

Sukuk As an Alternative Financing for Small Farmers' Agricultural Development in Nigeria

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ABSTRACT

The agricultural sector occupies a strategic and essential position in Nigerian economic development. The function of the agriculture sector is to improve economic development, provide food security, increase income, alleviate poverty and provide environmental assistance. Nevertheless, this sector's contribution to the country's GDP is small, which stands at 24.18%. Therefore, this study aims to conceptually explore Sukuk's role as an alternative for small farmers in the country. The method adopted by the researchers is the review of the previous literature to assist the study in understanding the role of Sukuk as an alternative for agricultural sector development. One of the problems facing the agricultural sector is the non-availability of financing. Easy access to financing not only assists in enhancing the farmers' productivity but also enhances social indicators in the long run. Consequently, integration between the agricultural sector and the Islamic capital market is necessary. The current study tries to develop a scheme of financing depending on Sukuk Salam, which could be used to develop agriculture. The study, therefore, proposes the Sukuk Salam model that can be utilised to finance small farmers. The novelty of this study depends on the model proposed (i.e. Sukuk Salam financing) for small farmers. Hence, government commitment is profoundly required.

Keywords: Agriculture; Islamic Finance; Sukuk; Salam; Small Farmers.

INTRODUCTION

In the last three decades, Islamic finance has improved immensely in numerous sectors, such as Islamic banks and Shariah-compliant instruments financing. *Sukuk* is one of the innovative products in Islamic finance recently introduced to the world. *Sukuk* is the most significant financial investment instrument for investors to invest their money in the Islamic financial product. In some cases, *Sukuk* is called an Islamic investment certificate or bond. The *Sukuk* market has encountered significant development in recent times. The *Sukuk* market has developed from \$33.606 billion to \$116.771 billion from 2006 to 2017.

Furthermore, this innovative product has likewise given opportunities to numerous non-Muslim countries' issuers to invest in Africa, Asia, and Europe (Paltrinier *et al.*, 2019). The *Sukuk* product appears as a new Islamic financial innovation in the world after the global crisis in terms of finance. Alternatively, *Sukuk* are a means of raising funds to meet the financial needs of the governments, private sectors, and farmers and to enhance socio-economic development (Zulkhibri, 2015).

The Accounting and Auditing Organization for Islamic Finance Institution (AAOIFI) defines *Sukuk* as "certificates of equal value representing undivided shares in ownership of tangible assets, usufruct, and services or of the assets of a particular project or specific investment activity" (AAOIFI, 2018., p. 468). Similarly, the Islamic Financial Services Board (IFSB) defines *Sukuk* as "Certificates that represent proportional undivided ownership right intangible assets, or a pool of tangible assets and other types of assets. These assets could be in a specific project or specific investment activity that is Shariah-compliant" (IFSB, 2018., p. ix). *Sukuk* have special features such as less speculation, less volatility, safe fund, and low trading turnover (AbdulKareem *et al.*, 2021). The table below shows the majority of the countries that contributed to the *Sukuk* market development towards the end year of 2018.

| N/O | Country | percentage |
|-----|---------------------|------------|
| 1 | Malaysia | 62.5% |
| 2 | Saudi Arabia | 9.7% |
| 3 | United Arab Emirate | 7.3% |
| 4 | Indonesia | 6.4% |
| 5 | Bahrain | 2.8% |
| 6 | Qatar | 2.6% |
| 7 | Turkey | 2%) |

Source: IIFM (2018); Qizam and Fong (2019).

