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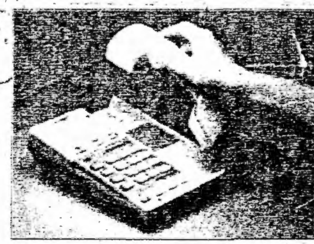

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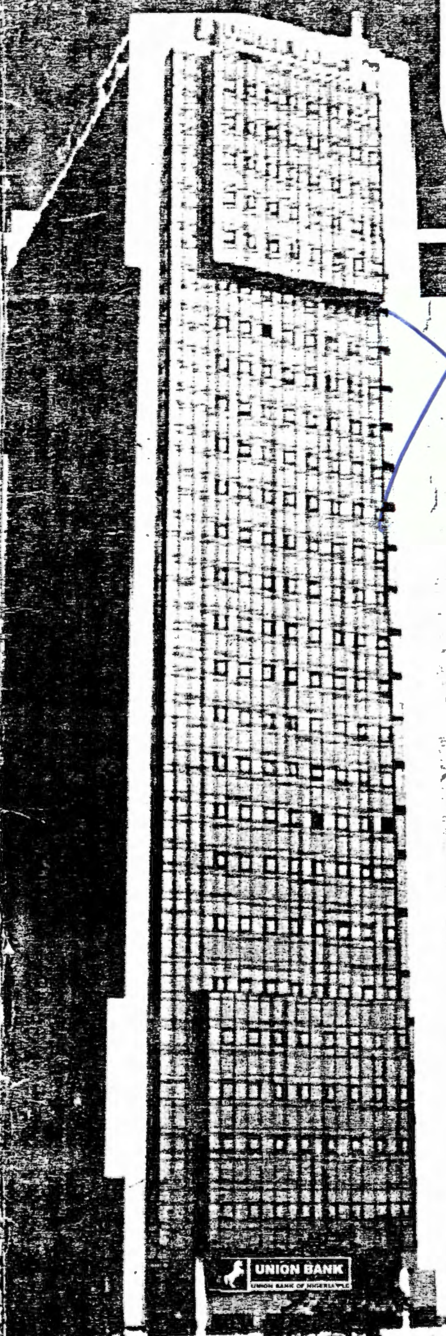

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CREDIT RISK MANAGEMENT IN BANK LENDING TO AGRICULTURE IN A GLOBALIZED NIGERIAN ECONOMY

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1.0 INTRODUCTION

The Nigerian economy is increasingly being globalized by deliberate government actions since July 1986 when the Federal Government began the implementation of the Structural Adjustment Programme (SAP). The SAP sought to deregulate and free the economy from government control with a view to allowing market forces determine the production and consumption decisions of economic agents within the country. The deregulation process, which was accompanied by privatization and commercialization of government enterprises, has had far-reaching impacts on the entire economy. In particular, deregulation of interest rates affected bank lending to the real sectors of the economy, including agriculture. In more recent times, government adopted business consolidation strategies, viz mergers, acquisitions and takeovers as part of its efforts to facilitate the ability of firms in the financial services industry to become global market players. According to the Governor of the Central Bank of Nigeria, business consolidation in the banking sector was to, among other things, "make Nigerian banks compete favorably in the global financial markets" and to generate a high capital base that "will provide banks with the resources to meet the cost of compliance in the areas of credit and market risk management" (Soludo, 2005: 98-99).

The issue of risk analysis and management became topical since October 1988 when the Basel Committee on Banking Supervision introduced the "Capital Accord" agreement, which linked bank credit risk to capital. It specified the features of a

good capital instrument as follows: (i) it must be easily understood, (ii) it must be permanent (i.e. patient money); and (iii) it must be able to absorb losses on a going-concern basis. These three features are expected to guide member countries, including Nigeria, in assessing instruments to be used in raising bank capital. The bottom line is that debt capital is a risky instrument for financing bank operations and should be discouraged as much as possible. The Basel Committee on Banking Supervision also introduced the "New Capital Accord" which is to be implemented in 2007. The New Capital Accord requires capital charges to be made for credit, market, and operational risks. This is aimed at protecting depositors, consumers, and the general public against losses arising from banking fragility and failure (Umoh, 2005). Ever since 1988, captains of the Nigerian banking industry have shown keen interest in improving the risk analysis, measurement and management capacity of firms in the banking sector. Recently, risk managers of major banks came together in Lagos to form an organization named Credit Risk Association of Nigeria ((CRAN). It is hoped than CRAN will offer them opportunities for networking on issues of bank risk management. Concerted efforts are also being made by captains of the banking industry to reduce the risk exposure of banks in lending to borrowers generally but especially to the agricultural sector, which is traditionally prone to market and credit risks.

Nigerian banks are traditionally reluctant in financing agricultural firms because of credit risks and high costs of loan administration. This made Government to adopt several subtle and overt measures to encourage the flow of bank credit to farmers. Beginning with the 1972 fiscal year, the Central Bank of Nigeria (CBN) used credit guidelines to prescribe the size of credit allocation by banks to preferred sectors of the economy, including agriculture. Also the CBN, through its Monetary Policy Circulars, directed banks to lend a specified minimum percentage of their loan portfolio to agriculture. Failure to comply attracted a penalty in the form of the amount in default being given interestfree to the Nigerian Agricultural and Cooperative Bank. With effect from 1985, the CBN started stipulating grace period for agricultural loans, which ranged from one year for loans for staple crop production to seven year for livestock production loans. Concessionary interest rate(s) was introduced in 1980 whereby interest charged on loans to farmers was kept below or at par with the Minimum Rediscount Rate (MRR) of the CBN. The Rural Banking Scheme (RBS), Nigerian Agricultural Insurance Corporation (NAIC), and the Agricultural Credit Guarantee Scheme (ACGS) were other measures used by Government to promote bank lending to farmers (Nnanna, 2005).