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Report Highlights:
Nigeria's agricultural development is constrained by the lack of access to credit for the predominantly smallholder farmers. Efforts by successive governments to address the problem have been largely unsuccessful. Commercial banks in the country perceive agricultural finance to be high-risk. The Central Bank of Nigeria is making efforts to de-risk the sector and encourage banks to lend to farmers.

Executive Summary: Agriculture occupies a priority status in Nigeria as the sector serves as the key driver of growth, wealth creation and poverty reduction for a large portion of the population. It is the leading economic activity in the country contributing about 40 per cent of GDP and providing 60 percent of employment in 2010. More than 80 percent of Nigeria's agricultural production is dominated by poor and small-scale producers in the rural areas. This group lacks access to capital to acquire the needed inputs to increase output and incomes. To overcome this challenge, farmers have continued to exploit various avenues by relying on both non-institutional and institutional sources of credit. Efforts and initiatives by successive Nigerian governments to address the problem have produced lower than expected results as rural farmers still encounter difficulties in accessing credit from the formal financial institutions. Many have resorted to self-help and mostly informal financing options.

Background:

Like many other African countries, Nigeria is primarily agrarian with its abundant land and water resources. Despite the rapid growth of the oil industry over the years, agriculture still accounts for 40% of GDP and provides employment (both formal and informal) for about 60% of Nigerian's 150 million people. Nigeria's agriculture remains largely subsistence-based with about 80% of agricultural output coming from rural farmers living on less than a dollar per day, earned from farming less than one hectare (2.47 acres). Nigeria has diverse agro-ecological conditions that can support a variety of farming models to create its own green revolution. However, successive administrations neglected agriculture over the years and failed to diversify the economy away from overdependence on the capital-intensive oil sector. Nigeria was once a large net exporter of agricultural products and the sector was the major foreign exchange earner before the advent of oil in 1970s. Nigeria is currently a huge net importer of agricultural products, with such imports exceeding $3 billion in 2010. The country has the potential to return to its previous position if adequate attention is given to agricultural growth policies, finance and provision of rural infrastructure.

The fact of the matter is most of the smallholder farmers lack access to capital to acquire the needed inputs to increase their productivity and incomes and reduce their poverty. Farmers require credit to purchase seeds, fertilizers, herbicides, and buy or rent mechanized equipment and related services.

Nigerian agricultural policy recognizes the vital role of agriculture finance in attaining the much desired green revolution. A major focus of the policy is to establish a system of sustainable agricultural financing schemes, programs and institutions that could provide micro and macro credit facilities for the small, medium and large-scale producers, processors and marketers. However, public expenditure on agriculture which serves as the bedrock of financing for the sector has consistently fallen short of recommendations. It is therefore not surprising that these policies have failed to achieve the set goals of food self-sufficiency, self reliance, poverty reduction and rural development. Importantly, Nigeria's agriculture is abysmally under-financed. At a public forum in early 2011, the Governor of the Central Bank of Nigeria (CBN) was quoted to have said "currently agriculture accounts for 40 percent of the GDP, yet it receives only one percent of total commercial bank loans." This is significantly below the level of other developing countries, e.g. Kenya and Brazil which reportedly registers 6 percent and 18 percent, respectively.

The Nigeria Agriculture Public Expenditure Review, a collaborative study carried out by the International Food Policy Research Institute (IFPRI) and the World Bank in 2008, revealed that public spending on agriculture was less than 2 percent of federal expenditure during 2001 to 2005. This is far below the 10% goal set by African leaders under the Comprehensive Africa Agricultural Development Program (CAADP). CAADP was established by the AU assembly in 2003 with a focus on improving food security, nutrition, and increasing incomes in Africa's largely farming based economies. It aims to do this by raising agricultural productivity by at least 6% per year and increasing public investment in agriculture to 10% of national budgets per year. Very low levels of funds are available for activities considered vital for promoting agricultural growth, such basic and applied agricultural research, agricultural extension and capacity building, and agricultural credit and irrigation development. In spite of this poor investment, agriculture contributed on average 32% to the country's total GDP during 1996-2000 and 42% between 2001 and 2009. For a successful transformation of the agricultural sector, experts suggest that Nigerian agriculture requires additional annual investments of as much as $8 billion.

