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Policy Briefing

THE JOHN A. KUFUOR FOUNDATION
Leadership · Governance · Development

FINANCING RICE VALE CHAIN IN NIGERIA: POLICY OPTIONS

Summary:
This policy brief assesses the pressing demand for access to finance and suggests actions that could be useful in mitigating the challenge facing rice value chain actors in Nigeria. The brief recommends the formulation of policies and strategies governing the establishment of Warehouse Receipt Systems in Nigeria as well as the integration of financial literacy in extension services to stimulate productivity and mitigate credit risk.

1. INTRODUCTION

Nigeria, almost food self-sufficient in the 1960s, has become a food-deficit country importing large quantities of foods. In 2010, the value of Nigeria's imports of food and beverages was EUR 2.974 million (NBS, 2011). About 85 per cent of Nigeria's total land area is agricultural land (78.5 million hectares) out of which 39.5 million ha is arable. Of the arable land, only 60 per cent has so far been cultivated.lack of access to finance among value chain actors have immensely contributed to the sector dwindling fortunes.

Rice is a major staple food in Nigeria. Due to its large population, Nigeria is also the region's largest consumer of rice in absolute terms. The country's estimated annual demand for milled rice is 5.2 million tonnes, while the average national production is 3.3 million tonnes. The supply and demand gap of 1.9 million tonnes can only be bridged by importing rice. Nigeria's rice processing capacity is 2.8 million tonnes of paddy (JICA, 2013)[1]
Increasing rice production in Nigeria for that matter, cannot be overlooked.

"The possibility of expanding the area to meet the rising demand however, is limited, due to the inadequate access to finance among rice value chain actors".

A recent study conducted by the JAK Foundation confirmed that: access to finance remains the number one priority need among all the major actors long the rice value chain thus constraining the sector ability to optimise its potential.[2]

This policy brief has the following objectives:

- Assess the demand for Finance within the Rice Value Chain in Nigeria
- Analyse a number of innovative approaches that have been shown to overcome constraints to financing the rice value chain
- Suggest actions and the attendant implications the Government of Nigeria and development partners (including the JAK Foundation) can undertake to create access to finance among rice value chain actor

2. DEMAND FOR FINANCE WITHIN THE RICE VALUE CHAIN IN NIGERIA

2.1. Input Dealers

There are opportunities for the agro-input dealer business to thrive in the Nigerian rice value

[1] Status of NRDS Implementation in Nigeria, Presentation at the Fifth General Meeting of CARD, 5-6 February 2013, Dakar, Senegal

[2] For the full report see JAK Foundation, Prioritization of Policy Areas for Private Sector and Evidence Based Policy Papers and Guidelines for selected private sector priority areas

chain, due to increased demand for rice. Input dealers on the contrary, are unable to meet the demand of producers/farmers in terms availability and cost of products. Agro Input dealers' access to finance in terms of cash and or credit (products) is essential in optimizing the agricultural and financial cycles. For example input dealers can purchase or acquire and stock inputs in adequate amounts and at the right time and provide these on credit to farmers at reasonable cost without suffering losses.

2.2. Producers/ Farmers

Producers or farmers require funding to cover production costs: labour, seeds, fertilisers, herbicides, pesticides, irrigation, and transport. Rice farming is characterised by periodic income after harvest, whereas production costs and other private expenses are incurred throughout the season.

The right financing at the right time means greater efficiency, improved product quality and increased incomes. Due to lack of access to finance in terms of savings and credit, Rice farmers in Nigeria are forced to sell produce immediately after harvesting when price is very low. This keeps rice farmers in low-investment/low-productivity agricultural operations.

2.3. Farmer Based Organisations (FBOs)

Farmer Based Organizations (FBOs) have a critical role in the rice value chain. Given access to capital, FBOs could buy farm inputs for distribution to farmers, buy produce from farmers for delivery to traders or other off-takers as well as facilitate term of loans for investment in storage, transport and (pre)processing facilities. A recent study conducted by JAK Foundation in Nigeria[3], corroborated the above as producers/farmers' expectations of FBOs. FBOs are however, constrained in providing these useful services due to lack of finance.

2.4. Processors/ Millers

Processors and millers have had their challenges compounded with the current spate of erratic power supply in Nigeria. The need to acquire alternative sources for power such as using power generators for milling has become indispensable. Moreover, Processors/Millers require capital to buy agricultural produce, term loans for investment in processing facilities as well as Insurance to take care of rampant unpredictable calamities, theft and or loss.

