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CONSTRAINTS OF INFORMAL AGRICULTURAL FINANCING IN THE RURAL ECONOMY OF KWARA STATE, NIGERIA: IMPLICATIONS FOR RURAL AGRICULTURAL FINANCE POLICY

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and
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Abstract

The rural farmers who constitute a large percentage of food producers in Nigeria have problem of access to financial resources from the formal financial institutions because of the institutions' stringent conditions and location. In effect, most of the rural farmers have to rely mainly on the informal financial institutions for funding. The objective of this study was to examine the constraints facing informal agricultural financing institutions in the rural economy of Kwara State, Nigeria. The source of data for this study was mainly primary that was collected using structured questionnaire from sampled farmers who were participating in three informal financing schemes namely: (i) periodic savings; (ii) money lending; and (iii) rotating savings in the sampled nine Local Government Areas spread through the three senatorial districts of Kwara State, Nigeria. Employing a multi-stage random sampling method, a total of 1,350 farmers were selected for the study. The returned 1,249 copies of questionnaire were then processed using descriptive statistics. The findings indicated that the farmers patronized and used the three sources of finance and the constraints facing the institutions among the farmers varied across the three senatorial districts. While high interest rate was the most severe constraint in the south senatorial district, lack of fund as a constraint of the institutions cut across the three senatorial districts. Based on the results, the study recommended that to reduce the high dependency on money lenders with their outrageous interest rates, attempt should be made to link the informal financial institutions with the microfinance banks in the rural areas to partner with them for group savings and group credit delivery at competitive interest rates.

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Introduction

The financial systems of most developing countries including Nigeria are made of two sectors: the formal and the informal financial sectors that operate side by side. The formal sector, also known as the organized sector is made up of the Central Bank, Commercial Banks, Development Banks, Building Societies, Insurance Companies etc. These institutions are mostly found in the urban and semi-urban settings. On the other hand, the informal financial sector also known as un-organized sector consists of individuals such as money lenders, relatives, friends, neighbours, landlords, traders and group of individuals that operates mainly in the rural setting, (Mehrteab 2005). While the formal financial sector is an inheritance from the colonial administration or a legacy of foreign systems whose activities are being regulated by the Government, the informal financial sector is an age-long one, an ancient one, that dates back at least to the 16th century, the activities predate those of the formal financial system but are not subjected to Government regulation, (Iganiga et al 2008; Siebel and Damachi 1982).

The informal financial sector constitutes an important sector in the economy of the developing nations of the world because of the enormous financial resources that change hands in the sector. For example in Nigeria, Soludo (2004) has put the amount of currency circulating outside the banking system in the region of N400billion which he reported is due to the large informal economy among other reasons. Akingbola (2006), emphasizing the depth of the Nigerian informal financial sector, stated that the capitalization exercise in the banking industry also achieved another significant feat, raking-up a sizeable proportion of funds hitherto circulating in the informal financial sector and bringing to the fore the amazing depth of this sector of the economy in Nigeria. Emphasis was also made that with adequate creativity and policy support, the quest to align this sector with its formal counterpart can be achieved in the very near future.

As a result of the importance of the informal financial sector to the developing economies of the world, there have been an increasing number of studies on the sector to know the impact of the sector on the overall economy. For example, while Adeoye (2005); Olatu, (2005); Iganiga and Asemota, (2008); and Oloyede, (2005) undertook studies on informal sector financing in Nigeria, (Reddy, Naidu and Mohanty, 2005; Reweyemamu et. Al 2003; and Okurut and Thuto, 2007) had at one time or the other studied informal sector financing in Fiji, South Pacific Island, Tanzania and Botswana respectively. The aim of this study was to examine the constraints facing the informal financial institutions in the financing of agriculture in the rural economy of Kwara State, Nigeria.