Budgetary Allocation to Agriculture (# Billions)
1990-2002

Year	Total Budget	Allocation to Agric	% of Agric to total
1990	39.76	1.96	4.95
1991	38.66	0.67	1.74
1992	52.03	0.92	1.78
1993	112.10	2.83	2.53
1994	110.20	3.71	3.37
1995	153.49	6.92	4.51
1996	337.21	5.71	1.69
1997	428.21	8.66	2.02
1998	487.11	9.04	1.86
1999	947.69	12.15	1.28
2000	701.05	13.60	1.94
2001	1, 018.02	64.94	6.38
2002	1,018.15	44.80	4.40

Sources: CBN Statistical Bulletin and Annual Report

Contribution of Agriculture to Gross Domestic Product 2001- 2007

Year	Total GDP (#Billion)	Share of Agric. GDP	% Share of Agric in Total GDP

1990	267.55	84.35	31.53
1991	265.38	87.50	32.97
1992	271.37	89.35	32.92
1993	274.83	90.60	32.97
1994	275.45	92.83	33.70
1995	284.41	96.22	33.83
1996	293.75	100.22	34.12
1997	302.02	104.51	34.60
1998	310.89	108.81	35.00
1999	312.18	114.57	36.70
2000	329.18	117.95	35.83
2001	431.78	182.66	42.30
2002	451.71	190.37	42.14
2003	495.01	203.01	41.01
2004	527.58	216.21	40.98
2005	561.83	231.46	41.19
2006	595.82	248.60	41.72
2007	634.86	267.06	42.20
2008	672.20	283.18	42.13
2009	716.95	309.00	43.10

Source: CBN (2005, 2007& 2010) GDP is at 1990 constant price.

Structure of Farming in Nigeria

For purposes of clarity, this report will focus on two distinct farming groups in Nigeria: small-scale farmers (10 ha or less) and medium to large-scale farmers (above 10 ha).

Medium to Large-Scale farmers:

Recent reform programs of the Government of Nigeria (GON) brought an increase in private sector acquisition of land for medium to large-scale agricultural operations. These are mainly retired civil servants and private sector workers who use their retirement benefits to start their own farming operations. In a few states, such as Kwara and Kano, there are specialized institutions established by the government to provide training in commercial agriculture. Because these farmers are fairly well educated, they adapt easily to new technologies and are able to structure their operations to attract financing from development banks and in some cases, commercial banks.

Loan conditions from commercial banks are very stringent and interest rates are high. Nigeria is largely a cash-based trading economy and there is almost complete absence of long-term funds for investments in agriculture. Local farming sources indicate that in Nigeria today, it is almost impossible to obtain long-term (7-15 years) loans from commercial banks to invest in agriculture. Long gestation crops such as oil palm, cashew, cocoa and rubber are most affected by the lack of long-term loans. A case in point is that of 13 Zimbabwean farmers (displaced white farmers from Zimbabwe) in Kwara State. The government of Kwara State invited the farmers to come and farm in Nigeria and allocated to them 1000 hectares of land each for commercial agriculture. The program is a part of the overall goal of developing commercial agriculture in the state and the country at large.

The program was almost scuttled at inception because for more than two years after the Zimbabwean farmers relocated to Nigeria they could not secure long-term loans from the commercial banks to commence farming operations. It took the intervention and secured guarantee from the government of the state before a consortium of banks would extend credit to them. Even recently one of the farmers was quoted as saying that the main challenge to the development of commercial agriculture in Nigeria is the lack of understanding, particularly by commercial banks, of long term, medium term and short term finance. These farmers are now fully settled and engaged in commercial production of corn, soybeans, cassava and dairy. This experiment in Kwara has turned out to be a huge success and is today a reference point for other states and private sector individuals planning to venture into commercial agriculture.

