Effect of Conventional Agriculture Financing on Development of Small-Scale Farming in Nigeria

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Abstract:

This study explores the impact of conventional agriculture financing on the development of small-scale farming in Nigeria. Conventional financing, primarily through commercial banks, microfinance institutions, and government-backed credit schemes, plays a critical role in supporting agricultural productivity. However, small-scale farmers often face barriers such as limited access to credit, high interest rates, and stringent collateral requirements, which undermine their ability to fully benefit from these financial services. The overview highlights how these challenges affect farm output, technology adoption, and overall livelihood improvement among smallholder farmers. Additionally, it examines the effectiveness of existing financing models and policies in bridging the funding gap. By synthesizing recent studies, policy reports, and field data, the paper identifies gaps in current financing structures and proposes strategies for more inclusive and sustainable financial interventions. Ultimately, the study underscores the need for a more flexible, accessible, and farmer-friendly financing framework to enhance the productivity and resilience of small-scale agriculture in Nigeria.

Keywords: Agriculture Financing, Small-Scale Farming, Rural Development, Credit Accessibility, Nigeria.

Introduction

Agriculture is a vital economic growth contributor in Nigeria. As a primary source of income generation, poverty reduction and employment creation particularly in rural areas, the agricultural sector is pivotal to sustainable food security and can serve as a catalyst for Nigeria's inclusive growth prospects. Crop production remains the major driver in agriculture, contributing 23.5 percent of Nigeria's Gross Domestic Product (GDP), employing about 37.99 percent of the labour force (NBS, 2024). However, the sector represents only 1percent of exports. Over the period 2020-2023, government financing of agriculture which was mainly channelled through the Central Bank of Nigeria (CBN) peaked at over N1.3Trillion, yet the contribution of agriculture to GDP averaged 23.5percent.

To reverse the under-performance, several factors responsible for low productivity such as, interest rate charges on conventional agriculture by needs to be examined. In Nigeria, small-scale farming has historically encountered significant barriers in accessing formal financial services (Adebayo, 2019). Other factors such as land ownership, non-active participation of States and Local Government Areas (LGAs) in agriculture financing have effect on the development of small-scale farming. The agriculture sector in Nigeria is largely dominated by subsistence farming with an arable land area of 34 million hectares: 6.5 million hectares for permanent crops, and 28.6 million hectares for meadows and pastures (BOI, 2022).

BIO (2022) connotes that Agriculture in Nigeria is characterized by small-scale farming with about 38Million small scale farmers; 20 percent of Nigeria's estimated population, being responsible for 90percent of Nigeria's agricultural produce. Of these, more than 72percent live below the poverty line of \$1.9/day. To reduce reliance on importation of grains the CBN within the period of this Study implemented several agriculture financing initiatives such as; Anchor Borrowers Programme (ABP); National Food Security Programme (NFSP); Paddy Aggregation Scheme (PAS); Maize Aggregation Scheme (MAS); Accelerated Agricultural Development Scheme (AADS); and the Private Sector-led Accelerated Agricultural Development Scheme (P-AADS).

The policy objectives of the initiatives were; enhanced crop production, creating employment and boosting the contribution of agriculture sector to economic growth and development. Dumoteim (2018) asserts that historically, mmajority of government agriculture financing has been channeled through the CBN with development financing in the CBN beginning in 1964 with the financing of then Commodity Boards. By 2009 – 2010, the CBN began increasing its agriculture financing interventions because of the need to boost the economy following the 2007-2008 global financial crises (CBN 2020). Despite the increased agriculture financing initiatives, there has not been a commensurate development of small-scale farming as small-scale farmers remain challenged by poor access to conventional agriculture financing and poverty pressure points.

There are Two (2) main types of financing agriculture in Nigeria. The first is the conventional agriculture financing where the CBN is in Public Private Partnership (PPP) model with Commercial Banks (CBs) and Private Financial Institutions (PFIs). The CBN charges 2% interest on its funds accessed by the CBs and PFIs who are allowed to charge 9% interest rate to the Aggregators/Anchors that guarantee the loans on behalf of the small-scale farmers. Such conventional agriculture financing funding structure dependent on interest rate loans is a factor in poor loan recoveries and poor access to government agriculture financing which hinders the development potential of small-scale farming (Mohammed and Gupta, 2022).The CBN in September 2023, announced a halt to further agriculture financing interventions (CBN 2023) due to poor loan recoveries and lack of collateral by beneficiaries thus creating a gap for which alternative funding source becomes imperative.

