Role of Financial Inclusion in Sustainable Agricultural Development

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Abstract

The potential contribution of the agricultural sector to sustainable development in Nigeria is yet to be realized as agricultural productivity in the country is still relatively low when compared with the rest of the world. The country's agricultural productivity and growth is hindered by limited or insufficient access to credit facilities among rural farmers. Without credit access, farmers may be unable to bear the risks and upfront costs associated with the innovation and investment necessary to enhance productivity, income and well-being. The low performance of the sector also results in increased poverty, undernourishment and food insecurity. This study x-rayed the role of financial inclusion, particularly credit access, in addressing this challenge. Data was obtained from secondary sources including the Central Bank of Nigeria (CBN), Enhancing Financial Innovations and Access (EFInA), and the World Bank. The results indicate that an effective financial inclusion strategy is germane to the achievement of sustainable agricultural development in the country.

Key words: Financial inclusion, Credit, Agriculture, Nigeria

Introduction

One of the key objectives of the Sustainable Development Goals (SDGs) is to build a sustainable future that will help overcome food insecurity, poverty and inequality all over the world. And financial inclusion has been identified as one of the mechanisms of poverty reduction and attainment of national prosperity (Ajide, 2014). Similarly, a well-developed and sustainable agricultural sector is one of the means of ensuring food security for the citizenry. This is because agriculture remains a significant sector in agrarian economies. It contributes 30%–50% of the national income in sub-Saharan Africa and can generate considerably greater income and stimulate economic growth. In 2014, Nigeria's gross domestic product (GDP) growth rate was 6.3 percent and this reduced to 2.7 percent in the year 2015 (World Bank, 2014).

However, in Nigeria, public spending on agriculture was less than 2 percent of federal expenditure during 2001 to 2005. The agriculture sector share of the total Nigerian budgetary allocation was 1.8, 1.6 , 1.7, 1.4 and 0.9 percent in 2011, 2012, 2013, 2014 and 2015 respectively. The 2017 budgetary allocation of ₦196.33 billion to agriculture was 1.6 percent while ₦203 billion, the 2018 allocation to agriculture, was 3.2 percent of the total budget for the year. These figures or allocations are far below the 2003 recommended AU-Maputo Declaration's Comprehensive Africa Agriculture Development Programme (CAADP), which requires African countries to allocate at least 10 percent of their annual budgets to agriculture and achieve 6 percent annual growth in agricultural GDP.

Agricultural financing differs from other forms of financing, and the understanding of this distinction is important because it affects the ability of borrowers to repay borrowed loans. Timely and sustainable access to financial services including credit is an essential component of agricultural development, but spatial and risk characteristics peculiar to the agricultural sector pose special challenges for financial institutions in their bid to render services to this sector. These risks and uncertainties range from yield risks to weather uncertainties, price fluctuations, illness, accidents and other life cycle risks. Others include non-mobility of land, high transaction costs and seasonality of production. Given the critical role of credit in sustainable agriculture, the need for a functional financial system in achieving universal financial inclusion cannot be overemphasized. The SDGs also require that

by 2030, all men and women, particularly the poor and the vulnerable, have equal rights to economic resources, as well as basic services, improved technologies and financial services.

Problem Statement

Agriculture accounts for 44% of the gross domestic product (GDP) in Nigeria but receives only 2% of total lending by commercial banks (Terfa, 2015). Domestic credit to the private sector is 14.2% of GDP, well below sub-Saharan Africa's average of 46.0% (table 1). Access to finance remains a major obstacle for both rural and urban private sectors. For example, only 2 percent of the adult population obtained loans from a financial institution in 2014 (Demirgüç-Kunt et al., 2014). This is far below the world average of 9 percent (Kenya and South Africa were at the world average of 9 percent).

Table 1: Financial sector depth

Indicator (%GDP)	Nigeria	Sub-Saharan Africa	Low-Income Countries	Ghana	Indonesia	Brazil	South Africa
Domestic credit to private sector	14.2	46.0	19.6	20.4	39.1	67.9	149.2
Money and quasi money (M2)	19.5	37.5	34.9	34.0	39.	95.2	94.1

Source: WDI, 2015; WBDatabase, 2015.

According to Financial Inclusion Microscope 2015 overall score, Nigeria ranks low at 28 with an 8% change in terms of improvement, and scoring 48 out of 100 points (Economist Intelligence Unit, 2015). EFInA(2016) also finds that only 38.3% of the adult population are banked. The financial exclusion is more manifest in the rural agriculture-based sector, to which 53% of the population belong and of which 73.2% are relatively poor (NBS, 2012).