In February 2009, the Government of Nigeria (GON) through the Central Bank of Nigeria set aside 200 billion naira ($1.33 billion) under the Commercial Agriculture Credit Scheme (CACS), designed primarily to nurture the growth and development of medium to large-scale commercial agriculture in Nigeria, with a broader focus on the entire value chain. The funds are channeled through a selected number of commercial banks. Unlike previous initiatives, the CACS appears to be working. Bank sources have reported that less than two years from the establishment of CACS, about 50 percent of the available funds have been taken up by medium to large-scale farmers. Overall, loan disbursements under the scheme are making steady progress. In this scheme, the private commercial banks are obligated to recover their loans, so the selection of projects is very thorough and the funded projects are achieving the desired expansion in scale, while steady repayment has started on some of the facilities.

Smallholder Farmers:

Small-scale peasant farmers are the heart of farming in Nigeria, with more than 80 percent of Nigeria's agricultural production coming from these resource-poor, subsistence farmers operating on less than one hectare of land. This segment of the farming population does not adapt to new technologies as quickly as the medium to large-scale farmers and as such, they only obtain very low crop yield levels. Most of these farmers do not have funds to acquire seeds, fertilizers, chemicals and farm machinery to scale up operations and remain outside the reach of most types of available modern financing.

Overview of agricultural finance in Nigeria

Since independence in 1960, successive Nigerian governments have made efforts to address the problem of lack of access to credit to the rural poor. In recognition of the vital role of small-scale farmers in wealth creation, the GON has experimented with various financing initiatives. These are largely subsidized, targeted credit programs to promote agricultural production and improve the lives of smallholders. Following are the most important of the formal, mostly government financial schemes and institutions:

i. Nigeria Agricultural Cooperative and Rural Development Bank (NACRDB): Jointly owned by the GON and the Central Bank of Nigeria, it plays the role of providing finance in the rural landscape. In practice, its deposit mobilization and credit services are also extended to urban clients. The bank is required to lend 70% of its loan portfolio at single digit interest rates through loans of 250,000 Naira ($1,666) or less. The very low repayment rates and the interest rate cap have both been found to undermine the viability of the institution as well as restricting its ability to satisfy the demand for loans from its target clientele;

ii. The People's Bank of Nigeria (PBN): Created in the early 1990s through a military Decree in order to reach the unbanked public, it essentially provided micro credit of 250,000 Naira ($1,666) or less to clients at a service charge of 20%. Clients had to have compulsory savings of 30% of the loan amount on hand when they obtained their loan;

iii. The Community Bank (CB): was set up with the goal of encouraging locally-owned savings and loans institutions to meet the needs of the rural population not served by the commercial banks and government owned banks. The imposition of the ceiling on interest rates led to an inability of many CBs to recover their costs and eventually many became distressed;

iv. Microfinance Banks (MFI) 2005 to Date: introduced by the CBN with the specific objective of making financial services accessible to a larger segment of the potentially productive Nigerian population who otherwise have no access to such services and permit them to contribute to rural transformation, promote synergy, and mainstream/graduate the informal subsector into the formal financial system. Through this microfinance policy, the CBN introduced a new regulatory and supervisory framework that made it compulsory for all institutions to obtain a new license and have a minimum share capital of 20 million Naira. Some modest success has been achieved, especially through the MFIs that are supported by NGOs. These are important financial providers for the rural poor in states such as Benue, Nassarawa and Bauchi, although their overall impact remains small. The limitation with NGO-MFIs is that they are prohibited from mobilizing deposits and find it difficult to grow;

v. The National Poverty Eradication Program (NAPEP): currently has several micro-finance initiatives underway. From the onset, the program recognized the tendency for delinquency rates among borrowers to be higher for those who accessed government funds than those who access funds from commercial financial intermediaries. Building on the success with community approaches in the past, NAPEP loans are channeled through community-based financial intermediaries;

