FINANCE FOR SMALL AND MEDIUM ENTERPRISES:

NIGERIA'S

AGRICULTURAL CREDIT GUARANTEE SCHEME FUND

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ISSN 1816-2495
www.ifmaonline.org

Finance for the SMEs – Nigeria's Agricultural Credit Guarantee Scheme Fund

Abstract

A major challenge facing many developing countries, especially in Africa, is devising appropriate development strategies that will capture the financial services requirements of farmers and small and medium entrepreneurs who constitute about 70 percent of the population. The Federal Government of Nigeria considers this segment critical for its development efforts to be fully realised. The Government has instituted various policies to achieve its aims, including a commercial bill financing scheme; regional commodity boards (later called national commodity boards); an export financing and rediscount facility (1987); the Nigerian Agricultural Cooperative and Rural Development Bank Ltd; community banks, People's Bank; the Agricultural Credit Guarantee Scheme Fund (ACGSF); and the Small and Medium Enterprises Equity Investment Scheme among others. These policies have contributed to improving the livelihoods of farmers and entrepreneurs.

Keywords: finance, farmer, bank, guarantee, small & micro enterprises

1.0 Introduction

In Nigeria, credit has been recognised as an essential tool for promoting Small and Micro Enterprises (SMEs). About 70 percent of the population is engaged in the informal sector or in agricultural production. The Federal and State governments in Nigeria have recognized that for sustainable growth and development the financial empowerment of the rural areas is vital, being the repository of the predominantly poor in society and in particular the SMEs. If this growth strategy is adopted and the latent entrepreneurial capabilities of this large segment of the people is sufficiently stimulated and sustained, then positive multipliers will be felt throughout the economy. **To give effect to these aspirations various policies have been instituted over time by the Federal Government to improve agricultural production capabilities, positively channel the potential of SMEs to enhance their standard of living and to put the sector in the front burner of Government's development strategy.**

This paper focuses on policies taken by Nigeria to either institutionalize or enhance the availability of credit to SMEs. It also examines the operations of the Agricultural Credit Guarantee Scheme Fund and the strategies adopted to sustain micro financing and development of entrepreneurship in Nigeria.

In addressing this issue, the paper is divided into six parts. Following the Introduction in Part I, Part II examines Government policies aimed at channeling finance to the agricultural sector. Part III highlights the operations and achievements of the Agricultural Credit Guarantee Scheme Fund. Part IV discusses innovations and initiatives by the Central Bank of Nigeria (CBN) to sustain its operations in the face of changing economic conditions. Part V discusses constraints, new products for financing SMEs introduced by the CBN and prospects for the Scheme, while Part VI concludes the paper.

2.0 Government Policies for providing Micro Finance for the Development of Agriculture

Micro finance policies to bring credit to the under banked sector of the economy were generally biased towards developing agriculture. Policies implemented by the Federal Government included a commercial bill financing scheme (1962), regional commodity boards (later called national commodity boards, 1977), and an export financing and rediscount facility (1987). Others were:

(i) Nigeria Agricultural Co-operative & Rural Development Bank (NACRDB)

The Nigeria Agricultural and Co-operative Bank Ltd was established in 1972. The Nigeria Agricultural Co-operative & Rural Development Bank evolved recently from the merger of the Nigeria Agricultural and Co- operative Bank with the People's Bank.

(ii) Community Banks

The community banking concept was also introduced into the financial landscape. They provide banking and financial services for the rural economies and micro-enterprises in the urban centres and are structured on communal ownership. The first community bank started operations in 1990. There were five hundred and four community banks by May 2004.

(iii) Sectoral Allocation of Credit & Concessional Interest

Until 1996, the Central Bank of Nigeria issued guidelines on sectoral allocation of credit with concessional interest rates for agriculture.

(iv) Specified Percentage of Total Deposits Mobilised in the Rural Areas

A specified percentage of total deposits mobilised in the rural areas were to be lent to borrowers in such areas.

(v) Rural Banking Programme (1977)

A rural banking policy, which compelled commercial banks to open a specified number of branches in rural areas was implemented in the 1980s and early 1990s. Over 700 rural branches were opened before the programme was discontinued.

3.0 The Agricultural Credit Guarantee Scheme

In a study conducted in 1976 by the CBN, shortage of primary production credit was identified as one of the major causes for declining agricultural production. This shortage was attributed to reluctance by the banks to provide credit for real sector activities, especially agricultural production. The reasons were obvious:

- inherent risks associated with agricultural production;
- urban/semi urban based nature and mode of operations of the banks;
- high cost of administration of agricultural loans and;
- inability of farmers to provide the necessary collateral.