Literature Review

Adeoye (2005) stated that the constraints to the development of the informal financial institutions include among others the followings: (i) facing uncertainties, irregularities, and inconsistencies in the timing of their income generation; (ii) operating within an atmosphere of difficult economic environment (iii); facing high risk of no income by the nature of their business/trade in which they found themselves; (iv) confronted with high incidences of business failure affecting their business/trade; (v) faced with the ugly monster of power/energy irregularities to their business/trade without any form of government support or aids to cushion the effects of power outages; (vi) facing the risk of default and total abscondment by the collectors with the proceeds of collection without any means of insurance coverage; (vii) coping with complete absence of infrastructural facilities which are capable of enhancing their business prospects such as electricity, roads, portable water and in some cases telephone services; and (viii) coping with total absence of government presence as prime mover in the economy from where they can draw inspiration for their business success.

According to Abdulrasaq (2005), the problem of informal financial institutions is the lack of investment opportunities for savings which have been mobilized but which have not been lent. He stated further that another constraint of the sector lies in the fact that the volume and availability of loanable funds are subject to seasonal fluctuations. There is also the lack of proper record keeping in the informal sector as it seldom keeps a written record of borrowing and or savings activities of its clients and where it does, the procedures are relatively simple (Abdulrasaq 2005). In the view of Conteh and Braima (2003), the constraint to the growth of informal sector financing in Sierra Leone included the inadequacy of rural infrastructure which hinders access to market and technology. The road network is in state of disrepair, power, water supply and communication are grossly absent in the rural areas. The absence of these facilities tend to increase costs of doing business and result in low quality and uncompetitive products. They reduce potentials for expansion and for attaining rapid rural economic recovery (Conteh and Braima 2003). As a matter of fact, Zeller (2003) in his concluding remark in his work warned that although rural households especially the poor face complex multiple constraints on earning opportunities, addressing these constraints such as lack of access to knowledge, infrastructure and markets may often prove a better strategy for agricultural and rural development and poverty reduction. Conteh and Braima (2003) further reported that as a result of out-migration of most of the educated and skilled citizens from rural settings, there is dearth of skilled or trained staff to run micro-finance entities in the rural areas where most of the

informal financial institutions are predominant. Another reason adduced by Conteh and Braima (2003) as the constraint of the informal financial institutions in Sierra Leone is that the existing bank licensing and supervision regulation is patterned after traditional banking laws and not designed to favour the rules which are applicable and or peculiar to micro finance institutions (MFIs) such as ROSCAs, Thrift and Credit Unions etc.

Reddy, Naidu and Mohanty (2005) reported that lack of ideals of appropriate skills and of finance were the impediments to the development of informal financial sector as moneylenders who charge outrageous interest rates dominated the financing of the informal financial sector in Fiji. According to Rweyemamu Kimaro and Urassa (2003), monopolistic power in the hands of few operators of the informal financial sector, excessive high rates and exploitation through under valuation of collaterals were the factors that have restricted the sector from providing credit to farmers for agricultural purposes in Tanzania. Koning (1997) was also of the view that the short term nature of the available funds in the informal market with little or non-existence of medium to long term credits constrained the development of the sector in developing countries.

In an attempt to tap the informal financial sector resources, mobilize the idle cash in the system in Nigeria and bring banking culture to the grassroots of the economy for the overall development of the nation, a number of programmes were launched by the Government. The programmes included: A rural banking programme was launched in 1977 under which commercial banks were given specific targets on the number of branches to be established in the rural area over the following decade (Brownbridge 1996). The objectives were to attract cash held in the rural areas into the banking system so as to increase the effectiveness of monetary policy, extend rural credit facilities and spread the banking habit (Adegbite, 1994). Olaitan (2006) reported that over 700 rural branches were opened before the programme was discontinued in early 1990s. The rural banking programme cannot be said to have achieved the objective as a lot more need to be accomplished to transform the rural areas (Atoyebi, 2003). He stated that the banking industry is noted to be a profit maximizer and that the banking institutions prefer to invest in low risk and high returns which they cannot find in the rural areas where agriculture is the dominant project. Atoyebi (2003) further pointed out that the programme is also made difficult because of the complete absence or inadequate infrastructural facilities such as access roads, water, electricity, telephone and health services in the rural areas.