vi. Financial Agricultural Cooperatives: Rare in Nigeria due to traditional views on sharing personal wealth information, these tend to be found in the northern states of Gombe and Bauchi, where experience with cooperatives has been positive. Very little is known about them however, including their number. Small-scale cooperatives are common across the country since most formal financial providers will only lend to farmers through this vehicle. These cooperatives are usually stand alone entities and are not federated under an apex body. In recent years, the GON promoted the formation of cooperatives in local communities and along commodity lines as a way of improving access to financing for the small-holder farmers. Cooperatives provide the required guarantees which the individual farmer cannot provide. Currently, there is a Directorate of Cooperatives in the Federal Ministry of Agriculture with more than 30,000 registered cooperatives spread across the country. Except for a few isolated cases, cooperatives have not helped to improve access to bank finance for the small-scale farmers. The concept of cooperatives is alien to Nigerian farmers who tend to want to keep matters relating to their farm operation and finances in secret;

vii. <u>Agricultural Credit Guarantee Scheme (ACGSF)</u>: Set up since 1977, primarily to induce banks to increase and sustain lending to agriculture. Under the scheme, bank loans to farmers are guaranteed 75 percent against default by the CBN. Commercial Banks in the country see agricultural finance as development finance and they are generally not pro-development finance. Banks consider the guarantee provided under ACGSF as inadequate to build their confidence to finance a sector that is reputed for loan default. There is also the problem of a large backlog of unsettled claims, some of which span over twenty years. This is highly undesirable as it has eroded the confidence of banks in not only the scheme but also all other government initiatives to provide credit to the agricultural sector;

viii. <u>Preferred Sector Allocation of Credits 1970-1996:</u> The GON mandated all commercial banks to allocate a minimum of 40% of their total loan portfolio to agriculture or be penalized. Virtually all the banks opted to pay the penalty.

The direct intervention by Government in lending to small-scale farmers did not only fail but it also planted a seed in farmers that government-backed loans are mere grants or “gifts”. Traditionally, repayments defaults are very high for almost all of these government-supported efforts. This explains the unwillingness of commercial banks to finance small-scale farmers because of the poor loan repayment history, despite credit guarantees provided by the government. The problem is that these farmers often see such loans as their share of the “national cake” (i.e. national oil revenue) which they sometimes channel to non-farming activities, such as marrying new wives, vehicle purchase, etc.

Analysis of Impact:

Several studies have been conducted by national and multi-lateral organizations to assess the performance of these institutions using indicators such as outreach, financing structure, financial performance and profitability. A summary of the findings is presented below:

Outreach: Of all the Rural Finance Institutions (RFIs) discussed above, community banks have the most significant scale and with the exception of NGO-MFIs which cannot legally mobilize savings, all the institutions have more savers than borrowers.

Financing structure: The community banks are the most leveraged, relying mostly on client deposits and private investment, respectively. However, the NGO-MFIs rely heavily on grants to fund their operations. As for the NACRDB, branches finance operations through client deposits and funds from head office, which represent about half of each branch's total assets.

Portfolio Quality and Financial Performance: NACRDB and the rural NGO-MFIs- those institutions dealing with poorer rural segments-are not operationally self-sustainable and have negative returns on assets primarily due to poor loan recovery. NACRDB and the NGO-MFIs essentially survive with injections from government and donors respectively. In contrast, the cooperative, community and commercial banks demonstrate some profitability.

Efficiency: In terms of cost per borrower and saver most of the institutions located in the rural areas are the least cost-efficient in terms of lending.

Where Smallholders Find Credit

It is an established fact that financing from commercial banks to the smallholder farmers is virtually non-existent. To overcome this challenge, farmers have continued to exploit various avenues by relying on informal rural financial institutions for credit.

i. *Savings and credit associations:* These are self-help associations, which consist of members who agreed to make regular fixed cash contributions, with each member being handed with the whole contribution on a rotating basis. This approach allows farmers to have access to funds that they invest in farm inputs. The weakness with this financing option is that it does not allow timely access to funds for farming operations for all members due to the limited amount available for disbursement. Another weakness is that this option does not take into account the time value of money. In one establish case; the first contributor to collect was able to purchase a motorcycle while the last to collect, 30 months after could only purchase a bicycle;
ii. *Money lenders:* These are usually sole-proprietors who have mobilized enough savings to meet the financial needs of farmers who are in need for their farming operation. The interest paid on money lenders' credit is usually about 25 percent per month (300 percent per year). This high cost of fund is the major drawback of this system;
iii. *Daily savings/Itinerant banking:* This is a type of personalized banking involving the money collector (banker) and his or her clients. A savings-only itinerant banker collects deposits daily and charges the saver one contribution of the 30 deposits made during the month. Contribution size is fixed, making the cost to the saver to be 3.3 percent.