The second source of agriculture financing is the non-interest financing rooted in Islamic Finance which offers a wide range of short, medium and long-term non-interest financing instruments as sources of capital for investing in agricultural development purposes. The non-interest financing are based on certain Islamic ethical moral principles which emphasises fairness, transparency, equitable distribution of wealth among individuals through forward contract sales, profit and loss sharing (PLS) partnerships, joint ventures, leasing and cost plus financing contracts, asset leasing, as well as Sukuks (Bonds) which are suitable for agriculture financing. These can serve as development catalysts for the development of small-scale farming.

The non-interest financing instruments include forward contract sales (Bay al-Salam), (Mudarabah: partnerships) and Musharakah (Joint ventures) which are profit and loss sharing PLS contracts, Murabaha (cost plus financing), Ijara (lease contracts), Istisna (asset) and Sukuk (Bonds). These financing instruments principally eliminate the burden of interest rate and can serve or the development of small-scale farming in Nigeria. Other deliverables include profit and loss sharing, wealth distribution, economic empowerment, poverty reduction and financial inclusion. The objective of this study is to examine effect of conventional agriculture financing on small-scale farming and the need to explore non-interest financing instruments as alternatives from a development studies perspective rather than just a financial service.

Theoretical Framework

For this study, the Financial Intermediation Theory is utilize The Financial Intermediation Theory was largely developed by economists such as Joseph Schumpeter (1934), who emphasized the role of financial institutions in facilitating innovation and economic development. Later, scholars like Gurley and Shaw (1960) and Goldsmith (1969) expanded the theory, arguing that financial intermediaries play a crucial role in mobilizing savings and allocating credit efficiently. These theorists highlighted how intermediaries reduce transaction costs, manage risk, and bridge the gap between savers and borrowers in an economy.

This theory explains how financial institutions facilitate the efficient allocation of resources by channelling funds from savers to borrowers. In the context of agriculture, financial intermediaries such as banks and microfinance institutions act as a bridge between financial resources and small-scale farmers who require capital for production, expansion, and sustainability. According to the theory, access to financial services enhances productive investments, increases income levels, and promotes economic growth (Schumpeter, 1934). However, small-scale farmers often face significant obstacles within the financial intermediation process, including information asymmetry, high transaction costs, and collateral requirements. These barriers hinder the effective distribution of agricultural credit and, by extension, the growth of small-scale farming in Nigeria.

Additionally, Credit Rationing Theory (Stiglitz & Weiss, 1981) complements the analysis by explaining why financial institutions may limit lending to small-scale farmers, even when there is demand. This theory suggests that due to risks and information asymmetries, lenders prefer to ration credit rather than increase interest rates, which disproportionately affects farmers with little collateral or financial history. In the context of this study, conventional agriculture financing refers to credit and funding provided through formal financial intermediaries such as commercial banks, microfinance institutions, and government-backed schemes. The Financial Intermediation Theory, as proposed by Schumpeter (1934), Gurley & Shaw (1960), and Goldsmith (1969), argues that these intermediaries are vital in linking surplus units (savers) with deficit units (borrowers, such as small-scale farmers). Through this intermediation, financial institutions can stimulate productivity and innovation in sectors like agriculture.

However, in Nigeria, small-scale farmers often face constraints in accessing conventional financing due to collateral requirements, high interest rates, and credit rationing—issues that are also explained by Credit Rationing Theory (Stiglitz & Weiss, 1981). These limitations hinder the efficient flow of financial resources, thereby slowing the development of small-scale agriculture. Thus, the theoretical framework helps in analyzing the effectiveness, accessibility, and limitations of conventional financial intermediaries in supporting smallholder agricultural development, thereby providing a robust lens for evaluating policy and practice

Methodology:

In this study, ***content analysis*** was employed as the primary research method to assess and evaluate the financing mechanisms for agricultural development in Nigeria. Content analysis is a qualitative research technique that involves systematically examining and interpreting various forms of textual or visual data to identify patterns, themes, and insights related to the research questions (Krippendorff, 2018). This method was used to examine existing literature, mainly on CBN Reports on its agricultural financing initiatives. The Secondary data provided information on both scale of funding and number of SSF beneficiaries which was derived from purposive sampling for the period.

