Policy Brief
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Unlocking Affordable Financing for Agricultural Mechanisation

Stimulating Growth through Improved Access to Credit Risk Guarantees (CRGs)

Recommendations to improve access to CRGs.

The Federal Government, through the Central Bank and NIRSAL, should:

- Promote information sharing and transparency through internal restructuring and improved inter and intra communication and coordination.
- Improve wide-spread knowledge on the selection and evaluation criteria to access CRGs.
- Review and increase the limit on quantity of tractors covered by CRGs.
- Consider diversifying the channels for agricultural lending risk-sharing.

The transformative power of mechanisation to agricultural productivity and food security in Nigeria cannot be overemphasised. The use of mechanical power in crop production offers exponential benefits to farmers compared to human labour, generating an estimated NGN35,143 in cost savings and about three hours in time savings per hectare compared to five days required for human labour.[1] The time and cost savings along with increased precision of farming and land utilisation generate productivity gains that transform the lives of millions of farmers and rural families by increasing incomes, improving livelihoods, reducing poverty levels. However, the level of mechanisation in Nigeria remains low with limited access to required machinery such as tractors. Tractors continue to be the primary focus of government and much of the private sector as an entry point to developing mechanisation given its versatile nature and availability of diverse implements that are applicable in all areas of farm operations. With only 5,000 functional tractors equating to 6.8 functional tractors per 100 kilometres, tractor supply is grossly

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insufficient when compared to the global average of 200 functional tractors per 100 kilometres and 11, 27, and 43 tractors per 100 kilometres in Ghana, Kenya, and South Africa respectively.[2] On the basis of average global farm mechanisation levels, Nigeria currently has a short fall of 188 tractors per 10,000ha, indicating a gross shortfall of 639,200 tractors required to mechanise the 80 million hectares of arable land (37 million of which is currently under cultivation) in the country.[3]

What is the problem?

Access to affordable financing is the single most

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critical factor to scaling up the agricultural mechanisation services sector in Nigeria. Government policy has so far addressed this problem through the Nigeria Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL) by structuring a 75% credit risk guarantee (CRG) to unlock lending for mechanisation investments. The introduction of government backed CRGs catalysed the development of tractor financing products by some commercial banks and financing of close to 1,000 tractors for commercial providers of mechanisation services. However, NIRSAL's CRGs are reputedly difficult to access and lending for mechanisation investments has remained constrained by persisting financial and non-financial sector risk aversion to such high-risk investments with limited access to the reliable risk-hedge which the guarantees present. Willingness to provide a line of credit to mechanisation service providers who invest in tractors is deterred by low machinery utilisation rates, which result in unattractive cashflows and raise bank concerns about profitability and borrowers' ability to repay loans. The practice of single season cropping in Nigeria also means that tractors must be used over long periods to make mechanisation loans serviceable. Consequently, high risk profiles are attached to mechanisation investments and this risk aversion is demonstrated through high interest rates on agricultural loans ranging between 23 to 25 percent. Even in instances where government agriculture intervention programmes allow banks to access loans at 6% and offer it at 9% for the acquisition of machineries, many banks are reluctant to access this financing on behalf of their customers given that the funds are not covered by any guarantees, thus, leaving the banks to bear all the risk.

The lending challenge is further complicated by new realities in the market which have heightened financial sector risk aversion and deepened difficulties with accessing credit, thereby making access to CRGs vital now more than ever. An emerging complication is the exponential increase in the cost of tractors by as high as 77 percent (from approximately NGN 11 million in 2019 to NGN 16 million in 2020 for 75HP tractors depending on the brand) due to a weakened Naira. This has significantly eroded the return on investment to tractor acquisitions for Mechanisation Service Providers (MSPs), who typically utilise their tractors for a maximum of 100 days per annum at NGN 75,000 per day. Financiers and non-financial sector investors have in turn become more unenthusiastic, with the now exorbitant cost of tractors depressing traditionally projected Return on Investment (ROI) and payback periods, economic uncertainty caused by the COVID-19 pandemic, and an expected economic recession. Borrowers seeking financing for mechanisation assets now face reduced loan tenures of up to 2 years from 4 years and at prevailing high interest rates, making debt-financing untenable without a corresponding increase in the fees charged to farmers for tractor services.