The Challenges Facing Agricultural Finance Policies in Nigeria

Following are some of the identified challenges of agricultural finance policies in Nigeria:

- Paucity of loan funds: The portfolio of funds deployed to agricultural financing among Nigerian commercial banks is less than one percent of the aggregate investable funds;
- Low management capacity of farmers: Most farmers who should benefit from the financing

policies lack the basic skills of farm management, including record keeping. And when these records are called up as requirement for accessing credit facilities, as is always the case, the farmers find they are ineligible;

- Lack of adequate skills to deliver services effectively: Most of the credit institutions undertook lending to agriculture without the use of trained agricultural credit officers with knowledge of agriculture and the constraints holding back farmer performance. Additionally, supervision of credit programs has often been below acceptable standards, resulting in poor repayment performance;
- Inadequate funding of public agricultural financing institutions: The NACRDB, for instance, has a capital base of N50 billion to be contributed to by the Federal Government and the CBN in a 60:40 ratio. To date, only about N23 billion has been paid up. These institutions cannot deliver effectively in the face of this dearth of funding.;
- There is a general lack of interest among commercial banks because agricultural finance in Nigeria is longer term (7 years) finance, and not what they do;
- Nigerian banks favor giving short-term loans, typically with three months tenor, more for the marketing of agricultural products rather than their production, which has long gestation periods, often exceeding one year;
- Most commercial banks do not have clearly defined structures for the administration of agricultural finance;
- Most of the initiatives and institutions established by the GON are not adequately funded for effective performance;
- Inadequate funding of public financing institutions. Government owned development banks, such as the Nigerian Agricultural Development and Cooperative Bank are poorly funded;
- Private financial institutions are skeptical about government agricultural initiatives due to cumbersome processing procedures, high transaction costs and a weak legal system;
- High dispersion of farmers which increases the lending and recollection costs; a lack of acceptable collateral by small-scale farmers; seasonality and low profitability of smallholder agriculture; and the high cost of borrowing money;
- Financial institutions are unwilling to support farmers, even with the mandatory (preferred sector) lending and guarantee of exposure citing low productivity and higher risk relative to other sectors. Historically, commercial banks opted to pay a penalty rather than abide by CBN directives to channel a fixed proportion of their loan portfolio to agriculture;
- About 65% of Nigeria’s economically active population lack access to formal financial services, hence the failure of the various efforts by government at all levels to address the issue.

The failure of these initiatives and programs may have informed the direct involvement of the government at the local, state and federal levels in the provision of subsidies on farm inputs to farmers across the country. In addition to increased protection offered to local industries through high tariffs, the GON gives financial support for the production and distribution of subsidized planting seeds and seedlings for Nigeria’s major cash crops, such as cocoa and palm oil. The GON supplies fertilizer to farmers at a 25 percent subsidy. Again, inefficient and under-funded delivery systems often prevent such programs from successfully reaching the intended small-scale farmers and supplies are sold to directly to those with political connections who then resell at higher prices.

A New Program is Attempted

Dating back to the 1960s and 1970, agricultural finance in Nigeria has been characterized by the notion that subsidized and targeted credit could promote agricultural development and improve the lives of smallholders. Most of the initiatives of the GON are enumerated in the overview of agricultural finance in Nigeria section of this report. Poor funding and implementation have limited the ability of these programs to provide credit to this vital sector. Commercial banks continue to perceive the smallholder farmers as high risk. They see financing of the smallholder farmers as 'development finance' and that credit guarantees provided by the government are insufficient to encourage them to venture into this sector. In fact, at a public forum in April 2011, representatives of some of Nigeria's major banks admitted that their banks are ill-equipped to fund the agricultural sector.

