a particular segment of the marketing system, value chain finance represents “a flow of funds to different links of the value chain, or among these links, in order to improve efficiency and competitiveness, to reduce risk within the chain and also to promote and develop the chain” (Shwedel, 2010). Cheng and Birthal (2015) defines value chain finance as “the flows of funds to and among the various links within a value chain”. The approach allows chain actors an increased access to finance with product market without much emphasis on collateral. Transactions are intertwined to allow automatic repayments of loans via transaction proceeds in the product market. And, because of scale economies in product as well as financial markets, it reduces lending costs and risks (Miller and Jones 2010xiii).

Value chain finance is an evolving term that has taken on a range of meanings and connotations. The flows of funds to and among the various links within a value chain comprise what is known as value chain finance. Stated another way, it is any or all of the financial services, products and support services flowing to and/or through a value chain to address the needs and constraints of those involved in that chain, be it a need to access finance, secure sales, procure products, reduce risk and/or improve efficiency within the chain. The comprehensive nature of value chain finance, therefore, makes it essential to analyse and fully understand the value chain in all aspects (Kaplinsky & Morris, 2000)

Value chain finance should not be confused with traditional financing from financial institutions, such as banks, it is not value chain finance unless there is a direct correlation to the value chain. An example of a value chain would be input supply, production, trading, processing and consumption. Value chain finance can be employed in different sectors for example agriculture and manufacturing. Understanding value chain finance can improve the overall effectiveness of those providing and requiring agricultural or manufacturing financing. It can improve the quality and efficiency of financing value chains by: identifying financing needs for strengthening the chain; tailoring financial products to fit the needs of the participants in the chain; reducing financial transaction costs through direct discount repayments and delivery of financial services; and using value chain linkages and knowledge of the chain to mitigate risks of the chain and its partners (Silvestro & Lustrato, 2014).

Statement of the Problem

There is a large demand for agricultural finance as farmers, suppliers, processors and buyers need access to finance to operate and develop their businesses. However, on the supply side, bankers often struggle to contain their risks and costs in financing agriculture which results in a large gap in adequate financing. Financial institutions often discriminate against smallholder farmers in their lending the small farmers (Dzadze, Osei, Aidoo & Nurah, 2012).

Financing agricultural commodities is risky, as they have an intrinsically low value when compared with commodities and therefore need to be traded in high volumes with low margins in order to make a profit. This result in large-sized deals, which can bankrupt a trader if a single deal goes wrong, whether as the result of crop deterioration, non-performance by the farmer, port congestion, local gluts or non-payment from buyers or offtakers (Gibbon, 2013).

In Africa’s agricultural sector traditional value chain financing is widespread, involving spot market transactions and a large number of small retailers and producers. Although the Kenyan government has made some advances in broadening access to credit, most small-scale and emerging farmers still do not have access to affordable credit (World Bank, 2009). Attempts to foster financial systems in the Kenyan tea subsector have been advocated by officials concerned with the value chain financing. Therefore, this paper seeks to investigate influence of value chain financing on performance of Tea sub sector under KTDA.

The research identifies the relationship of the various interventions in relation with value chain finance and the efficiency of the value chain. Other researcher will benefit from this study to use it as a reference to undertake similar studies and will serve as filling some of the gaps that have been observed in earlier related researches.

Objectives of The study

The specific objective of this study was to

i. To examine influence of agricultural value chain finance on financial performance of Tea Factory under Kenya Tea Development Agency

II. LITERATURE REVIEW

Theoretical Framework

This paper was guided by theory of investment. Value investing for the first time was established by Benjamin and Dodd, (1928). It was further explored by economic theorists such as Keynes (1936) and Hayek (1939), who focused on the employment of capital and investment from a firm's point of view. Investment is the change in capital stock during a period. One of the earliest investment theories, however, came from in his "Nature of Capital and Income" and his later work "Theory of Interest" (Fisher, 1930). In his theory, although simplistic and open to a number of assumptions, he developed a basic investment frontier. This investment frontier indicates the optimum return for an investment over certain time periods, and would form the basis of the more popular investment frontier models today (Hirshleifer, 1958). Investment decisions as explored by the economists mentioned above concerns the decision to construct a new plant, replace machinery, etc., mostly from a production point of view.

It is observed that there are two separate factors affecting the rate of investment, namely expected return and perceived risk. Confidence effectively dominates whether investment will be contemplated or not for financial decisions. It is not important how attractive the expected return, investment will not be done unless the probability of failure is acceptably low (Myers, 2004). Based on this theory if tea factory help in developing the value chain and actively finance and invest in the value chain it will improve the financial performance of these firms.