Another scheme which has the same objectives as the rural banking scheme is the Peoples Bank of Nigeria (PBN) that was established in 1989. The objectives included: creation of opportunities for self-employment,

elimination of exploitation by shylock moneylenders, checking of rural-urban migration and inculcation of banking habit at the grassroots' level (Atoyebi, 2003). According to Atoyebi (2003), the bank achieved a modest measure of success in the area of branch expansion as well as in deposit generation and lending activity. He stated that, for example, the bank which took off in 1989, by June 1992, its total branches had increased to 204 while its satellite centres were 304 in number in all parts of the federation. The number of borrowers as at June 1992 stood at 79,061 and outstanding loans to the bank stood at N740million (Atoyebi, 2003). The bank was however merged with Nigerian Agricultural and Cooperative Bank (NACB) to form the Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB) in 2000 (Manyong et al, 2003).

The introduction of Community Banking System which was launched in 1990 was another scheme designed to bring banking facilities nearer to the rural areas. As the commercial banks could not meet the needs of the rural populace as most of the banks experienced operating losses which could not be sustained, Community Bank was therefore designed to fill the credit gap created by the Peoples Bank and the Conventional Banks (Atoyebi, 2003). A Community Bank was owned and managed by the community itself or a group of communities (Community Banking Act, 1992). A community Bank was a financial institution that caters for the savings and credit needs of small-scale producers throughout the country. It represented an institutional attempt at modernising the system of credit provision to the people at the grassroots. It was a way of formalising traditional and informal systems of credit provision in the country and constitutes a means of promoting development at the grassroots (Community Banking Act, 1992). As at 1990, 504 Community Banks had been established and by May 2004, 282 of them had obtained final operating licenses to carry out community banking (Olaitan 2006). However it was reported that upon appraisal of the existing microfinance oriented institutions in Nigeria in February 2004, the followings were revealed: (i) weak institutional capacity; (ii) weak capacity base; (iii) the existence of huge un-served market; (iv) economic empowerment of the poor, employment generation and poverty reduction were not properly addressed; (v) the need for increased savings outlets; and (vi) utilization of only 10% of the Small and Medium Industries Equity Investment Scheme, (SMIEIS) funds dedicated to micro financing, (Anyanwu, 2004).

In order to address the above problem, the Central Bank of Nigeria (CBN) designed Microfinance Policy, Regulatory and Supervisory Framework for Nigeria in December 2005 in line with the World's International Best Practice and proposed the conversion of Community

Banks and Microfinance Institution- Non Governmental Organizations, (NGOs) to Microfinance Banks and the establishment of new ones by individuals, corporate organizations, deposit money banks, Community Development Associations and Foreign Investors. The scheme also entails setting aside of 1% of annual budgets of Local Government Councils nationwide to support the programme (Microfinance Policy, Regulatory Framework for Nigeria- CBN, Abuja, 2005). All licensed Community Banks were mandated to convert to Microfinance Banks within a period of 24 months, that is, 31st December 2007. This was another programme to bring banking culture to the grassroots, the rural poor, who are traditionally not served by the conventional financial institutions.

It is the current programme designed to mobilize deposits and provide credits to the economically active poor, micro, small and medium enterprises to conduct or expand their business enterprises. It is fashioned against the Grameen Bank, the Bank for the Poor of Bangladesh pioneered by Prof Mohammed Yunus who won the 2006 Norwegian Nobel Peace Prize for successful efforts to create economic and social development through an efficient and sustainable microfinance programme (Unpublished Lecture, CBN 2007). There are two categories of microfinance banks. There are those licensed to operate as unit banks with a minimum capital of N20million and those licensed to operate as state banks with a minimum capital base of N1billion (CBN-Regulatory and Supervisory Guideline for Microfinance Banks in Nigeria, 2005). It is hoped that this new initiative of the Government will realise its objective with good management of the banks and policy consistency.