There was a paradigm shift which began in the 1990s with microfinance approach that typically worked fairly well in urban and densely populated rural areas. This approach continues to evolve as attempts are made to extend it into rural areas and to farm households. It treats finance as a valuable way to expand and integrate markets, rather than as a policy tool targeted for specific market segments. The new paradigm reflects a financial systems approach, using market principles to deliver financial services to smallholder farmers. Currently, there is considerable interest in using the value chain approach. The relevance of this approach to rural finance rose from the gradual emergence of integrated operations between the real and financial sectors to facilitate the flow of commodities and services from producers to consumers within the activity clusters and sub-sectors.

Taking full cognizance of the posture of the commercial banks and as part of its developmental role, the CBN is adding its weight to this initiative by attempting to "de-risk" agricultural financing through the establishment of the Nigerian Incentive Based Risk Sharing for Agricultural Lending (NIRSAL). The design which has been completed is to provide the singular transformational, one bullet solution to break the seeming jinx in Nigeria's agricultural lending and development. This initiative which is being implemented in partnership with the Alliance for A Green Revolution in Africa (AGRA) is intended to un-lock financing for the entire agricultural value chain. It comes with a regime of incentives for lending banks, capacity building, agricultural insurance and risk sharing. The good thing about NIRSAL is that it has worked in other African countries and there appears to be a commitment to make it work in Nigeria.

NIRSAL breaks tradition in two significant ways. First, it fixes the agricultural value chains so that banks can lend with confidence to performing projects across commercially healthy agricultural value chains. Second, it encourages banks to lend into the value chains from their balance sheets and without recourse to government funds, by offering incentives and technical assistance.

Conclusion

Insufficient institutional credit is a major contributor to the persistent poor performance of the Nigerian agricultural sector. Research has shown a strong positive correlation between the number and volume of guaranteed loans and agricultural GDP. Medium to large-scale agricultural production in Nigeria is small but growing. Access to credit for this small, well structured large-scale farm operators has improved somewhat, albeit at very high interest rates. However, the dominant smallholder farmers lack access to financing from the formal financial institutions. Most of these farmers (65% of population) reside in the rural areas and gain their livelihood from the farm and other rural based economic activities with little or no access to formal financial services. If government agricultural financing policies are to achieve the targets for rural development, it is a generally held view that Nigeria will need an adequate level of strategically targeted investments in agriculture to upgrade rural infrastructure, boost productivity, and increase competitiveness of smallholders.

The various financing schemes/initiatives of successive Nigerian administrations designed to improve access to credit for the rural poor have been largely inefficient and ineffective. This is primarily because of inadequate budgetary provision to fund the initiatives properly. Over the years, the GON has consistently failed to abide by its commitments to the Comprehensive Africa Agricultural Development Program (CAADP). In order to make Nigeria's agricultural system work better, experts suggest that the country requires additional annual investments of as much as $8 billion annually.

Recent effort by the CBN to de-risk agricultural lending-NIRSAL could improve access to credit for the rural poor if properly implemented. Under this program, the CBN has reportedly established $500 million to be used to leverage $3 billion from the commercial banks and Rural Finance Institutions (RFI) into agriculture. This initiative is expected to focus on providing affordable financial products to farmers, while at the same time reducing the risk of loans offered to farmers by the financial institutions. By reducing part of the risk of lending by banks, it will be possible to leverage substantial flows of funds in support of agriculture across the value chain and allow farmers to secure the financing they need to increase production. However, in order to sustainably improve outreach and lower the risk for RFIs, it is imperative that performance based capacity building take place and for organizational innovations to take place.

The NIRSAL seeks to synchronize agricultural and trade policies utilizing the value chain approach. This should ensure that the system does not generate systemic overproduction, as it did during the Presidential Initiative on Cassava (PIC). In 1999, the GON inaugurated PIC to promote increased production of cassava for domestic use and exports. By 2003, cassava production in the country had almost double and farmers suffered great loss because of limited market outlets.