III. METHODOLOGY

A desktop review was carried out to examine influence of agricultural value chain finance on financial performance. Systematic review and meta-analysis research designs were utilized. The aim of a systematic review is to identify all empirical evidence that fits the pre-specified inclusion criteria to answer a particular research question or hypothesis. The study targeted all studies that focused on the influence of agricultural value chain financing on performance both locally and internationally. This implies that studies on other value chain financing were excluded. Due to lack of adequate studies on agricultural value chain financing, the study reviewed studies that from 2000 to date (2020). This provided the researcher with adequate studies to achieve research objectives. In total, ten papers were found suitable and therefore were used for final analysis.

IV. FINDINGS AND DISCUSSIONS

Ngugi, Gitau and Nyoro (2007) empirically found that in Africa 'Value Chain actors are driven more by the desire to expand markets than by the profitability of the finance. The nature and motive of traders for the value chain finance is often different. Traders, for example, commonly use finance as a procurement facility while input suppliers often employ it as part of a sales incentive strategy. For financial institutions, it offers an approach to lower risk and cost in providing financial services. For the recipients of value chain finance, such as smallholder farmers or those purchasing their products, in value chain finance offers a mechanism to obtain financing that will not be available otherwise to members due to the lack of collateral or transaction costs of securing a loan, and it can be a way to guarantee a market for products.

In Nigeria, Ojo and Ayanwale (2019) assessed value chain financing and plantain produced. These results indicate the positive impact of VCF, measured in terms of net present value and net benefit, expressed as producer and consumer surplus. This suggests VCF is a viable and beneficial financing innovation for food production in Nigeria. Lack of value chain financing has resulted to decline in people involving in agriculture related activity noticed in the reports. People are moving to other sectors in Assam, North East India (Borbora, 2014). That can be generalized as a case of non-attraction due to lower returns. These lower returns can be improved by strengthening the market linkage and value chain.

In South Africa, Oberholster, Adendorff and Jonker (2015) examined financing agricultural production from a value chain perspective. The results indicated that partnering, risk management, supporting services, sustainable production, product range and external financing positively influence value chain competitiveness. In the same manner value chain competitiveness positively influences the perceived success of agricultural value chain financing in this study.

In Kenya, Agarwal, Jagongo and Mbewa (2017) revealed that Financing through raw material and working capital do not have statistical significant relationship to financial performance of Edible Oil Manufacturing Companies. Dissimilar results were obtained by Lumi and Opusunju (2016) whereby there is significant relation between value chain and performance of Agro Allied SMEs in Sokoto State. Other findings primary activities of value chain contribute significantly to the performance of Agro SMEs in Sokoto State and secondary activities of value chain contribute significantly to the performance of Agro SMEs in Niger State. Kopparthi and Kagabo (2012) provided empirical evidence that impact of the access to value chain financing products had a straight link to the levels of profit and production among Rwanda farmers. However, Rajiv and Jagongo (2014) indicated that there is a positive effects of Agricultural value chain financing on financial performance of BIDCO the edible oil manufacturing firms in Kenya Study also confirms that Value chain financing strategies adopted by BIDCO edible oil company in Kenya effect positively financial performance of the firms in Kenya.

Discussions of Key Findings

It is evident that few studies have conducted to investigate value chain financing and financial performance both in Kenya and outside the Kenya. Though agriculture remain key economic activities in developing countries, lack of study in agricultural value chain financing implies that African farmers will continue to remain poor due low return from agricultural value chain. From the studies which have conducted on value chain financing and financial performance, Ojo and Ayanwale (2019) revealed positive impact of VCF, measured in terms of net present value and net benefit, expressed as producer and consumer surplus, however, the study did not investigate influence of value chain financing on financial performance but of plantain production.

Soundarrajan and Vivek (2015) indicated that agricultural value chain financing is important in India, as it has resulted to rural financial deepening due to low cost transaction hence improvement in financial access among actors in value chain. This was further supported by Lumi and Opusunju (2016) who revealed that value chain financing influenced performance of Agro Allied SMEs in Sokoto State in Nigeria. However, secondary activities of value chain contribute significantly to the performance of Agro SMEs in Niger State. The scope of the study was wide as it focused on Agro Allied Small and Medium Scale Enterprise. The study did not indicate what entails primary activities of value chain as used in their study. In a similar study, Kopparthi and Kagabo (2012) revealed that level of profits and production are related with agricultural value chain financing among small scale farmers in Rwanda.