Sovereigns, Quasi Sovereign, financial institutions, and corporate organisations have facilitated the improvement of the *Sukuk* market globally. The *Sukuk* market is considered an alternative financing source for governments, banks, financial institutions, projects, businesses, and farmers as secure funding sources (Smaoui & Khawaja, 2017). The expectation is that, via the fast global development of the *Sukuk* market, the Islamic capital market (ICM) could grow to the extent that it can compete with its traditional counterpart. Agriculture is the major occupation in Nigeria. Before the country discovered crude oil, it depended on agriculture and was well known as a giant in exporting cotton, groundnuts, cocoa, redwood, and red oil. At that time, Nigeria and Nigerians enjoyed a lot of stability and peace. People were generally and gainfully employed in the agricultural sector. Much cash was made from the sector, which was utilised to build numerous infrastructural development projects. For instance, refineries, industries, parks, museums, universities, railways, airports, markets, hospitals, and good roads were built. The food was so abundant everywhere and cheap that everyone could bear the cost of food for themselves and their family members (Anucha *et al.*, 2018).

The country must return to agriculture, which will reduce poverty and unemployment (Awoyemi *et al.*, 2017). According to Udih and Odibo (2016), Nigeria and Nigerians have abandoned agriculture, which has impacted the development and growth of the country both in its workforce and economy. Agriculture was neglected for oil/petroleum. More so, Nwankpa (2017) posits that the Nigerian government must revive the agricultural sector so that hunger, poverty, and unemployment among the youth and graduates can be reduced. The author further stated that if the sector is adequately revisited and the government provides funds for the small farmers, not only youths will go back to agriculture but will attract foreign investors to invest, enhancing the country's economy.

The country is the most highly populated in Africa, representing approximately 47% of the entire West African population, with a landmass of 923,773 km² (Zabbey *et al.*, 2017). Nigeria is posturing to participate in the growth of ICM as well as the opportunities made available by the *Sukuk* products. Via the Central Bank of Nigeria (CBN) and the Debt Management Office (DMO), the Nigerian Federal Government (NFG) has taken a significant move by proposing a draft of the *Sukuk* Act in the country. The reason behind this movement is to accelerate the improvement of *Sukuk* instruments and ICM in the country. Likewise, the *Sukuk* is expected to become a significant means of fundraising that could fit into the country's

investment opportunities. Hence, the government deserves more investment, especially in sectors like agriculture and others, to ameliorate the country's unemployment and poverty problems (Titiloye *et al.*, 2018). The country is blessed with immense agricultural potential. According to the Food and Agricultural Organization (FAO), “agriculture remains the base of the Nigeria economy, providing the main source of livelihood of most Nigerians”.

However, the agricultural sector in the country faces numerous constraints preventing the utilisation of its potential, among which are poor access to funds, distribution of fertilisers, inefficient procurement, inadequate storage facilities, etc. (Oginni, 2019; Jones *et al.*, 2017). Therefore, integrating the Capital Market with the economic sectors is deemed for the country's good. The present investigation examines the significance of integrating the ICM with the most sensitive and crucial sector of the Nigerian economy (i.e. the agricultural sector) using the *Sukuk* instruments. *Sukuk* instrument innovation based on the agricultural development financing scheme becomes necessary in the country. The study proposes the *Sukuk Salam* model for financing small farmers' agricultural development in Nigeria. An effective way to develop greater productivity in the agricultural segment is by granting the farmers access to funds via Islamic finance products.

OVERVIEW OF THE AGRICULTURAL SECTOR IN NIGERIA AND ITS ECONOMIC DEVELOPMENT

Nigeria is a country located in the West African region, bordered by the Republic of Niger toward the North, the Republic of Chad toward the North East, the Republic of Cameroon toward the East, the Republic of Benin toward the West, and the Atlantic Ocean toward the South. It has a landmass of 923,773 km² (Aluede, 2017). Nigeria comprises 36 States and a Federal Capital Territory (FCT) known as Abuja (Balogun, 2013). The climate of the country is significantly suitable and fit for agriculture. The agricultural segment has played and continues to play an essential role in Nigeria's economic development and growth (Uchechi & Enemona, 2020).