CRGs have become pivotal to facilitating access to credit for capital intensive agricultural machinery, such as tractors, from both traditional and non-traditional sources. Commercial banks facing increased risks with the exponential increase in investment cost of tractors will not provide loans without a CRG from NIRSAL. Equipment vendors, although now open to alternative financing arrangements such as lease financing, also insist on a credit guarantee or equity contributions as high as 40 percent in lieu of a guarantee. Evidently, every route to increasing the stock of tractors and scaling up mechanisation services depends on accessing credit guarantee from NIRSAL, which with access difficulties and limited alternatives have become a supply-side bottleneck to agricultural financing.

Why does the problem persist?

The difficulty in accessing CRGs is attributed to a lack of clarity on the evaluation metrics and selection criteria for obtaining CRGs. The result is perceived politicisation of access, increasing financial sector skepticism of NIRSAL's integrity to honour CRGs and lack of confidence in the instrument. This, along with concerns about the effectiveness of the judicial system as a legal recourse if a CRG is not honoured, has led commercial banks to require additional securities as a prerequisite for lending even where a CRG has been obtained from NIRSAL. Furthermore, funds for CRGs from NIRSAL reportedly only cover a specified number of tractors, necessitating high level of lobbying.

Conversely, NIRSAL alludes to poor financial sector understanding of and compliance with the appropriate CRG expression of interest process as the primary cause of the access challenge, citing procedural failures such as commercial banks inadequately executing their role as middlemen by advising private sector enterprises to approach NIRSAL directly.

The disconnect between NIRSAL and other stakeholders is apparent and has necessarily compromised NIRSAL's ability to fulfil the purpose for which it was created. In its current form, the role of CRGs in minimising information asymmetry and the need for high collaterals is farfetched in Nigeria.

Evidence from other countries reveal successful implementation of government-led credit guarantee schemes. For instance, the partial credit guarantee funds by the government of Chile, resulting in a 40 percent increase in the volume of credit; and Slovenia small business development fund, which was later privatised, attracting private capital. These successes were hinged on 3 key factors:

- A strong regulatory and supervisory system.
- Transparency and fairness – for example guarantees are allocated to financial institutions through sealed bid auction.
- An intensive publicity and promotional campaign by the government to explain the utility of the programme.

Also, efforts were made to acquaint commercial banks with the Fund and its policy, and they were invited to join the Fund's committee.

Guarantee schemes outside public guarantee schemes seem more readily available outside Nigeria. For instance, the Korean Technology Credit Guarantee funds, KOTEC, is a non-profit guaranteeing institution; mutual guarantee schemes, corporate guarantee schemes as well as international schemes implemented by bi- and multilateral governments like the European Investment funds, the ILO, and USAID. In-country, the USAID Development Credit Authority (DCA) has been used to stimulate on-lending, albeit targeted at the health sector, it has had limited reach and use as commercial banks find the requirements and the partial guarantees unattractive. The role of these types of guarantees, when adapted to fit the Nigerian business environment, has the potential to stimulate sector growth through credit additionality, economic additionality, and financial sustainability.

A decade of evolving government policies in mechanisation

The Agricultural Transformation Agenda (2011-2015).

- Zero-tariffs (custom, exercise, and value added) for import of agricultural equipment and agro-processing equipment.
- Consolidate establishment of private service providers of mechanised operations to overcome labour constraints for farmers.

The Agriculture Promotion Policy (2016-2020).

- Promote private-sector-led mechanisation services and cooperative solutions for private sector-led tractor hiring system.
- Stimulate domestic production of equipment linked with complementary targeted import and standardisation of agro-technology.
- Work with the relevant commercial institutions (especially Banks) to make mechanisation funds available and accessible to private sector service provision businesses at single digit interest rates and longer repayment tenure.
- Avoid government direct purchase and distribution of tractors to farmers.

