CHAPTER 7
Agricultural Finance

OBJECTIVES

At the end of the chapter, students should be able to:
â—† define agricultural finance.
â—† state and discuss the importance of agricultural finance.
â—† determine the sources of farm financing.
â—† discuss the sources of farm financing.
â—† classify credit.
â—† mention the types of credits based on periods and sources of credits.
â—† mention the problems faced by farmers in procuring agricultural credit.
â—† list and discuss the problems faced by the institution in granting loans to farmers.
â—† state the meaning of capital market.
â—† list the institutions that are involved in the capital market.
â—† state the sources of fund for the capital market.
â—† list and define the role of capital market in the development of agric business.

7.1 Introduction

All agricultural activities require fiscal cash for effective facting activities. In most cases, the cash has to be raised by the farmer and where he cannot, he sources for loan. These loans which can be short, medium or long term are paid by the farmer with interest. Farmers face a lot of problems in order to obtain the loan as they are required to provide collateral security or to pay high interest rate. Most financial institutions do not give loan due to the nature of agricultural activities. The project takes long time and the yield is not encouraging. The capital markets are involved in medium- and long-term financing of agricultural activities. They are carried out by sale of shares and stocks, which are normally quoted at the stock market. Most capital markets consist of banking sectors and the manufacturing industries.

Definition of Agricultural Finance

This is the process of sourcing, acquiring and application of capital in agricultural business. It deals with the supply and demand of fund in agricultural sector economy. A farmer must have money in order to carry out his farming activities.

7.2 Importance of Farm Financing

The farmer needs money to enable him carry out farming business in the following ways:
â—† It enables the farmer to carry out farming activities on a daily basis.
â—† It helps the farmer to pay wages and other expenses.
â—† It enables the farmer to adjust to changing economic conditions.
â—† It increases efficiency on the farm. â—† It encourages the farmer to take up new farming innovation.
â—† It ensures timeliness of farm operation.
â—† It facilitates the purchase and increased use of farm machinery.
â—† It enables the creation and maintenance of an adequate farm size.
â—† It protects against adverse conditions and crop failures.
â—† It enables farmers to adjust to seasonal and annual fluctuations in income and expenditure.

7.3 Sources of Farm Financing

Farmers can source for finance to carry out agricultural activities from the following sources to obtain loans or credit facilities.

Commercial banks: Commercial banks are sources through which farmers can obtain credits. The commercial banks provide short-, medium- and long-term loans. The Commercial banks assist farmers to procure credits and overdraft. When farmers obtain these loans, it enables them to expand the agricultural business venture. The commercial banks are usually biased in favour of large-scale farmers only. They demand collateral which farmers cannot afford. The interest rate charged is usually high.
Micro finance: They also provide the farmers with credits, although the credit granted is usually small and inadequate to meet the needs of farmers. They insist that any borrower should be willing to open an account with them before the loan is given.
Money lenders: These are individuals or group of people engaged in the business of giving/lending money to people with interest. Most rural farmers borrow from them since they find it difficult to get to commercial banks or other financial institutions due to their location and lean resources. The interest they charge on money borrowed is usually high. They are usually unbiased toward enterprises that bring in quick returns to repay the loan. They do not enjoy much popularity due to their shrewdness of recovering their interest and money.
Family sources: The farmer borrows from immediate and extended family members to finance his business. The capital from this source is usually small and so the size of the loan obtained is small and inadequate. It is usually a short-term loan.
Credit and thrift societies: These are associations of people who voluntarily contribute fixed sums of money on daily, weekly and monthly basis. Farmers who are members can obtain loan from them at a reduced interest rate.
Self-financing: This consists of the farmersâ€™ savings. The process may be too long and difficult. The farmer deprives himself a lot of luxuries in order to save some money. The farmer may not be able to generate the required amount needed for the business.
Co-operative societies: This is a business organization where various co-operators pool their resources together with a view of making profit. At times, a number of people may decide to produce commodity and the proceeds are distributed among the members. Also some co-operative unions give loan to farmers.