According to Sertoglu *et al.* (2017), Nigeria is bestowed with an assortment of vegetation, viable agro-climatological conditions, and dynamic topography. The country is one of the few in Africa blessed with great arable farmland for agricultural development activities. Furthermore, four (4) sectors in Nigeria contribute to economic development and growth, such as services, petroleum/oil, manufacturing, and agriculture (Olukunle, 2013). The agriculture sector has numerous other sub-sectors in Nigeria, such as fishery, forestry, livestock, and crop production. Crop production remains the most extensive section, accounting for about 87.6% of the

segment's total output. This is followed by livestock at 8.1%, fishing at 3.2%, and forestry at 1.1%. The agricultural sector continues to be the most significant contributor to the average Nigerian Gross Domestic Product (GDP), about 24% from 2013 to 2019. More so, agriculture employs more than 36% of the Nigerian labour force, an accomplishment that ranks the sector as the biggest employer of labour in the country.

This sector creates employment opportunities and raw materials for several agro-allied industries (Sertoglu *et al.*, 2017). Anucha *et al.* (2018) stated that the agricultural sector has the highest contribution to the GDP with a share of 22% of GDP, while petroleum/oil, 14%, service 9%, and manufacturing 7% of the GDP as of 2013. In 2014, the US Department of State asserted that construction, finance, telecommunication, and service contributed about 52% of the GDP; in 2016, the agriculture sector contributed approximately 24.18% of Nigeria's GDP more than manufacturing and petroleum/oil combined (CBN, 2019). Hence, it is clear that agriculture is essential to developing and reviving the Nigerian economy, which has not done well at present due to a lack of financing for farmers to invest in their farms.

According to Ayeomoni and Aladejana (2016), agriculture essentially has a wide dimension. This sector can be divided into two sections based on the business scale dimension. That is, small-scale agriculture is operated mainly by smallholder farmers who do not have adequate working capital and medium- and large-scale agriculture is owned and managed by bigger organisations or farmers. This second section mostly has sufficient working capital. A large portion of the labour force working in the agricultural sector in Nigeria belongs to the first classification. This class of farmers uses a small space of land for their farms, which is inefficient. Sabo *et al.* (2017) state that more than 88% of Nigerian farmers are considered smallholder farmers. These small farmers are viewed as individuals with landholdings of under 10 hectares.

These farmers make up 80 to 88% of Nigeria's farming populace and are responsible for 80% to 90% of food production in the country. However, they are the poorest people in Nigeria (Mgbenka & Mbah, 2016). Girei *et al.* (2018) document that the major issues facing the agricultural sector in Nigeria, especially the small-scale type, which encompasses animal husbandry, fishery, and forestry, is a lack of easy access to financing and difficulty in marketing farm produce. Sources of financing are required to increase production. These sources act as a form of investment and working capital (Udemezue & Kanu, 2019).

The growth and development of agriculture in Nigeria have documented that credit facilities constitute a significant source of financing that has played a crucial role. Since the initiation of development in agriculture in Nigeria, it has been mostly financed by financial institutions and the government as part of packaged development. Such a package has been of numerous benefits to smallholder farmers. The package has equally made extra capital available to farmers for production, thereby lowering farmers' dependence on money lenders that charge a high-interest rate that eventually burdens farmers—such a burden traps farmers in perpetual poverty, which is detrimental to the development of agriculture. Nonetheless, accessing credit facilities for agricultural financing is still limited (Marshall *et al.*, 2020; Afolabi *et al.*, 2021). Besides, to increase agriculture, the government should give special incentives to the farmers by providing sufficient funding and provide infrastructural facilities such as electricity, pipe-borne water, and good roads (Ayeomoni & Aladejana, 2016). In line with the National Bureau of Statistics (NBS), the credit facility given to the agricultural sector in Nigeria ranges between 3.26% and 3.36% of the total credit given to the private sector in 2016 and 2017, respectively. To increase productivity via the Agricultural Credit Guarantee Scheme (ACGSF) Amendment Act approved by Muhammadu Buhari, President of Nigeria, the federal government increased the credit fund from 3 billion to 50 billion nairas. The increment is because it was established that the agricultural sector receives the lowest credit facility from the banks compared to other sectors. Meanwhile, the agricultural sector contributes more to the Nigerian GDP than the other sectors (Nevin *et al.*, 2019; Osabohien *et al.*, 2020).