Programmes borne from these policies include:

1. The Growth Enhancement Support Scheme aimed to provide direct support to farmers to enable them procure inputs including mechanisation equipment at a subsidised rate.
2. The National Centre for Agricultural Mechanisation (NCAM) established to accelerate the pace of agricultural mechanisation through research, design, and development and commercialisaton of machinery and equipment and training value chain actors amongst other things.
3. The Agricultural Equipment Hiring Enterprise Programme (AEHE) sets up centers to provide access to agricultural equipment, maintenance services and training.
4. The commercial Agriculture Credit Scheme to fast-track development of the agricultural sector by providing credit facilities to commercial agricultural enterprises at a single digit interest rates – e.g., 9% as opposed to commercial bank loans of 25%.
5. The Anchor Borrowers Scheme to create economic linkages between smallholder farmers and large-scale processors by providing single digit working capital loans to the latter for purchase of farm output.
6. The Nigerian Incentive-based Risk-sharing System for Agricultural Lending (NIRSAL) created to facilitate to enable the flow of affordable financing to players along agricultural value chains by reducing the risks of financing institutions in granting agricultural loans.

Implications for the Agriculture Sector

Difficulties in accessing CRGs inevitably impede financial sector lending to the agriculture sector with strongly negative implications for high capital investments, such as agricultural mechanisation.

The continued disconnect between NIRSAL and the financial institutions inherently limits availability of tractors per time, making the attainment of the desired 639,200 tractors required to mechanise Nigeria an illusion.

More importantly, this limits the growth of the mechanisation sector and loss of the associated productivity gains for the over 80 million farming population who are unable to access the equipment/services. Moreover, the additionalities are also lost in the process.

Recommended Actions

To get the existing vehicle to more effectively serve the purpose for which it was created:

1. **NIRSAL needs to promote transparency in information sharing.** This can be achieved through internal capacity restructuring and enhanced coordination and communication within NIRSAL and between NIRSAL and commercial banks.
2. **There should be wide-spread information dissemination** on the selection and/ or evaluation criteria, with possible trainings organised for personnel of the commercial banks.
3. **Review the cap to the number of tractors covered by CRGs.** The Central Bank of Nigeria, and by extension NIRSAL, should devise a more systematic approach to increase the fleet of tractors available for mechanisation and necessary for achieving scale.

Clear roles exist for advocacy from various actors, including FMARD and the private sector to NIRSAL, to resolve the bottlenecks around accessing credit risk guarantees. A starting point could be improving transparency and information sharing on the appropriate procedures, criteria, and evaluation metrics for accessing credit risk guarantees to improve understanding and allay concerns the financial sector has about CRG credibility. Actions may include sending out a circular to financial sector actors through the CBN, publishing detailed information on the agency's website, and conducting financial sector dialogues to build industry understanding of its processes and guidelines. Advocacy to CBN to allow NIRSAL CRGs to be accepted as bank guarantees may also resolve financial sector lack of interest in the instrument.

Other recommendations include diversifying the channels for agricultural lending risk-sharing by involving other organisations such as the Nigeria Agricultural Insurance Corporation (NAIC), private sector organisations, and donor institutions willing to act as guarantors in the agricultural space. However, the vagaries of legally instituting these measures emphasise the need to support NIRSAL to work more effectively in the immediate and long term.

What is Propcom Mai-karfi's Role?

The course of action for PM is commencing advocacy to NIRSAL as outlined above, while also initiating the deliberations on the possibilities of diversifying the sources of CRGs as part of holistic agricultural mechanisation sector policy influencing. The elements of PM's advocacy to Central Bank/NIRSAL include:

- Improved transparency and information sharing on the requirements and comprehensive application process for CRGs to bridge the knowledge gap of the public and stakeholders.
- Facilitating access to CRGs for tractors to MSPs and farmers in the Propcom Mai-Karfi network in accordance with NIRSAL's CRG guidelines and subject to meeting its due diligence criteria of the funding counterparties over the next two years. (2019-2021).
- Active involvement in structuring of Mechanisation Service Providers transactions that will require Credit Risk Guarantee Cover under the Propcom-Mai-Karfi Scheme
- Engagement with NIRSAL and CBN to facilitate budgetary increase for the funds available to NIRSAL for CRG.
- The expected outcome of this engagement is facilitating third party (MSP) access to financing for mechanised agricultural equipment.

References

1. PM Impact Assessment Study 2018
2. World Bank Agribusiness Indicators 2014
3. PM Mechanisation Sector Study 2019