As a probable solution to the above problems the Agricultural Credit Guarantee Scheme Fund was established by the Federal Government (60 percent) and Central Bank of Nigeria (40 percent) in 1977 with an initial Fund of Naira (₦)100 million subscribed and paid up capital of ₦ 85million.

The Scheme provides guarantee cover for loans advanced to the agricultural sector by banks. The cover pledges to pay to the banks, 75% of any outstanding default balance by borrowers provided that collateral pledged has been realised and applied to the account. The Central Bank of Nigeria manages the Fund, and is responsible to a Board. To operate the Scheme, the CBN opened Agricultural Finance Offices (now Development Finance Offices) in its branch offices in 22 states of the federation. Through the branch offices, the Central Bank of Nigeria handles the day-to-day operations of the Scheme. The CBN issues a Guarantee Certificate to the lending bank to pay 75% of any outstanding balance in the event of default less the amount realised from the security pledged by the borrower. The lending bank can file a claim on the Fund if the above has been fulfilled.

(a) <u>Scope of the Scheme</u>

Agricultural activities the Fund can guarantee are:

- establishment or management of rubber, oil palm, cocoa, coffee, tea and similar crops;
- cultivation or production of cereal crops, tubers, fruit of all kinds, cotton, beans, groundnuts, sheanuts, benniseed, vegetables, pineapples, banana and plantains;
- animal husbandry, that is, poultry, pigs, cattle rearing and the like, fish farming and fish capture; and
- processing in general where it is integrated with at least 50 per cent of farm output e.g. cassava to garri, oil palm to palm oil and kernel, groundnut to groundnut oil etc.

(b) <u>Loan Limits Under The Scheme</u>

The Scheme now has a capital base of ₦3.0 billion and loan limits of ₦20,000 for loans without tangible securities, ₦1.0 million for individual borrowers, and ₦10.00 million for cooperatives and corporate borrowers.

(c) <u>Types of Security Accepted for Loans:</u>

Acceptable securities for loans under the Scheme can be any of the following:

(i) a charge on land on which the borrower holds a legal interest, or a charge on fixed assets, crops or livestock;

(ii) a charge on any moveable property of the borrower;

(iii) a life assurance policy, a promissory note or other negotiable security;

(iv) stocks and shares;

(v) a personal guarantee and

(vi) Any other security acceptable to the bank.

(d) <u>Performance of the ACGSF to date:</u>

<u>Loans guaranteed</u>:

Despite the fact that micro finance services are not readily available in Nigeria, the ACGS has achieved giant strides. From its inception in 1978 to 2004 it guaranteed a total of 397,422 loans valued at ₦ 7.603 billion. Micro lending under the ACGS (that is loans under ₦ 50,000) were 365,423 or 91.9 percent, valued at ₦ 3.856 billion or 50.6 percent of total loan value.

The volume of guaranteed lending by banks peaked in 1989 when 34,518 loans were guaranteed. Thereafter the total number of loans dwindled being only 12, 859 in 1999, before increasing to 35,035 in 2004. The major factor responsible for the increase was that banks now see lending under the Scheme as being very profitable. Six banks currently participate in the Scheme out of 89 operating in the country. The introduction of the Structural Adjustment Programme in 1986, market liberalization in the 1990s, closure of unprofitable rural branches, and banking sector distress greatly reduced and affected banks' participation under the ACGS.

Loan Repayments:

Between 1978 and 2004, 252,608 loans valued at ₦ 4.538 billion were fully repaid out of the 397,422 loans guaranteed with a value of ₦7.603b. This represents 64 and 60 percent rate respectively.

Claims Filed and Claim Settled:

One of the major mandates of the Scheme is to process and settle genuine claims filed by the banks. A total of 6994 claims for ₦289,721,500 have been filed by the banks since Scheme inception, with 2961 claims valued at ₦26,410,700 settled. Furthermore, 1596 claims valued ₦44,218,500 were recovered from defaulters in the States before they could be settled.

4.0 Constraints Militating Against the Scheme:

One of the major factors militating against the success of the ACGS is scarcity of loanable funds due to lack of bank support for the Scheme. The number of participating banks rose gradually from 10 in 1978 to 28 in 1986 and peaked at 34 in 1989. Thereafter, the number declined with only six participating now.