Thus, the potential contribution of the agriculture sector to sustainable development in the country is yet to be realized as agricultural productivity is still low when compared with the rest of the world. (Salami and Arawomo, 2013). Similarly, half of the people working in the sector remain in the bottom two income quintiles. Observed low levels of financial inclusion in the agriculture sector is attributed to special causes: complicated

credit appraisal procedure, perceived high risks, high transaction cost, and inadequate or poor understanding of the peculiarities of the sector. Other challenges of agricultural lending include insufficient access to credit and insurance products, inadequate mechanism and channels for agricultural financing, as well as prohibitive interest rates for agricultural lending (Agbor, 2004; Olagunju, 2013).

Meanwhile, the poorest of the poor are excluded from formal financial services because of their limited understanding of financial institutions, illiteracy, and limited usefulness of available products; as well as being actively excluded by financial service providers who see them as too risky and expensive to reach (Smith et al., 2015). Thus, the need for an enabling policy environment to actively promote both the demand for and the supply of financial services to the unbanked and under-banked in any given economy, cannot be overemphasized. An inclusive financial sector is characterized by the diversity of financial service providers, the level of competition between them, and the legal and regulatory environments that ensure the integrity of the financial sector and access to appropriate and affordable financial services for all individuals, households and businesses, irrespective of the income level.

Without access to credit, producers may be unable to bear the risks and upfront costs associated with the innovations and investment necessary to enhance their productivity, income and well-being. It has also been established that lack of access to credit and insurance prevents farmers from making investments that could increase crop yields and strengthen food security (FAO, 2015). Producers who are unable to cover their short-term expenses or who want to purchase more productive but more expensive technologies must rely on either credit markets or other credit sources.

In view of the numerous benefits, financial inclusion has now become a top priority the world over (Demirguc-Kunt et al., 2014). In Nigeria, where financial inclusion is still relatively poor, there is the need for an inclusive financial system that will contribute to poverty reduction and sustainable development. Agricultural policies in the country over the years have therefore focused on the establishment of a system of sustainable agricultural financing schemes, programmes and institutions that can provide micro and macro credit facilities for small, medium and large-scale farmers along the value chain. The current policy trust of government,

amongst other things, is to enhance availability of credit to all farmers and agribusinesses through stimulating cooperative banking and affordable loans through commercial banks, increase incapacity and size of market-driven guarantee and risk schemes, engage with legislature to increase public sector funding to the minimum recommended 10% of the national budget, and improve use of existing collateral (and asset-based lending). Financial services such as savings, credit and insurance provide opportunities for improving agricultural output, food security and economic vitality at the household, community and national levels.

Financial Inclusion in Nigeria

Financial inclusion is the provision of a relevant, appropriate and affordable broad range of high quality financial products (savings, credit, insurance) for the entire adult population and especially for the low-income segment. It is also defined as "an economic state where individuals and firms are not denied access to basic financial services based on motivations other than efficiency criteria (Amidzic, Massara and Mialou, 2014). The global financial inclusion average, defined as the number of adults with access to financial services, is less than 50 percent. Access to affordable, safe and reliable financial services provides the necessary lubricant for economic growth and contributes to poverty reduction.

In 2008, the report of a survey on Enhancing Finance Innovation and Access (EFInA) revealed that only 23% of Nigeria's adult population had access to formal financial institutions, 24% to informal financial services while the remaining 53% were financially excluded. By 2010 however, the exclusion rate had reduced to 46.3% and by 2012, the rate of exclusion was 39.7% (Central Bank of Nigeria, 2013). This positive development encouraged the Central Bank of Nigeria (CBN), in collaboration with other stakeholders, to launch the National Financial Inclusion Strategy in order to further reduce the exclusion rate. Specifically, the strategy is aimed at increasing access by Nigerian adults to credit, among other financial inclusion services, from 2% to 40% and to reduce the exclusion rate to 20% by 2020. Consequently, since 2005, the Nigerian financial services sector has witnessed increasing activities by both the government and the regulatory authorities aimed at deliberately promoting policies that are intended to grow financial inclusion. The Central Bank of Nigeria (CBN) has been at the forefront of encouraging and supporting products that are specifically

targeted at the low-income earners and the financially-excluded, while the government has focused more on both interventionist financing arrangements and building institutions and frameworks that promote financial inclusion.

Financial inclusion was incorporated as one of the cardinal objectives of the Nigerian Financial System 2020 (FSS 2020). The FSS 2020 represents a holistic and strategic road map and framework for developing the Nigerian financial sector into a growth catalyst that will enable Nigeria be one of the 20 largest economies by 2020. The strategy (FSS, 2020) identified six important stakeholders within the financial sector that are required in the financial inclusion process. These are: banking institutions, non-bank financial institutions, insurance companies, capital market players, pension institutions and technology providers, together with their regulatory bodies. The aim is to ensure financial inclusion in which adults (persons above the age of 18) have formal easy access to a broad range of financial products, which are appropriate, provided at affordable cost, and with dignity for the clients.