The Self-Help Group Linkage Programme with Banks is another scheme launched in 1991 by the Government to introduce banking culture to the operators of the informal financial institutions in the country. The concept of Self-Help Groups Linkage Programme with Banks was adopted after a successful study was conducted by the German Technical Co-operation (GTC) and African Regional Agricultural Credit Association (AFRACA) member institutions in Nigeria in 1991 with the Central Bank of Nigeria acting as the coordinator of the linkage programme (Siebel, 1999; Lawal, 1995). Siebel (1999) reported that in Nigeria, 8 commercial banks have been involved through 54 participating branches in 22 states. He stated that 313 groups have directly been involved, comprising 137 cooperatives and 176 informal groups. The scheme is an arrangement in which Self-Help Groups are integrated into formal financial systems through savings and through obtaining facilities to satisfy the needs of members. The mode of operation under the programme is that farmers with a common purpose are encouraged to form groups of 5 to 15 members. They then undertake to make regular

savings into a partner bank of their choice. After they have made regular savings for at least six months with the partner bank, the group members are provided loans for their agricultural activities by the partner bank in the savings/loans ratios of 1:5 (Siebel 1999, Olaitan 2006, Seibel 2001 and Lawal 2001). The group savings passbooks are held as security and cannot be withdrawn as long as loans last. The aim of Self-Help Group Linkage Programme with Banks was to inculcate a culture of savings and banking in the group and to build up resources to finance their agricultural activities in the long-run (Olaitan, 2006). However, Zeller (2003) reported that although linking banking has some advantages for rural intermediation, little empirical evidence exists so far on its performance. This study was an attempt to document the constraints facing the informal agricultural financing institutions in the rural economy of Kwara State, Nigeria.

Methodology

Data Source

A survey aimed at gathering primary data on the Socio-economic and Demographic Characteristics of the respondents and the constraints facing Informal Financial Institutions in the rural areas of Kwara State, Nigeria was conducted through the distribution of copies of structured questionnaire on sampled farmers who were participating in the three identified informal financial schemes in nine Local Governments Areas covering the three Senatorial Districts of the State. Multi-stage random sampling method was used for selecting the respondents, by selecting 50% of the Local Government Areas in each of the senatorial districts, three (3) rural areas from each Local Government and fifty (50) farmers from each of the rural areas. A total of 1,350 farmers were selected for the study but only 1,249 farmers or 92% of the farmers satisfactorily completed the copies of the questionnaire which formed the basis for the analysis.

The questionnaire was backed with oral interviews to elicit more information from the rural farmers.

Data Analysis

The analysis was based on descriptive statistics. The descriptive statistics were employed to summarise the constraints facing the informal financial institutions in the study area. This involved the use of cross tabulations and percentages. The constraints from literature were: (i) lack of access to funds; (ii) short term nature of available funds; (iii) lack of education and managerial skills of operators; (iv) excessive high rates by moneylenders; (v) low level of economic activities in the rural areas; (vi) absence of or inadequate

infrastructural facilities e.g. power, road network etc.; (vii) risk of default and total abscondment with funds; and (viii) improper record keeping. The importance of each of these constraints was measured on a 5-point Likert scale of (1) not important (2) fairly important (3) do not know, (4) important, and (5) very important.

Results and Discussions

Table 4.1 Socio-Demographic Characteristics of the Respondents in the Rural Areas of Kwara State, Nigeria

S/No.	Variables	Frequency	Percentage (%)
1	Age of the Respondents		
	< 20	68	5.44
	21 – 30	331	26.50
	31 – 40	430	34.43
	41 – 50	336	26.90
	51 – 60	79	6.33
	> 60	05	0.40
2	Educational Status of Respondents		
	Informal	487	39
	Primary	400	32
	Secondary	300	24
	Tertiary	62	5
3	Marital Status of Respondents		
	Single	328	26.26
	Married	871	69.74
	Widow/Widower	44	3.52
	Others	6	0.48
4	Household Size of the Respondents		
	1 – 3	346	27.70
	4 – 6	680	54.45
	7 – 10	186	14.89
	> 10	37	2.96
5	Gender of Respondents		
	Male	573	45.88
	Female	676	54.12

Source: Author's Computation 2010

4.1 Socio-Demographic Characteristics of the Respondents

The age, educational status, marital status, household size and the gender of farmers are given in the table 4.1 above. Majority of the farmers (34.43%) fell within 31 to 40 years of age cohort. Quite negligible proportion of the respondents was younger than 21 years (5.41%). Those above 60 years were equally negligible (0.4%). The result implies that the farmers were in their active productive years. This is expected to impact positively on their

productivity. Given sufficient financial mobilization for the farmers, it is expected that their age would not have negative influence on productivity.