It has always been argued that banks are in business to make a profit. They cannot be borrowing short and lending long to micro and small enterprises that are characterized by high risk. Furthermore, in a free-market economy, which is private-sector driven, government's intervention is expected to be minimal.

Other constraints are (i) inadequate capital base, (ii) unwillingness of farmers sometimes to repay loans; (iii) non-settlement of claims; (iv) poor project appraisal by banks; (v) lack of adequate collateral; (vi) high cost of administering small loans; (vii) reduction in the number of participating banks.

5.0 Efforts by the CBN Management to enhance the Scheme:

(i) There was an increase in share and paid-up capital from ₦100million to ₦3billion in March 2001;

(ii) Loan limits were increased from:

₦5000 to ₦20, 000 with out collateral:

₦100, 000 to ₦500, 000 to individuals with collateral:

₦1million to ₦5million for cooperatives and corporate bodies;

(iii) Other measures included a Self Help Groups Linkage Banking Programme; a Trust Fund Model, an interest drawback program and a campaign to encourage more banks to participate.

ISSN 1816-2495
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5.1 Innovations and Initiatives by the CBN to Improve Lending Under the Scheme

To ensure that micro and small enterprises had the financial resources to widen their economic activities, the CBN initiated various models, products and strategies to improve lending under the Scheme. Prominent among these are the following:

5.1.1 Self-Help Groups Linkage Banking Programme

The Self-Help Groups Banking Linkage Programme (SHGBLP) for savings mobilisation was launched under the ACGS in 1991 and became operational in 1992. Under the programme, farmers with a common purpose are encouraged to form groups of between 5 and 15 people. They can then undertake regular savings, which are deposited in a partner bank of their choice. After saving for six months, they may then apply to the partner bank for a loan. The groups can be informal or registered (formal).

Bank loans to a group are normally in multiples of the balance in their savings account at the time of loan application. So far, banks have advanced loans nationwide four times the total balance in the savings accounts. Under this program, a lending bank holds the group savings as security, which can not be drawn on until loans are repaid. The aim of the Self-Help Groups Linkage Banking is to inculcate a culture of savings and banking in group members and for them to build up resources for financing their farm projects without recourse to bank borrowing in the long run.

5.1. 2 Trust Fund Model (TFM):

The Bank has widened the scope of Self-Help Groups Linkage Banking to include State Governments and blue chip companies willing to provide funds for farmers within their catchment areas or in the host communities where they operate. The intermediation is in the form of Trust Funds, which they deposit with partner lending banks to secure part of the banks' exposures to farmers. Companies participating in the TFM include the following:

(a) Micro Credit Scheme for Agricultural Development operated through the Shell Petroleum Development Company Ltd

(b) Green Card in association with Nigerian Agip Oil Company Ltd

(c) Total Oil Plc

State Governments participating in the TFM are Nassarawa, Ebonyi, Kogi, Benue, Lagos, Jigawa, Kwara and Katsina States. Katsina State Government raised a rural development loan from the International Fund for Agricultural Development and placed part of it with a partner lending bank to enable it to extend credit to farmers. In all the programmes, savings of the farmer groups were used to secure 25 per cent of the loans, the Trust Fund secures 25 per cent while the ACGSF guarantees 75 per cent of the balance.

5.1.3 Interest Drawback Programme (IDP)

The IDP is a scheme to rebate interest to borrowers who repay agricultural loans according to contractual terms. The IDP is designed to benefit farmers/entrepreneurs who borrow under the Agricultural Credit Guarantee Scheme. The current rebate is 40% of accrued interest. Farmers who fully repay their loans on time under the ACGS are refunded 40% of the interest on their agricultural loans. As at 31st January, 2005, 5,583 farmers had received ₦17.633million as rebated interest, being 40 percent of the interest paid.

5.1.4 Participation of Community Banks (CBs) under the ACGS

To further enhance the availability of credit to farmers and other micro entrepreneurs, the Central Bank of Nigeria approved CBs participation under the ACGS from 2004. This was done to improve outreach under the ACGS and to facilitate access by the disadvantaged to credit. The CBs are located in the rural areas, and have a deep knowledge of the financial needs of smallholder producers and micro entrepreneurs. They will be eligible for the guarantee cover.

5.1.5 The Nigerian Agricultural Insurance Company (NAIC)

The Nigerian Agricultural Insurance Company was established in December 1987 to provide insurance cover for farmers against natural disasters and other risks associated with agriculture. The CBN stipulates guidelines to assist NAIC's operations, one of which is mandatory insurance cover on loans granted by banks to the agricultural sector under the Agricultural Credit Guarantee Scheme. Insurance cover is also compulsory for farmers who benefit from any agro-allied credit by approved lending institutions or agencies.