SIGNIFICANCE OF BAY *SALAM* ON ECONOMIC DEVELOPMENT

Bay *Salam* is an agreement that depends on a forward sale concept (Meutia *et al.*, 2018). *Salam* indicates a future contract. Technically, a *Salam* contract is a contract between the buyer and the seller in which the seller takes the responsibility of delivering goods to the buyer at a future date and, in return, fully pays the price at the session of the contract (Ajmal *et al.*, 2017). The *Salam* contract is a financing model that is suitable for agricultural development. Farmers get the fund as a down payment or initial payment for agrarian products instated in quality and quantity between contracting parties (Hudaifah *et al.*, 2019).

Furthermore, *Salam* is considered the most suitable Islamic Financing Product for the agricultural sector compared with other similar products (ISRA, 2012). Waluyo and Rozza (2020) affirm that financing with *Salam* significantly impacts the farmers based on capital getting to develop the agricultural sectors. According to Kurniawansyah and Agustia (2017), the farmers

need a *Salam* contract financing instrument in which potential buyers book and make advance payments with the determined quantity, quality, and price stated in the contract agreement. This approach allows the farmers to get funds in advance. It provides an opportunity to meet the operational necessities of agriculture so that there is an increment in the quality and productivity of the farms. After harvest, the products are delivered to the buyers on the agreed date stipulated in the contract agreement.

Ajmal *et al.* (2017) argue that the *Salam* contract is different from the normal contract (sales). *Salam* is the combination of contracts involving both a buying and selling process and a lending and borrowing process. If the Islamic financial institutions (IFIs) act as buyers and another party provides services, this is called a *Salam* parallel. *Salam* parallel includes two transactions between IFIs and customers and between suppliers and IFIs of the third parties simultaneously. *Salam* parallel is allowed with the condition that a second contract is separate and does not relate to the first contract. Ahmed *et al.* (2019) asserted that *Salam* can potentially eliminate the exploitative role of intermediaries. Also, it fulfils several marketing, production, investment, and finance needs, along with other Islamic banking instruments. It represents a vast field of operations for IFIs. The authors added that the *Salam* contract has enormous financial ability, brings stability in supply and demand, and reduces the dependence on food item importation, therefore decreasing the burden on foreign exchange reserves.

MOTIVATION BEHIND *SALAM* CONTRACT AND ITS SHARIAH COMPLIANCE

The motivation behind the *Salam* contract is to meet the farmers' needs through the availability of cash to develop their agriculture and to take care of their family members before the time of harvest. The fundamentals of Islamic finance prohibit *riba* and *gharar*. Shariah believes lending with interest payment is exploitative, and the practice of interest-earning is prohibited under the Shariah of Islam. Almighty Allah (SW) prohibits the taking of usurious loans and farmers could not come close to it. Hence, the Prophet Muhammad (SAW) permitted the farmers to sell their agricultural products in advance to get the funds. Another reason may be to assist traders in exporting and importing. Under Islamic contract law, selling a good that is not in the seller's custody/possession is not allowed, and the good must be available at the time of the contract.

Conversely, under the *Salam* contract, it is legitimate for the farmers to sell the products in advance so that they can easily undertake their farming after receiving the cash. *Salam* is advantageous to the farmers because the cash is received ahead of delivery, and it is likewise helpful to the purchaser because the price of *Salam* is lower than the price in spot sales (Atah *et*

al., 2019; Muneeza *et al.*, 2011). According to Ahmed and Fida (2020), the *Salam* contract is allowed in Islam because it meets the basic needs of farmers. It is a public interest based on the objective of Shariah. The contract helps/supports small farmers to gain access to funding for agricultural financing production. Such help is needed to enhance farmers' living standards. Also, it is intended to secure the market for the farmers, in which they can sell products forward their expected farm goods for immediate money and deliver the goods in a predefined future date.