The educational status of the respondents as shown in table 4.1 indicates that majority of the farmers had primary (32%) and secondary (24%) education while only 5% had tertiary education. 39% had no formal education. This pattern of distribution is expected because the study area is a rural setting.

The distribution of the respondents by marital status shows that most of the farmers (69.74%) were married. This is typical of Nigeria rural setting because family members often serve as a source of additional labour on the one hand, and the cultural value attached to marriage on the other. Next to this category of those married were those that were single (26.26%).

The distribution of the respondents by household size shows that more than half of the respondents (54.45%) had between four to six household members. Household in the context of this study refers to total number of people eating from the same pot.

The gender distribution of the respondents shows that female farmers (54.12%) were greater in number than male farmers (45.88%) in the study area. It has been discovered that 60% of labour force in agriculture in Nigeria are women (Ajetomobi, Olamide and Ayanwale 2003).

Table 4.2 (A) Distribution of the Respondents by Constraints Facing Informal Financial Institutions (IFIs) in Kwara Central

Constraint	1 Least Severe	2 Less Severe	3 Moderately Severe	4 Severe	5 Most Severe	No. of resp.
Lack fund	9.89%	8.83%	20.44%	28.98%	31.86%	283
Short fund	16.25%	10.96%	21.20%	25.44%	26.15%	283
Lack Edu.	16.25%	15.20%	19.79%	18.37%	30.39%	283
High rate	6.66%	16.25%	15.90%	26.15%	35.04%	283
Low Econ.	13.79%	18.37%	16.51%	22.26%	29.07%	283
Infra	14.14%	15.74%	24.38%	16.25%	29.49%	283
Risk	18.73%	16.22%	17.31%	9.91%	28.55%	283
Record	13.07%	25.09%	11.77%	19.79%	30.28%	283

Source: Author's Computation 2010

Key - Lack fund; = Lack of access to adequate funds
Short fund = Short-term nature of available funds

- Lack Edu. = Lack of education and managerial skill of operators
 High rate = Excessive high interest rate by the moneylenders
 Low Econ. = Low level of economic activities in the rural areas
 Infra = Absence of or inadequate infrastructural facilities e.g. Power/energy, road network etc.
 Risk = risk of default and total abscondment with funds by the collector (ajo)
 Record = improper record keeping.

TABLE 4.2 (B) Distribution of the Respondents by Constraints Facing Informal Financial Institutions (IFIs) in Kwara North

Constraint	1 Least Severe	2 Less Severe	3 Moderately Severe	4 Severe	5 Most Severe	No. of resp.
Lack fund	2.98%	14.22%	24.54%	28.90%	29.36%	436
Short fund	17.73%	15.14%	20.59%	22.32%	24.22%	436
Lack Edu.	10.78%	14.68%	24.59%	25.73%	29.22%	436
High rate	7.33%	15.83%	21.10%	22.71%	33.03%	436
Low Econ.	8.77%	20.41%	18.49%	25.92%	26.47%	436
Infra	5.73%	18.12%	26.83%	21.56%	27.76%	436
Risk	13.76%	20.57%	21.00%	15.14%	25.53%	436
Record	11.93%	15.21%	24.54%	20.18%	28.14%	436

Source: Author's Computation 2010

TABLE 4.2 (C) Distribution of the Respondents by Constraints Facing Informal Financial Institutions (IFIs) in Kwara South