2.5. Aggregators/Marketers

Aggregators require working capital to buy rice produce. Capital or term loans for investment in storage facilities, transportation, equipment and insurance. Similarly, Marketers also require access to finance to buy processed produce. Working capital to provide stock finance to retailers. Capital or term loans for investment in storage facilities, transportation and equipment.

3. POLICY ALTERNATIVES FOR FINANCING THE RICE VALUE CHAIN IN NIGERIA

Over the years, numerous initiatives have been taken to improve the provision of agricultural finance through a variety of financial services. It must be noted that most "innovations" are not necessarily new, as some date back decades and in some cases even centuries. What is new, however, is agricultural financing in new environments and circumstances and for different category of farmers who hitherto, were oblivious of such alternatives. Some of the major financial innovations and the key factors of success for their implementation are discussed below. These innovations tackle specific constraints in agricultural finance and reduce lending risks.

3.1. Warehouse Receipt Finance

The Warehouse receipt finance is a process where producers deliver the grains to a certified and secured elevator for storage. The farmer subsequently hands

[3] Ibid

the warehouse receipt to the bank as collateral for credit — often 70%-80% of the value in storage[4]. Upon selling the product, the farmer notifies the bank, which obtains repayment from the buyer in return for the warehouse receipt. The buyer now presents the receipt to the warehouse to retrieve the product.

The bank transfers the balance (minus the loan amount + interest) to the farmer[5]. Default rates in warehouse receipt finance tend to be low — the borrower (producer) repays the loan with earnings from the sale of the product.

Warehouse receipt finance is practiced in the rice sector. In Latin America, and notably in Brazil and Mexico, warehouse receipt finance of cereals is well-known, and some banks own warehouse infrastructure[6]. The practice of Warehouse receipt financing is rapidly increasing in Eastern Africa — for example in Tanzania for rice, coffee, cashew, maize, sesame and pepper.

In 2002, the IFAD-funded Agricultural Marketing Systems Development Programme (AMSDP) introduced the Inventory Credit Scheme through the Warehouse Receipt System (WRS) for cereals (maize and paddy) in 11 districts[7] of Tanzania.

"The introduction of the WRS led to an increase in farm gate prices up to 300 per cent[8]. This led to an immediate and positive impact on farmers' income".

Again, the WRS scheme enabled farmers to improve the quality and increase the quantity of their produce and access financial services and loans[9]. WRS also contributed to the enactment of the Warehouse Receipt Act and the establishment of the Tanzania Warehouse Licensing Board. The practice is much less developed in West Africa, with Nigeria as the main exception. The practice in Nigeria, however, is common with maize and not the rice value chain.

[4] Warehouse receipts are "documents issued by warehouse operators as evidence that specified commodities, of stated quantity and quality, have been deposited at particular locations by named depositors" (Onumah, 2003). The form of the receipt depends on local regulations, and consists in some legal systems of two documents: a certificate of title and a certificate of pledge.
In Latin America, the documents used are (1) the warehouse receipt itself, confirming that the produce was received in storage; and (2) a warrant or chattel bond that represents ownership of the crop.

[5] Two possibilities: (1) the buyer pays the full amount to the bank, which pays the balance to the farmer; or (2) the buyer pays the bank the loan amount + interest due, and the rest to the farmer.

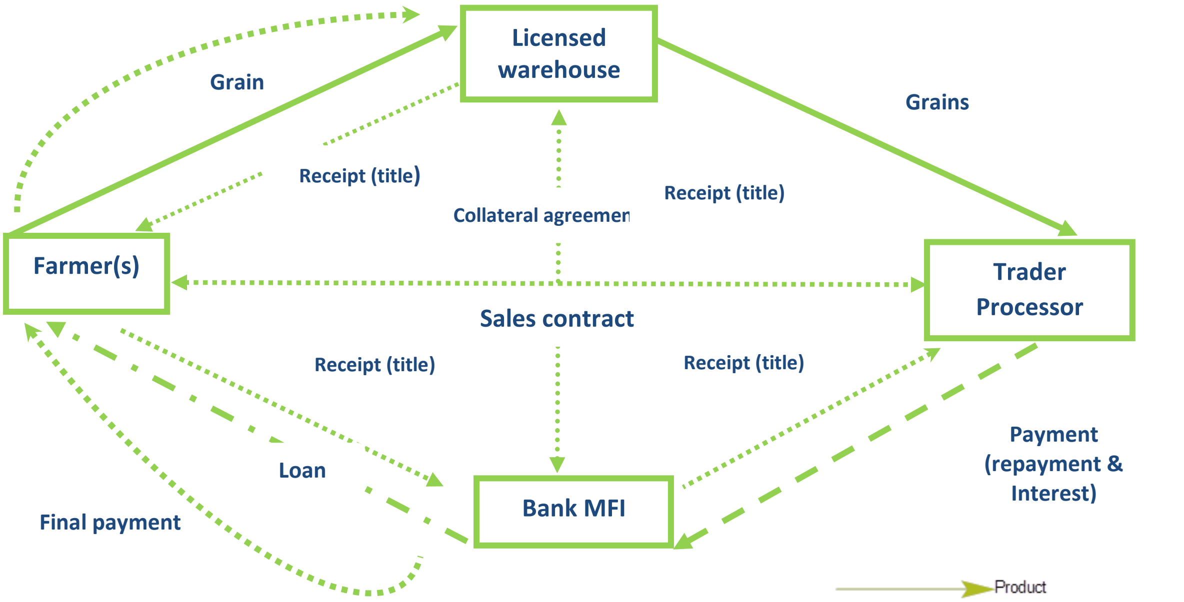
[6] "Financial Entities and Agricultural Value Chains", Agricultural Value Chain Finance Conference, Costa Rica.