7.4 Government Agencies

i. International agencies: Government in collaboration with foreign government and financial bodies obtains financial assistance for agriculture as in joint management of agricultural development projects. An example of such bodies is the Food and Agricultural Organization (FAO). The Federal and State Government usually share in the provision of finance supplies, external financial and technical assistance.
ii. Federal Government Agencies: Federal government often finances various infrastructural facilities such as roads, irrigation scheme, processing outlet and communication network. These are carried out using the following bodies: The Agricultural Development Project (ADP), the National Accelerated Food Production Programme (NAFPP), River Basin Authorities, FADAMA I, II and III.
iii. State Government: The state government sets up units in the Ministry of Agriculture which manages and enhances lending or provides credits to small-scale farmers. They also finance Agro-Service Centres where farmers obtain subsidized farm inputs such as improved seeds, herbicides, fertilizers and other chemicals. Examples are the volunteer service scheme and Agricultural Development Co-operation.
iv. Agricultural Credit Guarantee Scheme Fund: This scheme caters for the establishment and management of plantations such as rubber, fruits, plantain, vegetables, oil palm, tea, coffee and animals. Farmers are given loan and it is properly supervised.
v. Non-Government Organization: The non-government organizations assist in rural development by providing social amenities like road, improved crop varieties, improved breeds of animals and

funding of extension work. They carry out these activities through the following bodies: International Institute for Tropical Agriculture (IITA), West African Rice Development Agency (WARDA) (Now Africa Rice Centre), International Livestock Centre for Africa (ILCA) and International Fund for Agricultural Development (IFAD).

7.5 Classification of Credits

Credits are loans obtained by a farmer to start or expand his farming business. It may be in cash or kind. Credits are repayable over a period of time with some interest determined by the source of credit. Before a credit is given out to a farmer, the lender needs detailed information about the borrower. For example, certain vital statistics should be provided such as:

â—† The reliability of the citizen
â—† The intended purpose
â—† The plan for the proposed projects (feasibility study)
â—† The ability of the farmer to execute the project successfully
â—† Collateral security information of
(a) landed property (stationed in good site)
(b) stocks and shares
(c) life assurance policy

Types of Credits

There are three types of credits given to the farmer. They are based on length or period, namely,
i. short-term credit
ii. medium-term credit
iii. long-term credit.
â—† **Short-term credits:** These mature within a period of 1 year. They are used to produce crops such as grains and cereals and animals. Examples of animal production venture that matures within this period are piggery and poultry production. The interest rate is usually high.
â—† **Medium-term credits:** These can be repaid within a period of 2 to 5 years. Such credit can be used in cassava production, tea and other crops that mature within this stipulated time. It can be used to purchase machinery and livestock. The interest rate is comparatively low.
â—† **Long-term credits:** This loan matures between 5 to 20 years depending on the period stated on the agreement. It can beused to purchase fi xed assets such as land, construction of farm buildings, dams and irrigation project. It attracts interest which can be serviced for a long term.

7.6.1 Classification of Credits

Credit facilities available to farmers are classified based on:
â—† Sources
â—† Liquidity

7.6.2 Classification based on sources of credit

i. Institutional credits: Credits can be obtained from institutions in the form of cash. Such institutions include banks, co-operative society, government and non-governmental organizations.

ii. Non-institutional credits: These are credit sources which consist of personal savings, friends, relatives and money merchants.

7.6.3 Classification based on liquidity

Loan in cash: These are loans received in cash.
Loan in kinds: These are subsidies provided on farmer inputs such as equipment and machinery.