Results and Discussions

Table 1 of this section shows the contributions of agriculture to GDP growth for the period 2013 to 2020, whilst Table 2 is data from CBN on its agriculture financing up till 2022. The figures presented are not exhaustive but present the quantum of government agriculture financing which the CBN channelled through CBs and PFIs based on the PPP financing model. The figures in Tables 2 and 3 show increasing agriculture financing during the study period which ought to have influenced the contribution of agriculture to GDP within the period under review.

Table 1: Contribution of Agriculture to GDP

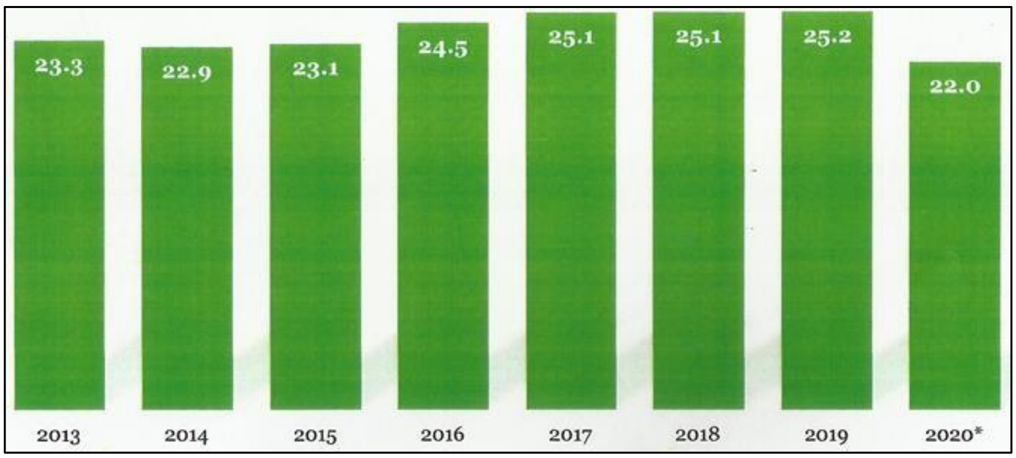

Figure -1. Agriculture's contribution to GDP (%)

Source: NBS PwC analysis, (2020).

Table 2: CBN Anchors Borrowers Funding

S/N	YEAR	AMOUNT BILLION ₦
1.	2018	94.7
2.	2019	120.0
3.	2020	336.1
4.	2021	324.3
5.	2022	149.1
Total	6Million beneficiaries	1,121.4 Trillion Naira

Source: CBN, (2023).

Table 3: Other CBN Agriculture Financing:

S/No.	Category	Amount
1	Commercial Agriculture Credit Scheme (CACS)	N745,063,575.50
2	Paddy Rice Aggregation Scheme (PAS)	N106,389,000,000.00
3	Maize Aggregation Scheme (MAS)	N6,352,500,000.00
4	Agriculture Credit Guarantee Scheme	N662,475,476.91

Source: CBN, 2023

The Study found that each financing initiative had its own total number of beneficiaries SSF. The ABP recorded 6Million SSF beneficiaries despite providing N1.121.4Trillion over the period of funding. According to the (CBN, 2020), the loans which the SSF could access were based on the following:

- The maximum loan was based on the farmers land size and CBN's Economics of Production (EOP).
- 9% interest rate on accessed sum.
- Loan is based on gestation period of the crop being cultivated.
- Loan is repaid in cash or produce.
- SSF are required to contribute 5% of the loan value as equity.
- Farmers are to provide soft collateral, such as promise to deliver the crop to the Anchor.

The foregoing profit making market orientation loan conditions became inhibiting factors to the SSF accessing the ABP and for the poor loan recoveries responsible as recorded by the CBN.

