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Access to Formal and Informal Credits by Smallholder Farmers in Nigeria

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Abstract: The informal productive sub-sector encompasses all economic activities involving the production of tangible goods, small scale agricultural production, mining and quarrying. The sector provides productive outlets for a large number of people to be self employed. Despite that about 70% of Nigeria's population live in rural areas and involve in agricultural production to survive, government efforts to promote low/free interest credit for farmers has been marginal. This study examined the factors that influence accessibility to credit by smallholder farmers in Nigeria. The logit regression was used to determine the factors that influence an individual's ability to secure loan from formal and informal financial institutions. The study concludes that there is a significant difference between the smallholder farmers access to credit in terms of formal and informal sources as classified, according to the states in the geopolitical zones in Nigeria.

Key words: Informal credit, bank loan, formal credit, smallholder farmers, Nigeria

INTRODUCTION

Nigeria is the most populous black nation in the world with an estimated population of about 150 million people. The country is endowed with abundant human and natural resources like oil, tin, limestone, bitumen, columbite, zinc, natural gas; good vegetation and climate which varies from being equatorial in the South, tropical in the centre and arid in the North. Despite that the Nigeria is world largest producer of crude oil in Africa, it is estimated that 70% of Nigerians live in poverty (IFAD, 2010). Meanwhile, about 75% of the world's poorest people live in rural areas and depend on agriculture related activities for their livelihood (FAO, 2010). It is also estimated that about 70% of Nigerians are employed in the agricultural sector (FAO, 2010). Notably, rural areas account for 3 out of every 4 people living on <$1.25 a day (UNDP, 2007). Life expectancy in Nigeria is unsatisfactorily low at 54 years, infant mortality at 77 per 1000 and maternal mortality at 704 per 100,000 (IFAD, 2010). These features are arguably legacies of global oil price fluctuations, decades of prolong military rule coupled with the phenomenon of debt burden and political corruption.

Since 1960, Nigeria has been struggling to eradicate the 3 major enemies facing mankind; namely, poverty, ignorance and diseases. Successive political leaderships have formulated/implemented several policies/reforms and agenda aimed at improving the standards of living of the people. Examples of these programmes are Operation Feed the Nation (OFN), green revolution, Structural Adjustment Programme (SAP), Directorate of Food, Roads and Rural Infrastructure (DFRRI), Family Economic Advancement Programme (FEAP), National Poverty Eradication Programme (NAPEP), 7 point and transformation agenda.

Specifically, these programmes were expected to promote macro-economic stability, increase private sector involvement in the economy in order to reduce poverty, diseases and ignorance. In the post SAP era, it became obvious that the reforms had glowing effects on medium and big businesses but adverse effects on small businesses, especially those involved in the informal sector (small scale agriculture).

Remarkably, the informal sector in Nigeria is categorized into productive; service and financial subsectors. Ekpo and Umoh (2013) further remarked that:

The informal productive sub-sector encompasses all economic activities involving the production of tangible goods. They include small scale agricultural production, mining and quarrying (excluding petroleum), small scale manufacturing, building and construction, etc. Informal service sub-sector includes repairs and maintenance, informal education services, health services, etc. There are also traditional spiritualists who offer counseling services, etc. Informal financial sub-sector are mostly underground, unofficial, irregular, informal, shadowy and parallel. The most predominant type of informal finance in Nigeria is the Esusu. Among the Yoruba, it is called either Esusu or Ajo. Among the lgbo, it is called lsusu or Utu while the Hausa call it Adashi. The general practice is that

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associations contribute a fixed amount periodically and give all or part of the accumulated funds to 1 or more member(s) in rotation until all members have benefited from the pool.

Generally, Esusu is a veritable source of credit for small businesses. However, the roles of the informal sector in Nigeria's economic growth are enormous. For instance, the sector provides productive outlets for a large number of people to be self employed. The sector also reduces the level of unemployment, stimulates innovation and helps in the mobilization of capital and human resources (Tenibiaje and Smith, 2009).

In most agriculturally based developing countries, credit is a major component of rural development programmes and also an important instrument in helping small scale farmers and micro-entrepreneurs to increase their income. Although, numerous programmes have been established especially in Africa to increase the volume of credit to serve this purpose, Fafchamps (1997) noted that insufficient funding prevents farmers from investing in new equipment and machinery. According to Zeller (1994), most of the smallholder farmers are poor and they need credit to help them improve their capital, output and income. Adera (1995) corroborated the earlier and argued that credit is a major factor in agricultural development and lack of it is usually given, as an explanation for problems facing the agricultural sector.