On the other hand, Agarwal, Jagongo and Mbewa (2017) failed to establish significant relationship between value chain financing and working capital management approach among Edible Oil Manufacturing Companies in Kenya. The pluralism of gaps emerged on the exclusion of producers in the value chain implying that not all aspect of agricultural value chain financing was captured**.**

V. CONCLUSION AND RECOMMENDATION

Study confirms based on theory and empirical evidence above and the performance review over last 8 years that there is a positive effect of Agricultural value chain financing on financial performance although such studies were not conducted in Tea sub sector. Value chain financing varies from country to country as well as from products to products. This implies that it is difficult to replicate value chain financing from one country to another. Similarly, it is practical impossible to impose value chain of one product to another due to various actors involved in the chain. Therefore, this research problem is unique as it focuses on tea farming in Kenya. The study confirms that strategies used in value chain financing which in this case, type and financing mechanism influence performance. On the off, all reviewed relevant studies were inadequate in form and content. Few of the studies have indeed revealed how type of value chain, direct or indirect would result to higher value chain financing.

It is difficult to establish whether financing within the chain would results to greater financial performance as compared to external via indirect value chain financing. On the other, studies have failed to isolate which value chain financing mechanism has resulted to superior financial performance yet the products have been in existence to support performance of actors within the chain. These inadequacies imply that further studies need to be conducted in regard to value chain financing and financial performance. The existing studies failed to conceptualize value chain finance and financial performance and therefore, this study proposes a conceptual framework based on the existing concepts of value chain finance and financial performance as indicated in Figure 1.

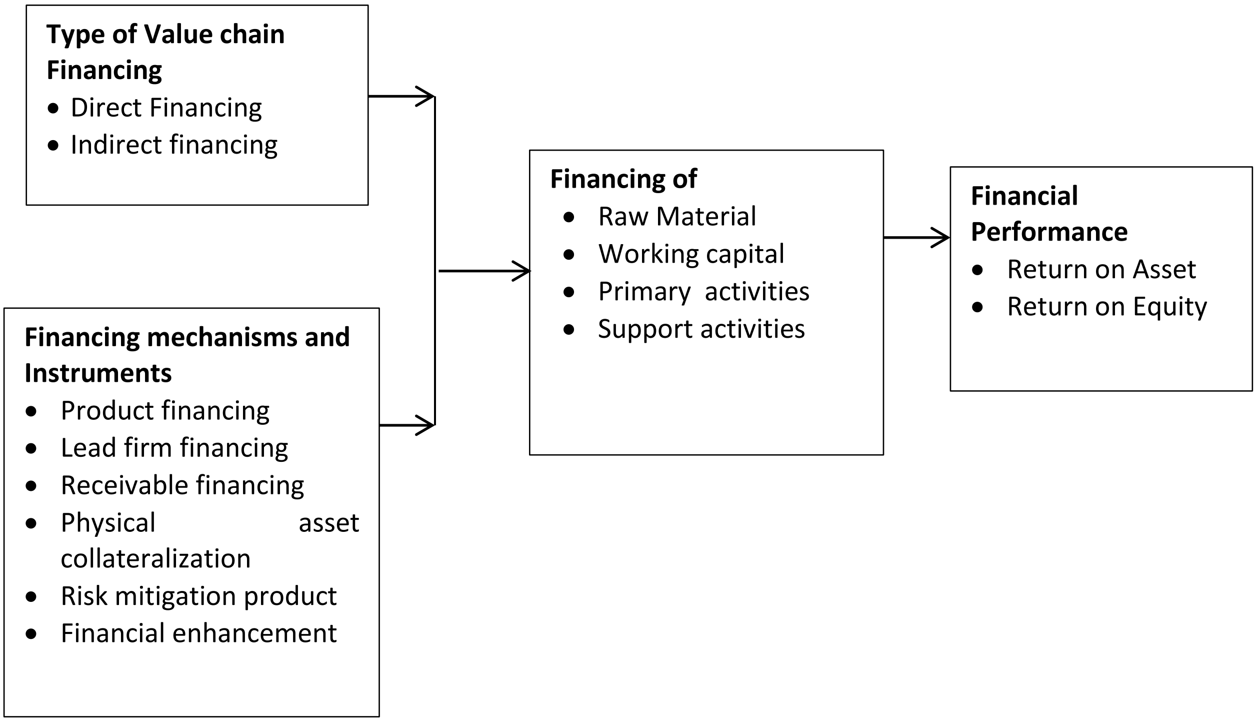

Figure 1: Proposed Conceptual Framework

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