METHODOLOGY

This is a conceptual study conducted on past theoretical and empirical investigations relating to the concept of *Salam* as alternative financing for small farmers' agricultural development. The primary approach employed is the review of existing literature to gain or deduce more understanding of the roles of the *Salam* contract in agricultural financing development. Consequently, the study explores previous investigations and relevant information from reputable journals, newspapers, textbooks, and internet sources based on the concept of *Salam* and *Sukuk Salam*, which are principal mechanisms of Islamic finance.

PROPOSE *SUKUK SALAM* SCHEME

The best solution to increasing agriculture development is through Islamic finance to finance the agricultural sectors. The ICM ought to be integrated into as much as the market has the capability for the mobilisation of massive funds for sustainable agricultural development. *Sukuk* is taken as the encouraging mechanism to be used in this respect. In Nigeria, the government has to implement the regulatory framework which governs the issuance of *Sukuk* in the country. This is in accordance with the development of ICM in the country, the Securities and Exchange Commission (SEC) Regulation and Rule 2013, and the National and State Assemblies passing pertinent Bond Laws to approve a sovereign *Sukuk* issuance (SEC, 2016). The present government's focus is to make the agricultural sector attractive to investors to enable them to invest their funds using the *Sukuk* instruments. The use of *Sukuk* to finance the agricultural sector constitutes a crucial innovation considering the history of Nigerian agricultural development. Numerous indicators that demonstrate promising possibilities of utilising the *Sukuk* instrument in the country are mentioned below:

- The optimistic prospect of macroeconomic development needs further investment in the real sector of the economy. This could create an opportunity for non-interest financing institutions to participate in making different financing options available through Islamic

schemes. The *Sukuk* is considered an attractive instrument considering the consistent oversubscription of the Federal Government *Sukuk*.

- IFIs have enormous potential that can be likened to various government policies that support SMEs' business development.
- Increasing awareness concerning Islamic Financial services around the globe, including *Sukuk* products.
- Belief by the investors that Islamic financial products offer fairer mechanisms, *Sukuk* products in particular.

As stated in the previous discussion, poor access to funding is one of the main problems facing small farmers' agricultural development, and it deserves urgent attention. Integrating ICM into agricultural growth through the instrument of *Sukuk* is one of the suitable solutions. For small farmers' agriculture, the issuance of *Sukuk Salam* is proposed. AAOIFI (2018) defined *Sukuk Salam* as "a certificate of equal value issued to mobilise *Salam* capital so that the goods to be delivered based on *Salam* come to be owned by the certificate holders" (p.470). The concept of *Salam Sukuk* refers to a sale whereby the seller accepts to supply a specific commodity to the buyer on a future date in return for an advanced price and paid in full on the spot. Hence, the price is in cash, but the delivery of goods is deferred. The holder of *Sukuk Salam* is the buyer of the commodity from the *Sukuk* issuer; the seller will have been paid an agreed price by the time of the contract, while the commodity will be delivered at a future date (Usmani, 1999; Beik & Hafidhuddin, 2008).

In this model, the FGN will establish a Special Purpose Vehicle (SPV) through the CBN. This SPV will issue a certificate to raise funds through the issue of *Sukuk Salam* to finance small farmers' agriculture by utilising the funds raised. FGN will own the establishment of SPV through CBN to give SPV the to carry out its task. Before SPV issues *Sukuk Salam*, it must prove to the people the quality of the *Sukuk* product offered. Moreover, the SPV issues *Sukuk Salam* to all interested investors who will purchase the certificate of this *Sukuk*. In this model, the *Sukuk* purchaser will not be reimbursed at the date of maturity. Alternatively, the investors would receive the products/goods at the agreed future date. The money raised by the SPV is then invested in financing small farmers' agriculture in return for receiving the products/goods at a future date. Hence, these goods/products will be delivered to the investors or buyers at future dates. Figure 1.1 describes this structure.