Summary of Findings

i. Conventional agriculture financing was mainly through the CBN and such recorded steady increases. Yet contribution of agriculture to GDP did not record a huge increases and the SFF did not record enhanced income generation or significant improvement to livelihood.
ii. Conventional agriculture financing initiatives were largely ad-hoc and had year 2025 exit dates rather than institutionalised for sustainable agriculture financing.
iii. Though the CBN funded the ABP from its Micro Small Medium Enterprises Development Fund (MSMEDF) account created to boost MSMEs and the agriculture value chain, the PFIs participating in the PPPs accessed the ABP based on a structural compliance with non-interest banking principles; however the CBN charged the PFIs a 2% interest on any disbursed sum. In addition the PFIs had CBN approval to charge a maximum of 9% p.a on any sum accessed by Anchors who in turn charged the SSF a higher interest rate. Such conflicting utilisation of non-interest financing structure to finance interest yielding PPPs indicates that the latent interest generation was invariably transferred unto the SSF. This is instructive because the ABP was funded from the MSMEDF which also funded non-interest financing initiatives for MSMEs *(Trader Moni and Market Moni)* through the Bank of Industry.
iv. As a consequence, the CBs and PFIs and the CBN reported low loan recoveries leading to a CBN policy pronouncement in July, 2023 of halting further agriculture financing initiatives. This is Two (2) years ahead of their scheduled termination and could create a gap in agriculture financing in Nigeria. This brings to fore the need for an institutionalised government agriculture financing for sustainable effect on SSF.
v. The CBN in July, 2023 announced a halt to further agriculture financing initiatives due to poor loan recoveries. The resultant gap in agriculture financing prompts the need for

alternatives such as non-interest based financing instruments which are suitable for financing agriculture.

Conclusion

This study has examined the effect of conventional agriculture financing on the development of small-scale farming in Nigeria, highlighting both the potential and limitations of existing financial structures. It is evident that while formal financial institutions play a critical role in providing capital for agricultural development, small-scale farmers continue to face significant barriers in accessing these resources. Issues such as stringent collateral requirements, high interest rates, and inadequate financial literacy have limited the effectiveness of conventional financing in driving meaningful growth in the smallholder sector.

The theoretical insights from the Financial Intermediation and Credit Rationing theories reinforce the need for more inclusive and flexible financing models that consider the unique challenges faced by small-scale farmers. To bridge the gap, there is a pressing need for policy reforms, tailored financial products, and stronger linkages between financial institutions and rural farming communities. Ultimately, enhancing access to affordable and sustainable agricultural financing is key to boosting productivity, ensuring food security, and improving rural livelihoods in Nigeria. Stakeholders—including the government, financial institutions, and development agencies—must collaborate to create an enabling environment that empowers small-scale farmers as active contributors to national economic growth.

Recommendations:

Based on the findings of this study on the effect of conventional agriculture financing on the development of small-scale farming in Nigeria, the following recommendations are proposed:

i. **Improve Access to Credit through Tailored Financial Products**
Financial institutions should develop loan products specifically designed for small-scale farmers, with flexible repayment terms, lower interest rates, and minimal collateral requirements to encourage greater participation.

ii. **Enhance Financial Literacy and Farmer Education**
Government agencies and non-governmental organizations should collaborate to provide regular training and awareness programs on financial management, loan utilization, and investment planning to empower farmers to make informed financial decisions.

iii. **Strengthen the Role of Agricultural Credit Guarantee Schemes**
Existing government-backed credit guarantee programs should be expanded and effectively implemented to reduce the lending risk for banks and increase their willingness to support smallholder farmers.

iv. **Promote Public-Private Partnerships in Agricultural Financing**
Collaborative efforts between the government, private sector, and donor agencies can mobilize more resources and develop innovative financing models that support rural farmers more effectively.

v. Establish Farmer Cooperatives and Unions for Collective Bargaining

Encouraging the formation of farmer cooperatives can help small-scale farmers access credit more easily, share resources, and improve their bargaining power with financial institutions and input suppliers. Implementing these recommendations can create a more inclusive, resilient, and productive agricultural sector, where small-scale farmers are empowered to contribute significantly to national food security and economic development.

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