Although, the small scale agricultural production is Nigeria's recipe for cutting down the increasing food import bills, the sector is often staved of funds. This is traceable to the inadequate operational practices of the major commercial banks that have led to the suffocation of the credit needs of small scale farmers; hence the agricultural sector has continued to be marginalized (Braverman and Guasch, 1986). This study examines the accessibility of formal and informal credits by smallholder farmers, as well as queries some factors that influence accessibility to credit by smallholder farmers in Nigeria.

Credits and smallholder farmers: Credit culture is arguably the back bone of development across the globe. It creates new businesses and helps people to execute their ideas. According to Nzenwa (2000), credit creates fund and increases investment for more production, thereby making more goods and services available for sales. By so doing, it creates a multiplier effect in terms of flow of goods and services. Anyanwu (2004) states that micro credit is the scheme aimed at enhancing the status of both the urban and rural poor. He furthered that micro credit is aimed at building communal capacity for wealth creation among enterprising poor people and promoting standard of living through strengthening rural banking methodology and eradicating poverty through the provision of micro credit for skill acquisition.

Hence, micro credit is a soft loan given to small or medium scale entrepreneurs, farmers and artisans/craftsmen, etc., to enable them procure, produce or improve their productivity, as well as increase their general welfare. No doubt, most of the various cottage industries, livestock farms, fish ponds and piggery farms in Nigeria were established with micro credit or other forms of informal credit. This credit has led to successful farming to the extent of export promotion of agricultural products such as palm produce, cashew, cocoanut and allied product. Micro credit in Nigeria is mainly facilitated by organized groups such as cooperative societies, clubs, town unions, age grades and individuals; it beneficiaries are usually ill-equipped in terms of educational skills and management techniques (Okali and Otite, 1992).

Meanwhile, micro credit loans attract little or no collateral with very low interest rate. It offers loans of maximum of 1 million naira to a group of not >20 members. Some of the microfinance institutions in Nigeria are: Justice Development and Peace Commission Ijebu Ode, Ogun State; Lift Above Poverty Organization, Benin City, Edo State; Save And Produce (SAP), Jos, Plateau State; Outreach Foundation (OF), Lagos State; Peace Development Centre (PDC) Uyo, Akwa Ibom State; Self-reliance Economic Advancement Programme, Ilorin Kwara State and Nalt-United Self-Help Organization (NUSHO), Nsukka-Enugu State. Researchers shall now turn to importance of credit for small scale farmers.

Importance of credit to small scale farmers: There are several reasons why credit markets are important for development. Capital is required for new startups or for substantial expansion of existing production lines. It is necessary to finance the ongoing production activity because of the existence of a substantial lag between the moment inputs have to be paid and sales generate money inflows. There is also demand for credit in order to smooth consumption or to cope with unforeseen negative shocks.

According to Tinuke (2012), access to financial credit is important for every small businesses aspiring to grow and become more profitable. Many states in Nigeria provide Small and Medium scale Enterprises (SMEs) with financial and technical support. In the late 1980s, the Federal Ministry of Industry supported efforts by the states to build functional industrial estates for SMEs by way of partial reimbursement of money actually spent on the provision of industrial estates for SMEs (Ekpo and Umoh, 2013). The Nigerian government established the community and peoples banks on the principles of a traditional rotational credit system between 1990 and 1992. These banks were expected to provide small loans and other forms of financial and business services for the poor and informal sector enterprises with the whole community acting as guarantor for loan repayment. Regrettably, only about 10% of informal sector workers were knowledgeable on how to take advantage of the new facilities (Tinuke, 2012). It was largely civil servants, wives of military officers and local government official that hijacked the scheme. They were able to access the loans far in excess of the approved official maximum. The trend has been the same for subsequent government efforts. Hence, food production capacity of Nigeria declined and food import bill rose.

It was the need for collateral that prevented small scale farmers from accessing the credit facilities. Ariyo *et al*. (2001), observed that in the Kano metropolitan area in Nigeria, rural grain traders have less access to diverse sources of capital (notably institutional or formal loans from the government, banks and private companies) to expand their activities than their urban counterparts due to lack of collateral. Meanwhile informal financial systems, such as credit from suppliers, money lenders or rotating credit systems can be important but may be very expensive (Olomola, 2000). Besides, there are inter-linked credit transactions which have been found to effectively address the problems of asymmetric information and enhance credit access (Olomola, 2010).