6.0 Constraints and Limitations to Successful Micro Financing in Nigeria:

Despite the progress outlined above, there are a number of constraints militating against successful financing of micro enterprises particular and agricultural production in general. Prominent among these are:

(a) Unwillingness of banks to lend to micro entrepreneurs despite the fact that generally they repay their loans.

(b) Inadequate or non-monitoring of micro and small enterprises by banks, leading to defaults.

(c) Delays by banks in processing and disbursement of loans.

(d) Diversion of funds.

(e) Over-concentration of decision making, where all loans are required by some banks to be sanctioned by Area/Head Offices.

(f) Inadequate staff training to handle lending to SMEs.

(g) Policy conflicts resulting from numerous alternative sources of credit with different interest rates e.g. NACRDB, community banks, State and Local Governments Agricultural Credit Agencies, etc.

(h) Inability of borrowers to offer acceptable collateral for large loans which places a limit on their probable scale of operation.

(i) Inadequate coverage of cash and tree crops owing to the long gestation nature of loans for such projects.

(j) Problems of illiteracy, which affects record keeping and decision-making ability of borrowers.

7.0 The Small and Medium Enterprises Equity Investment Scheme (SMEEIS)

The Small and Medium Enterprises Equity Investment Scheme facilitated by the CBN, was initiated by the Bankers' Committee (all the banks in Nigeria) as another means to funding small and medium scale enterprises in Nigeria. The scheme requires all banks to set aside 10 percent of their profit before tax annually for equity investment in small and medium enterprises. The scheme is to promote indigenous entrepreneurship, develop local technology, generate employment, facilitate the flow of funds from banks for the establishment of new, viable SMEs, ensure output expansion, re-distribute incomes and promote industrial linkages. The Scheme involves equity participation of banks in enterprises that they have appraised to be viable. The banks partner with the entrepreneurs.

(i) Activities Covered by SMEEIS:

SMEEIS funds can be used for the following business activities (with the exception of trading):

- Agro-allied,
- Information technology and telecommunication,
- Manufacturing,
- Educational establishments,
- Services,
- Tourism and leisure,
- Solid minerals; and,
- Construction.

(ii) Funds Set Aside and Investments made by Banks under SMEEIS

The total funds set aside were ₦41.433billion by 83 banks as at December 31st 2005. At this time ₦12.049billion had been invested by 58 banks in 2002 projects.

(iii) Ensuring Micro and Small Enterprises have unhindered access to SMEEIS Funds

Recently, the Bankers' Committee decided that ten percent of the SMEEIS funds be set aside for financing micro-entrepreneurs such as fashion designers, mechanics, vulcanizers, black smiths, carpenters, etc.

8.0 Microfinance Policy

The CBN recognised micro finance as an important tool for poverty alleviation through empowering the micro and small entrepreneurs. The CBN wanted to see sustainable financial services available to those who don't have access to formal financial resources. Microfinance institutions are important in achieving this objective and are being promoted to be commercially viable through an appropriate policy and regulatory framework. From this guidelines have been developed for microfinance institutions and other micro finance service providers. It is also important for the microfinance sector to gain both public and donor confidence.

9.0 Future Prospects

Measures are being put in place to restore the confidence of the banks and borrowers in the Scheme and to address the constraints outlined above. For instance, the Agricultural Credit Office in each CBN branch is given targets on loans to be guaranteed and repaid on an annual basis. The Development Finance Department of the CBN is also collaborating with the Federal and States Ministries of Agriculture on a campaign to increase participation in the Scheme's activities at the grass roots level down to agricultural families. Equally, an outreach strategy targeted at the Managing Directors of the banks to get them committed to lending under the Scheme has been put in place. In addition, the CBN organised free training programmes for desk officers of lending banks to improve their skill and capacity in agricultural credit administration. Advertising consultants were engaged to design and implement publicity programmes to capture the interest of banks and borrowers. The steps taken so far have been yielding fruitful results with 35,055 loans guaranteed last year valued at ₦2.08 billion.

10.0 Conclusion

Lack of access to economic resources, especially finance, by the numerous sparsely located SMEs and farmers across Nigeria, continues to inhibit economic growth and development. This calls for critical examination and the adoption of an approach to avoid declaring SMEs and farmers as "endangered species". It is important to double our efforts to transform the economy and continuously explore pragmatic methodologies to address the problems of our farmers and SMEs.

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