Review of Nigeria's Agricultural Credit Policies

The major focus of Nigeria's agricultural policy has been the establishment of a system of sustainable agricultural financing schemes, programmes and institutions that can provide micro and macro credit facilities for small, medium and large-scale farmers along the value chain. Thus, agricultural credit policies have proceeded through three major phases. The first phase, which spanned the period 1975 to 1989, witnessed government interventions with emphasis on implementing subsidized, targeted agricultural credit programmes. The phase was constrained by poor funding and implementation and also because farmers treated government-backed loans as mere grants or "gifts". As a result, repayment defaults were very high for almost all of these government-supported efforts. This explains the unwillingness of commercial banks to finance small-scale farmers. Commercial banks continue to perceive smallholder farmers as high risk. They see financing of smallholder farmers as "development finance" and that credit guarantees provided by government are insufficient to encourage them to venture into this sector.

The second phase began in the1990s with the microfinance approach, in which finance is treated as a unique way to expand and integrate markets,

rather than as a policy tool targeted at specific market segments. During this period, market principles were adopted in the deliverance of financial services to smallholder farmers. 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. By 2005, CBN licensed microfinance institutions with the specific objective of making financial services accessible to a larger segment of the potentially-productive Nigerian population who otherwise had no access to such services. This was to permit them to contribute to rural transformation, promote synergy, and mainstream the informal subsector into the formal financial system.

The third phase was implemented following the reluctance of commercial banks to extend credit, particularly to small-scale farmers due to high risk of default. This phase adopted the de-risk approach which featured the establishment of the Nigerian Incentive-based Risk Sharing for Agricultural Lending (NIRSAL). The aim is to provide a singular transformational, one-bullet solution to break the seeming jinx on Nigeria's agricultural lending and development. This initiative, which is being implemented in partnership with the Alliance for Green Revolution in Africa (AGRA), is intended to unlock financing for the entire agricultural value chain. It comes with a regime of incentives for lending banks, capacity building, agricultural insurance and risk sharing. NIRSAL thus 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.

Other ongoing or current policy efforts to mitigate credit constraints in the agriculture sector are as follows:

- government has mandated that 10 percent of all formal credit must go to agriculture between 2017 and 2018;
- licensing of new insurance providers, in addition to the Nigerian Agricultural Insurance Company (NAIC) by the Insurance Commission to retail agricultural insurance;

- stimulation of cooperative banking and affordable loans through commercial banks;
- deepening of the Federal Ministry of Agriculture and Rural Development's capacity to facilitate agribusiness investment agreements;
- engagement with legislature to increase public sector funding to the minimum recommended 10 per cent of the national budget;
- policies that support quasi-equity financing for growth of agribusiness companies,
- access to multi-year finance as well as seasonal shorter-term capital.

In spite of these policies however, agriculture receives only 2 percent of total lending by commercial banks.

Other lingering problems of agriculture financing in the country have been linked to several factors. Access to informal credit is limited to a small proportion of the population who can meet the stringent credit requirements (Okurut et al., 2005). Low levels of collateral among the poor, to a great extent limit their access to financial instruments in the formal financial market (Daniels, 2001). Smallholder farming households with low levels of income and asset accumulation are at high risk of default and are therefore less attractive to formal lenders (Dallimore and Mgimeti, 2003).

From the institutional perspective, the location of the lender and its conditions for credit allocation greatly influence the probability of access. Long distance and high transportation cost are major concerns which limit the poor rural household's access to formal financial services located in urban areas (Dallimore and Mgimeti, 2003). The high cost of gathering information about poor rural households naturally impedes financial markets from making contact with them (Schrieder, 2000). Besides, rural financial intermediation is expensive because participants are geographically scattered, financial transactions are small, and rural incomes are often unstable. Formal lenders in the credit markets incur high costs in assessing the creditworthiness of small borrowers yet make low returns due to the small loan amounts involved.

Conclusion

As the challenges of the agricultural sector are better understood, approaches or methods for agricultural financing are changing. Adapting financial services and credit management strategies to the agricultural system of each sector or region is a major step is providing easier access to agricultural financing. In other words, it is pertinent to have in place risk-management and risk-sharing mechanisms or strategies that will not only increase access of farmers to credit, but also ensure that risks associated with financing agriculture are reduced to the barest minimum. Sustainability of access to financial services is ensured if the offer is viable over the long term. Nevertheless, the peculiarities of the rural areas and agricultural activities should be taken into consideration by financial institutions when granting loans and managing risks associated with such loans.

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