[7] IFAD, Independent Office of Evaluation (2011). Rural Financial Services Programme and Agriculture Marketing Systems Development Programme. Interim Evaluation. p. 17.

[8] Ibid. p. 34.

[9] IFAD and The United Republic of Tanzania Prime Minister's Office (2010). Agricultural Marketing Systems Development Programme. Completion Report. p.V.

FIG 1: Warehouse receipt finance



Source: Triodos Facet value chain Finance Course

Box 1: IFAD, Independent Office of Evaluation (2011). Rural Financial Services Programme and Agriculture Marketing Systems Development Programme. Interim Evaluation.

In 2002, the IFAD-funded AMSDP introduced the Inventory Credit Scheme through the Warehouse Receipt System (WRS) for cereals (maize and paddy) in 11 districts1 of the country. Under this scheme, small-scale farmers were able to store their produce in warehouses during harvest, when prices are relatively low, and release them to the market at better prices during periods of low supply. To meet farmers' immediate financial needs while they deferred their incomes, the programme enabled them to access finance from commercial banks through Savings and Credit Co-operative Societies (SACCOS).

The role of the SACCOS is to mediate and provide guarantees to banks on behalf of farmers. As household incomes improved (due to the increase of farm gate prices by 200-300 per cent), the WRS also had other positive outcomes. For example, in the programme areas, access to education and health improved and some communities were able to build new and modern housing, as well as purchase motorcycles and bicycles to ease transportation problems. The programme also increased women's participation in SACCOS and promoted collective bargaining and selling among the farmers and farmer groups.
Results

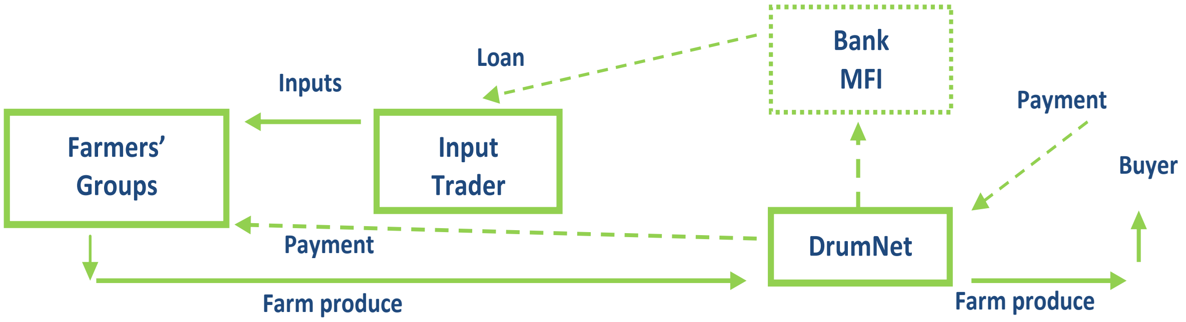
- After the WRS was introduced, farm gate prices increased up to 300 per cent. This led to an immediate and positive impact on farmers' income.
- The WRS scheme enabled farmers to improve the quality and increase the quantity of their produce and access financial services and loans.3
- Business relations between banks, SACCOS and smallholder farmers were strengthened, resulting in more favourable loan terms for agricultural producers; interest rates for commercial loans were reduced from 20 per cent to 13 per cent.
- Introducing the WRS in the pilot areas created employment in various activities related to the warehouse system, such as transportation, dusting and security.
- AMSDP contributed to the enactment of the Warehouse Receipt Act and the establishment of the Tanzania

3.2 Value chain intermediation

The World Bank (2005)[10] presents a special type of value chain finance where an intermediary, which is not itself a value chain partner, facilitates the process for all parties. DrumNet[11] Kenya has developed a technology platform allowing it to act as an intermediary between finance providers, farmers, input suppliers, and buyers. It combines elements of value chain finance and microfinance.