In fact, the access to credit by small producers in many African countries is rather disappointing. Very few small farmers and rural micro-entrepreneurs have been integrated into formal financial markets and many do not use credit or if they do, they continue to borrow from informal market lenders (Adams, 1984). Gonzalez-Vega (1983) reported that only a small fraction of farmers in low income countries have ever received formal loans. While it is estimated that only 15% of farmers in Asia and Latin America are financed through formal credit sources, just 5% in Africa are financed through formal credit sources (Gonzalez-Vega, 1983; Braverman and Huppi, 1991). Zeller (2001) noted that despite the big effort by the governments of developing countries and foreign donor agencies to establish functional micro credit schemes, it is estimated that only 2% of the population in the developing countries has accessed credit from these schemes.

Credit terms, service costs and smallholder farmers in Nigeria: Arguably, microfinance lending should be at a low interest margin because agricultural investment is largely the occupation of the rural poor. Even when other occupations are available, it is believed that rooting Micro Finance Banks (MFBs) services through universal banks, as was the case with Commercial Banks (Cbs) and their correspondent banks, invariably increases the cost of doing business for the MFBs. MFBs continue to perform such services as clearing of cheques, maintenance of correspondent bank accounts and money transfers through universal banks. Apart from the cost of their services, the MFBs often transfer these costs inherited from their correspondent banks to the customers (rural dwellers and small scale farmers) because they have to operate on sustainable basis.

Subsidized/regulated interest rate has been shown to work against microfinance loans reaching the targeted low-income earners by making the loans attractive to rich households or elites. It is equally not healthy when interest rate is higher than the market average because of the extra charges inherited from correspondent banks. Hence, the need to establish an apex microfinance bank to serve the clearing needs and other inter-bank transactions on behalf of the MFBs is relevant to make the credit facilities provided by the banks to be attractive to smallholder farmers in the rural areas.

High cost of credit to smallholder farmers in Nigeria persists because of over-reliance on formal credit sources and reluctance of the apex bank to integrate the informal credit institutions into the mainstream of financing. It is observed that not much has been done to achieve this integration of the informal traditional self help groups and associations to the mainstream except by stipulating provision of credits to them by MFBs. There is need for government to provide simplified avenues for more efficient participation of these associations through registration, as cooperatives and legal recognition of their activities. The bench mark of ₦20.0 million, as the minimum capital requirement for MFBs makes it obvious that many operators in the informal sector will continue to flourish outside the purview of any form of regulation by illegally collecting deposits and giving out credits without legal backing.

There are also informal money lenders and credit associations in Nigeria. Money lenders are believed to be highly exploitative with high rates of interest through which they extract economic surplus provided by peasant labour, capital and land. The very high interest rates that are sometimes observed reflect the fact that the lender has exclusive monopoly power over his clients and can, therefore charge a much higher price for loans than his opportunity cost.

Meanwhile, the lending rules and procedures of these commercial banks exclude small farmers who basically farm on non-secured lands and possess no tangible assets to offer as collateral and security for bank loans. Moreover, commercial banks regard smallholder farming, as the most risky investment areas and avoid them in a bid to reduce loan transaction costs and raise their profitability.

Selected empirical gap in literature: Previous studies such as Zeller (1993), used univariate probit model to estimate the factors that determine an individual's borrowing decision in terms of their participation in formal and informal credit in Madagascar. He concluded that informal lenders, age schooling, wage are significant determinants for credit. Atieno investigated the role of the institutional lending policies of formal and informal institutions in determining the access to credit facilities by small scale entrepreneurs in rural Kenya. He used both descriptive and analytical methods to show that limited used of credit reflect lack of supply resulting from the rationing of behavior of both formal and informal lending institutions. Mohamed (2003) used the logit analysis and the student t-test to conclude that age, education sex, affect credit accessibility. Oni *et al.* (2005) determined the factors that influence loan default among livestock farmers. Using descriptive statistics, they concluded that flock size of the farmers significantly influence default in loan repayment, age and the income of the farmer significantly influence default in loan repayment. Rarely do Nigerian specific studies address the subject directly.

MATERIALS AND METHODS

The logit regression was used to determine the factors that influence an individual's ability to secure loan from formal and informal financial institutions. Data was generated from the 6 geopolitical zones of Nigeria and analyzed using SPSS 15.0. Some of the selected predictors were regressed against the dependent variable (success in accessing credit or failure to access credit). Also, the multivariate hotellings t^2-test was applied to formal and informal access to credit classified, according to the states of operation in Nigeria. A total of 1000 respondents were purposively selected for the study to ensure that those selected are smallholder farmers from across the country. Table 1 shows the distribution of sample selected in each state from each geopolitical zone.