Constraint	1 Least Severe	2 Less Severe	3 Moderately Severe	4 Severe	5 Most Severe	No. of resp.
Lack fund	16.6%	6.15%	17.46%	30.36%	30.43%	530
Short fund	12.26%	8.87%	23.58%	38.31%	16.98%	530
Lack Edu.	9.25%	12.26%	20.00%	35.47%	23.02%	530
High rate	10.94%	14.15%	16.04%	25.85%	33.02%	530
Low Econ.	8.67%	14.91%	28.87%	28.30%	19.25%	530
Infra	8.87%	18.68%	31.32%	25.66%	15.47%	530
Risk	15.85%	39.93%	18.30%	13.96%	11.96%	530
Record	12.65%	13.77%	6.79%	38.11%	28.68%	530

Source: Author's Computation 2010

4.2 Constraints of Informal Agricultural Financing

The findings indicated that the rural farmers patronized and used the three sources of finance. The least patronized was money lender.

A breakdown of the major constraints facing Informal Financial Institutions (IFIs) among the farmers is summarized in Tables 4.2A, 4.2B and 4.2C. The constraints varied across the three senatorial districts. High rate of interest was the most severe constraint in Kwara South senatorial district. This might have been responsible for low patronage of the moneylenders. This is also the reason for the prevalence of other Informal Financial schemes in the region. Next to high interest rate problem is complaints about lack of funds. The amount of funds made available through the Informal Financial Institutions (IFIs) was hardly sufficient to meet the financial needs of the farmers. This is in line with the views of Rweyemamu, Kimaro and Urassa (2003) in their study on the assessment of semi-formal financial institutions in Tanzania where they reported that the institutions were incapable of solving all the agricultural problems. They reported that the sector would require complementary services such as infrastructural and marketing services. Another constraint of the institutions was found to be low economic activities in the study area. This is a corollary of poor infrastructural facility which is a

characteristic of rural settlements in Nigeria. This also conforms to the oral submission of the respondents that low economic activities were a result of the poor infrastructure in the study area which also impacted negatively on the operation of the institutions.

The three most severe problems in Kwara Central senatorial district were high interest rate, lack of fund, and lack of education in order of severity. The least severe constraint was short term nature of fund. It can be inferred logically that it is possible that funds were available at too high interest rate. The result for Kwara North senatorial district was quite similar to that of Kwara Central senatorial district. The most severe constraint to the patronage of money lending as a part of informal financial institutions is high interest rate. This was revealed in all the senatorial districts of the state.

Conclusion and Recommendations

This study examined the constraints facing informal agricultural financing in the rural economy of Kwara State, Nigeria. Three units of the informal financial institution, namely, periodic contribution, moneylender, and rotating savings were the focus of the study. The study covered the rural areas of the three Senatorial Districts in nine Local Governments Area of the State. A total of 1,350 copies of questionnaire were administered on randomly selected farmers who were participating in the three informal financial schemes. Only 1,249 of the copies of the questionnaire were returned which formed the basis for the analysis. The analysis was based on descriptive statistics.

The findings indicated that the rural farmers patronized and used the three sources of finance. The least patronized was money lender; and the constraints facing the institutions among the farmers varied across the three senatorial districts. Although high interest rate being charged by the moneylenders was found to be the most severe constraint in the south senatorial district, the result revealed that the low patronage of the moneylenders as one of the informal financial institutions across the three districts was as a result of the high interest rates. The high interest rate being charged by the moneylenders was followed by lack of fund, lack of education, poor record keeping, poor infrastructure, low economic activity and risk of default and total abscondment with funds by the money collectors in periodic savings "ajo" in order of severity;

Oral interview revealed that poor infrastructure in the rural area also contributed to the low patronage of the institutions.

Based on the findings of this study, it was recommended that: (i) to reduce the high dependency on money lenders with their outrageous interest rates, attempt should be made to link the informal financial institutions with the

microfinance banks in the rural areas to partner with them for group savings and group credit delivery at competitive interest rates, (ii) Government at all levels should improve infrastructure in the rural areas to boost economic activities as more money in the hands of the rural farmers will improve their propensity to save and enhance the informal financial institutions' performance in further financing of agriculture in the study area. In this way, the activities of informal agricultural financing will be further enhanced.

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