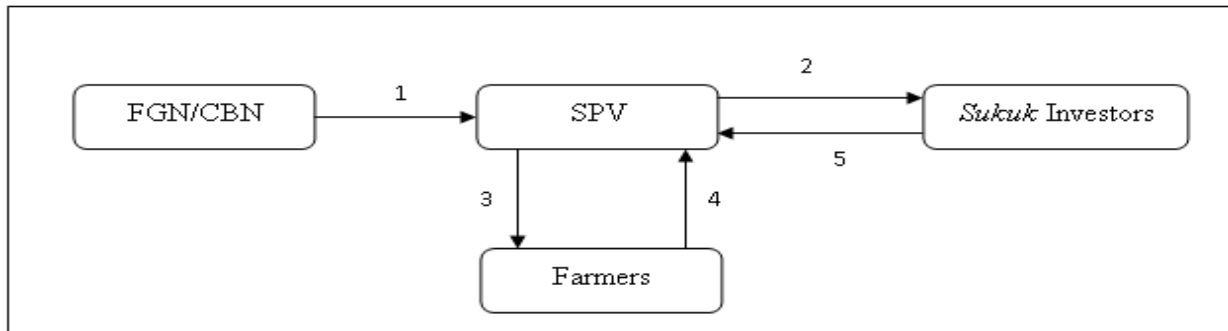


Figure 1.1 *Sukuk Salam* for agricultural financing

The following indicates the steps involved in the *Sukuk Istisna* structure:

- 1- FGN/CBN establishes an SPV.
- 2- SPV issued a certificate for *Sukuk Salam* to raise funds, and investors purchased the certificate.
- 3- SPV financing small farmers with funds raised.
- 4- Farmers deliver the goods/products to the SPV.
- 5- The investors received the goods/products from the SPV.

This model will give a lot of advantages, for instance, providing funds for small farmers' agriculture and fixing the price for a product after harvest. It will likewise support large-scale farming. Financing through *Sukuk Salam* would serve as an alternative for small farmers who have been taking loans from conventional banks. Furthermore, it will assist the farmers in advertising their products before selling them. Additional expenses in marketing or market risk would not occur. *Sukuk Salam* serves as an effective instrument for the stable price during the seasonal fall in demand.

SUMMARY AND CONCLUSION

Based on the literature reviewed above, it can be considered that Islamic finance products, especially *Sukuk Salam*, can be an alternative to provide funds for small farmers in Nigeria's agricultural sector. This is because extant literature documents evidence of the positive relationship between Islamic finance in the form of the *Salam* contract and social development. *Salam* effectively reduces poverty in the agricultural sector by empowering the farmers and banks to contact each other and get funds at the appropriate time, rather than a loan from the conventional banks, which eventually worsens through compounding interest that small farmers may not afford. Also, *Salam* has the potential to reduce the issue of unemployment among the youth by empowering agriculturists and farmers. In summary, *Salam* is an essential concept in Shariah that has improved the economic growth of various countries by providing funds for farmers and wealth redistribution. The study argues that based on the necessity, it is imperative to introduce *Sukuk Salam* as alternative financing for small farmers' sustenance in the agricultural sectors, which are weakened in the country. The agricultural sector has been Nigeria's essential income source in the past. It is suffering after the discovery of oil/petroleum, and it is hard to determine whether it is a blessing or otherwise for the country. The study has proposed a model

that indicates an integration of the mechanism utilised in the *Sukuk* proposal for small farmers. This model is based on *Sukuk Salam*. If this model can be achieved effectively, it will be significant for developing the agricultural sector in Nigeria. To achieve this goal, synergy and synchronisation of all regulations and rules are, without a doubt, required. With a complete strategy bundle, which incorporates the enactment of the *Sukuk* Act and Islamic Banking Act, it is anticipated that the integration process between the agricultural sector and the ICM in Nigeria will run smoothly. Hence, government commitment is profoundly required. Moreover, the paper added to the scarce literature accessible in the field. The major objective of this proposed model is to create efficient financial sustainability for small farmers.

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