The main objective of DrumNet is to simultaneously address credit and market limitations by integrating both into one approach.

FIG 2: Value Chain Intermediation



Source: CAMPAIGNE, J. and T. RAUSCH (2010), "The experience of DrumNet"

The programme has two features: i) Cashless microfinance; and ii) An integrated marketing and payment system. Farmers organised into farmers' groups sign a supply contract with a buyer, which could be an (export) trader, supermarket or agro-processor. Usually, DrumNet negotiates the contract on the farmers' behalf.

The price and supply conditions are set. With the contract in hand, the farmers' group obtains financing from a bank or Microfinance Institution (MFI). The bank or MFI disburses the money to certified input retailers (with agreed upon quality standards), who release the inputs to the farmers. At harvest, the product is certified and sent to the buyer, which triggers a payment in favour of DrumNet. DrumNet then pays off the bank and gives the remainder (minus its fees) to the farmers.

This is essentially contract financing, but with the innovation that an independent party sits in the middle, and manages the process through a master contract. The fact that farmers receive their loans in kind and that the loan repayment is withheld from harvest receipts reduces risk to the bank. Transaction costs are reduced via Drumnet, which aggregates financing, technical advice, input supply and marketing. Risk is also reduced due to technical advice and access to premium markets.

3.3 Extension services and financial literacy

Little literature exists on the link between extension services and agricultural finance. For many years, the key paradigm was that financial and non-financial services needed to be separated. This paradigm has recently been challenged. The generally low level of education and technical know-how of farmers is one of the main reasons why banks decline to finance agriculture.

[10] WORLD BANK (2005), Rural Finance Innovations – Topics and Case Studies (DrumNet), World Bank, Washington, D.C.
[11] DrumNet is a third party supply chain management company which facilitates the extension of credit to and the management of transactions for small scale farm producers in Eastern Africa

Box 2: PROMIFIN Project in Central America

The PROMIFIN Project in Central America executed by Triodos Facet and financed by the Swiss government conducted 3,210 financial education seminars for 23,485 people. It involved 45 MFIs and cooperatives in Nicaragua and Honduras (until 2011). An impact assessment of the project showed that those who participated had, compared to non-participants, four times higher savings. Due to better money management (fewer unnecessary expenses and more savings) investment in income-generating activities increased, and so did incomes. Consequently, indicators of family well-being (access to food, health, and education) improved. Research also showed that spouses actively discussed and collaborated in the management of family finances, whereas this had not been the case before. Misuse of money by (mostly male) family members was greatly reduced

Source: AFD (2012), Creating Access to Agricultural Finance

Farmers, and smallholders in particular, generate little cash, and even when they do, they may not be able to provide the documentation to convince bankers that this is so. Research undertaken in Moldova (EFSE, 2010) found a strong correlation between farm performance (increase in production and profits) and the use of extension services provided by the regional branches of the Ministry of Agriculture. Naturally, the farms' repayment capacity will have increased as well. In recognition of this finding, some banks in Moldova oblige their agricultural clients to seek government-subsidised extension services.

Research in India (Mahajan, 2010) found that credit to poor farmers has little impact on their income, hence levels of poverty. However, when combined with extension services and input supply for productivity enhancement, risk mitigation (through insurance), education and market development, the results were much better. It was found that farmers are willing to pay for these services. Farmers preferred cost-saving and risk-reducing solutions over yield-enhancing technology that requires investment.

4. RECOMMENDATIONS

To the Government:

- Formulate policies and strategies for the establishment of Warehouse Receipt System in Nigeria. The strategy should ensure strong participation of private value chain actors including umbrella bodies and financial institutions. Draw on best practices in other emerging markets to ensure a robust and self-sustaining systems
- Establish easy accessible funding mechanism for the grains/crop sub-sector in partnership with CSOs in agriculture, including umbrella bodies, commodity traders, input dealers, equipment service providers and financial institution to facilitate the flow of fund to the rice sector.
- Integrate extension services, financial literacy and access to finance schemes to stimulate productivity and mitigate credit risk

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