7.7 Problems Faced by Farmers in Procuring Agricultural Credit

Farmers face a lot of problems in obtaining loan/credit facilities. Some of these are as follows:
â—† Farmers may not have the necessary collateral security required to obtain loan.
â—† Agricultural crops take time to mature and it is not quick revenue yielding.
â—† Farmers are faced with a lot of natural hazards such as adverse weather conditions and drought.
â—† The interest rates charged by financial institutions are very high.
â—† Banks are reluctant to give loans to farmers than to businessmen.
â—† Most farmers do not keep proper records hence their true financial position cannot be ascertained.
â—† Most farmers find it difficult to pay back in bulk the principal, and the interest charged in case of natural disasters like flood, drought and fire.
â—† There are no adequate insurance policies covering agricultural activities.
â—† There is a track record of misuse of loan by farmers.
â—† Processes and procedure of obtaining loan is too cumbersome for most farmers.

7.8 Problems Faced by Institutions in Granting Loans to Farmers

Loan granting institutions face the following problems:
â—† Lack of proper record keeping by farmers.
â—† Diversion of loan by borrowers to nonagricultural purposes.
â—† High incidence of loan defaulters.
â—† Long gestation period of agricultural crops.
â—† Difficulty faced in recovering the loan.
â—† High cost of lending to agricultural ventures.
â—† Inadequate collateral such as stocks, shares and life assurance policy.
â—† A charge on land on which the borrower holds a legal interest.
â—† A change of hold on moveable property of the borrower.

Differences between Credits and Subsidy

CREDITS	SUBSIDY
Credits are repayable loans given to the farmer with or without interest to carry out his farm operations.	Subsidies are financial aids in the form of lump sums or as regular allowance paid by government or society to meet part of the cost of communities.
It is always in cash.	It may be either monetary or in kind.
It can be loan from banks, agricultural credit scheme and credit scheme and co-operative society	It can be reduction in prices of input like fertilizer, agro chemicals like lime, improved seedlings and cassava stems.

7.9 Meaning of Capital Market

The capital markets are financial institutions that deal with medium- and long-term financing of agricultural business. The loans given are usually for more than 2 years. However, unlike capital market, the money market is a financial institution that provides short-term finances. They attend to short-term borrowers and lenders together.
The borrowing term lasts from few months to 2 years. Financial institutions that operate on the money market are:
â—† Commercial banks or joint stock banks
â—† The Central Bank
â—† Merchant banks or acceptable finance houses
â—† Discount houses
â—† Finance companies

â—† Hire purchase companies
They use financial instruments to transfer money from the lenders to the borrowers in the form of treasury bills, treasury certificates, bills of exchange and money at call.

7.10 Institutions That Are Involved in the Capital Market

The following institutions are involved in the capital market:
â—† Commercial banks
â—† Mortgage banks
â—† Nigerian agricultural banks
â—† Co-operative and Rural Development Banks (NACRDB)
â—† Insurance companies
â—† Development banks
â—† Finance co-operation
â—† The stock exchange

7.11
Sources of Fund for the Capital Market

Financial instruments used are as follows:
â—† Bonds (company bond and government bond)
â—† Stock exchange (sales and purchase of share)
â—† Insurance companies
â—† Merchant banks

7.12 The Role of Capital Market in the Development of Agribusiness

The stock exchange market: The stock market or Equity market is a highly organized capital market which provides facilities for buying and selling of securities such as shares, stocks, debenture and government bonds. It comprises a loose network of economic transaction and not a physical facility or discrete entity for trading of company stock at an agreed price. The stock exchange is principally concerned with the creation of market or second hand securities. The stock are listed and traded on the stock exchange floor. A very good example of a stock exchange in West Africa is the Nigerian Stock Exchange which was incorporated in 1960. The principal dealers in the stock exchange are the:
i. Brokers
ii. Jobbers
â—† **Brokers** act as agents of individual or firm who wish to sell or buy securities. The public does not operate directly in the Stock Exchange. The brokers sell and buy securities on behalf of their clients or customers. They charge commission for performing the service.
â—† **The Jobbers** are the main dealers in stock, share and other form of securities. They transact business with brokers and have no direct dealing with public. They have two prices, a lower price for buying and a higher price for selling. They aim â€˜marginâ€™ or jobbers turn. The public sells securities to or buys from them through brokers. Some of the companies quoted in the stock exchange in Nigeria under agriculture:
1. Agro Allied are:
(a) Ellsh lake Plc
(b) FTN Cocoa processing Plc
(c) Livestock feeds Plc
(d) Okomu oil palm Plc
(e) PRESCO Plc