Table 1: Distribution of sample selected in each state from each geopolitical zones

Geopolitical zones	State selected	Sample size
South-South	Delta	168
South West	Osun	179
South East	Enugu	170
North East	Adamawa	200
North West	Niger	203
North Central	Kogi	80

The number of the sample from each state as shown in Table 1 was not equal due to the varying population strength of small-holder farmers in each state.

RESULTS AND DISCUSSION

On educational level of the head of family in the 6 geopolitical zones of Nigeria, about 19.2% of the farmers completed their secondary education; 15.2% attempted primary education; 14.4% completed primary education; 14.0 attempted secondary education; 13.2% went beyond secondary education while 11.4% had no education. On access to credit by gender, about 58.2% of the respondents were male while 41.8% were female.

The logit regression was conducted to determine factors that contribute significantly to credit accessibility and whether an individual has accessed credit or not was regressed on age, education level of head of family, gender, marital status of head of family, state of origin, sector (rural or urban), total annual expenditure, farm size and year of experience. Table 2 represents the logit regression result.

Table 2 shows that there is a positive significant relationship between sector (rural or urban), farm size (FARMOWNH), state of origin, year of experience (YRSOFEXP) and access to credit. Furthermore, there is a negative significant relationship between age (AGEHEADH), gender (GENDERHF), marital status of head of family (MRITALHF), education level of head of family (EDLEVHF) and access to credit. Again, there is no significant relationship between total annual expenditure (TOTAEXP) and access to credit.

The computation for the multivariate hotelling distribution using the mean difference of states selected from the 6 geopolitical zones shows that t^2 tabulated $<t^2$ calculated, therefore there is a significant difference between the small scale holders farmers access to credit in terms of formal and informal sources as classified, according to the states in the geopolitical zones in Nigeria. Smallholder farmers from North East, North West, South West and North Central access credits more than

Table 2: Logistic regression result

Variables	B-stat	SE	Significance
SECTOR	4.8390	0.297	0.000
MRITALHF	-0.4980	0.118	0.000
EDLEVHF	-0.5220	0.061	0.000
AGEHEADH	-0.5080	0.127	0.005
FARMOWNH	0.1070	0.053	0.043
TOTAEXP	0.0000	0.000	0.329
YRSOFEXP	2.8640	0.623	0.000
STATE	0.1520	0.020	0.000
GENDERHF	-1.5180	0.650	0.020
CONSTANT	-16.0620	2.339	0.000

Cox and Snell R^2 = 0.467; Nagelkerke R^2 = 0.625; χ^2 = 19.288; No. of observation = 1000 farmers in South-South and South East. Even within a zone some states access more credit than other. For instance in South East, Ebonyi, Enugu, Imo and Abia states access more credit than Anambra State. Despite that Anambra State access the least credit in South East, the state spends more due to the predominance of wealthy farmers. Smallholders farmers from North East, North West, South West and North Central access more formal credit than informal credit while farmers in South-South, South East access more informal credit than formal credit. Again, farmers from South-South, South East spend more before accessing credit than farmers from North East, North West, South West and North Central.

CONCLUSION

Small scale farming contributes significantly to national economy in terms of food production and employment. The study revealed that most small scale famers in Nigeria had not used credit before. Out of those who had the majority had used informal credit. The major reasons for not seeking credit were lack of information about credit and lack of required security. The one major conclusion is that the large number of potential borrowers who did not seek credit does not mean that they did not need credit because they were not credit constrained.

RECOMMENDATIONS

Government must encourage the establishment of free interest bank to ensure that the sector which has no tendency to wither is sustained for optimum contribution to the growth of the economy. The significant difference observed from the formal and informal sources of credit across Nigeria might be as a result of high collateral requirement.

Again, government should enhance the role of the informal financial institutions to supplement the formal sector. Government should further train every credit beneficiary to enhance their capacity to saving, reinvest and growth businesses.

Smallholder farmers need better organization and self-regulation to be able to engage more constructively with government and the formal sector to increase their power to lobby, negotiate and influence public policy.

Finally, given the wide and established branch network of commercial banks in Nigeria, improving their lending terms and conditions in favour of small scale enterprises would significantly facilitate the accessibility of small scale enterprises to credit. This is because although informal finance provides easier access to credit, the results of the study show that informal credit is confined to specific activities and at lower levels of income, thus limiting its use.

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