Roles of capital market: The roles of the capital market in agricultural development include:
â—† **Provision of loan:** o provide medium- and long-term loans to prospective investors in the

area of agricultural projects.
â—† **Technical and financial advice:** They offer technical and financial advice to potential investors in various sectors of the economy. They can therefore advice investors on how best to carry out their business operations.
â—† **Conduct studies on the economy:** They usually carry out detailed studies of the economy to be able to identify obstacles to economic progress in their various areas of endeavour and provide solutions to them.
â—† **Compensation to insurance companies:** They encourage the growth of business and its expansion by agreeing to indemnify (compensate against certain losses).
â—† **Provision of capital:** They help in raising capital for agricultural projects. This is done by bringing together the funds of large number of investors (insecurities) and making them available to firms.
â—† **Funding new projects:** They help to fund new agricultural ventures in which new investors can invest their money.
ACTIVITY
â—† **Administrative efficiency:** They help in raising the administrative efficiency of companies by quoting only companies with comparatively high degree of efficiency in business.
â—† **Mandating banks:** The stock exchange urges banks in the country to encourage the small- and medium-scale enterprises to list their share in the exchange. Through this agricultural sectors can raise money.
â—† **Dynamics of economy:** It has been shown that the price of shares and other assets is an important part of the dynamics of economic activity and can influence or be an indicator of social mood.
â—† **Clearing house:** Exchange also acts as the clearing house for each transaction, meaning that they collect and deliver the shares and guarantee payment to the seller of a security.

ACTIVITY
Take a trip to any stock exchange centre. Allow students to observe trading section and other transactions carried out on the floor. Record your observations for class discussion.

REVISION QUESTIONS
1. (a) What is agricultural financing?
(b) List four sources of farm financing.
2. (a) What are the differences between
    (i) Short-term loans
    (ii) Medium-term loans
    (iii) Long-term loans
    (b) Name five sources of credit to the farmers.
    (c) Differentiate between credits and subsidies.
3. (a) Mention four problems militating against a farmer in securing loan.
(b) Mention three problems militating against banks and organizations in granting loan to farmers.
4. (a) Define capital market.
(b) List five institutions involved in the capital market.
5. (a) List five sources of funds for the capital market.
(b) State two roles which the capital market plays in agricultural business.

OBJECTIVE QUESTIONS
1. Farm financing may be obtained from the following except
(a) commercial banks.
(b) savings and thrift societies.

(c) agricultural insurance scheme.
(d) central bank.

2. When granting loans to farmers, the credit officer should consider mostly
(a) age of the farmer.
(b) consumption needs of the farmer.
(c) the production and prospect of the farm.
(d) experience of the farmer.

3. The source of farm credit which is interest free is
(a) money lender.
(b) commercial bank.
(c) self-financing.
(d) agricultural and co-operative bank.

4. Which of the following constitute subsidy in agricultural enterprise?
(a) borrowing of money from thrift society.
(b) supply of fertilizers to farmers.
(c) provision of money to farmers through commercial banks.
(d) provision of loans.

5. Capital markets are financial institutions that
(a) deal with medium- and long-term financing.
(b) charge interest on loan.
(c) give money to farmers.
(d) supervise farming project.

6. Source of fund for capital market consists of
(a) giving loan and interest to farmers.
(b) provision of collateral securities.
(c) shares and bonds.
(d) supply of fertilizers and chemicals.

7. The following institutions are involved in capital market except
(a) commercial banks.
(b) insurance companies.
(c) development banks.
(d) Nigerian standard organisation.

Answers to Objective Questions

1. d 2. c 3. c 4. b
5. a 6. c 7. d