Theoretical Application of Salam Based into Agricultural Credit of Nigeria

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Abstract
Agricultural credit is the catalyst of agricultural production especially in developing countries. It is also a machinery of sourcing fund for agricultural support for the generation of income and employment to the farmers. However, it has been indicated that the agricultural credit facilities given to the Farmers in most of the developing countries is inadequate and Nigeria is not in isolation. The decline of agricultural credit resulted in the emergence of poverty, food shortage and unemployment in Nigeria. Some researchers are of the view that insufficient credit facilities is among the major problem of Nigerian farmers. The main objective of this paper is to explore the role of Salam mode of financing as an alternative to the conventional agricultural credit in Nigeria. This paper established a relationship between the two variables, if validated in an empirical manner will hope to contribute to the growth of agriculture in Nigeria. Thus we seek to propose the utilization of Partial Least Square Structural Equation Modelling PLS in data analysis. This paper may highly contribute to decision and policy makers, farmers and free interest financial institutions and explore the advantages of Salam mode of financing as an alternative approach of agricultural credit policy in Nigeria.
Keywords: Salam Financing, Agricultural Credit and Financial Institutions

1.0 Introduction

Salam refers to sale contract which the price (s) of the product (s) to be paid on the spot while with a future time delivery (Mohammed, Bashir & Ogunbado, 2016). It is also, a contract for sale of a good to be delivered to the buyer at the future date, which must be set at the time of contract (AbdulHalim, 1995). Likewise, it is a *Shariah* mode of financing mostly poor farmers who needed money to support their agricultural production and meet the daily needs before the harvest period. Additionally, it allows poor farmers to sell forward their expected farm produce for immediate cash and defer delivery of the produce to its buyer for specified future time (Rasmi & Markom 2014; Ogunbado & Ahmed, 2015).

Moreso, *Salam* allows farmers to sell forward their expected agricultural produce before harvest for immediate cash and defer delivery of the produce to its buyer (Khan, 1996). Salam is source of proving credit to farmers under certain conditions such as making of agreement of quality and quantity of the goods, deliberated on type, colour, weight, place of delivery and time among others. The *Salam* mode of financing agriculture provides opportunities for employment and streghten the activities of agribusiness and agro-allied as well as economy growth (Ayub, 2007). Furthermore, *Salam*f based was approved by the Prophet as part of *Shariah*-oriented public policy (Dandago, Muhammad & Osein, 2013). The most underlying cause of initiating *Salam* based was to aid the small scale farmers and traders who lack money to sustain crops and their trading (Siddiqi, 2006; Sayim, 2015).

On the otherhand, agriculture is the main channel of funding most of the developed and less developed countries (Mohammed et al., 2017; Ugwa & Kanu, 2012). It serves as a sustainable channel of financing economic growth and development (Anthony, 2010). Agricultural financing is a very crucial issue in a field of any production in which agricultural production is not different towards boosting the economy (Ogunbado & Ahmed, 2015). It is also refers as a financial instrument use in agricultural production and poverty eradication in a given economy (Onyechanya & Ukoha, 2007). Likewise, it can be regarded as a agricultural credit or central farm factor of accelerating agricultural production (Ahiapor & Asmah, 2012). This view is relevant to the study of Chisasa (2014b) that, farm credit or agricultural credit is accepted as a frequently conceived as credit machineries utilized for financing farm enrolment that include: cash, bill of exchange and banker's acceptance.

Agricultural or farm credit can be described as a systematic mode of borrowing money and inject into agricultural productivity under condition of payment (Atagana & Kalu, 2014). Agricultural input and output in Nigeria which is blessed with the abundance of both human and natural resources is essential. Nigeria has favourable climatic conditions for supporting agricultural production with 84 million arable land hectares. Nigeria is among the most agrarian, industrial and commercial as well as the most populous countries in Africa with subsistence and Commercial based agricultural production. The subsistence farmers are the majority and not in isolation from the problems of poor access to agricultural credit (National Population Commision (NPC), 2016; Ogunbado & Ahmed, 2015; Mohammed, Bashir & Ogunbado, 2016). In line with the argument of Cob-Douglas theory of the production function, access to affordable production farm credit is significant to the increase in agricultural output and farmer's socio-economic standard (Chisasa, 2014a).

Similarly, Schumpeter theory of economic development argued that financial intermediaries are the key driver of the productive sectors of the state GDP on attaining economic growth. Additionally, Chisasa (2014a) viewed that farm credit market theory revealed that the interest rate is associated with an increase in poverty, unemployment, high risk and cost of production in relation to agriculture and economic growth. This paper proposes to explore the role of *Salam* mode of financing as an alternative to the agricultural credit in Nigeria. The main objective of this paper is to establish a relationship between *Salam* based financing and agricultural credit as well as to explore the role of *Salam* mode of financing as an alternative to the conventional agricultural credit in the growth of Nigerian agricultural and economic development.

2.0 *Salam* mode of financing

The studies of Ayub (2007) and Sayim (2015) indicated that *Salam* based is a kind of financial transaction which is featured with free interest and strictly in line with the agreement undertaking contract. This means *Salam* based financing is a type of Islamic mode of transaction in the payment of the commodity and settle immediately after the agreement of the transaction with the delivery in an agreed future time and place (Ogunbado & Ahmed, 2015). The financial policy of *Salam* based is founded by *Shariah* law in which the party's agree to engage in *Salam* contract are subjects to have a mutually understanding and follow the conditions of the contract (Becirovic, 2011).

The socio economic benefits of *Salam* based is including: providing agricultural financing, creation of employment opportunities, improving agricultural market and agribusiness activities. It is also a general way and manner of poverty eradication and economic growth of a nation (Chong, Abdullah, Anderson & Amin, 2009). *Salam* based remain a financing strategy use to earn higher income to individuals and government that resulted to the socio-economic growth and advancement (Mohammed et al., 2016). Previous literature indicated the relationship between *Salam* based financing and agricultural credit. Hence, the proposition states that:

Proposition 1: *Salam* mode of financing relates to agricultural credit

Similarities between *Salam* Financing and conventional financing

Ayub (2007), Saqib, Nazeer, Khan and Zafar (2013) and Haneef, Pramanik, Mohamed, Muhammad and Amin (2015) reported that, *Salam* based as an Islamic Financial Institutions (IFIs) product operates in the same society where conventional financing do and perform all those functions which are expected from a financial institution. There is no restriction on the provision of such services by *Salam* based except that the service is against *Shariah*. However, there exists a difference in the mechanism of funds mobilization from savers to farmers as described:

i- Short term loans are provided to customers to meet working capital requirements of farmers by conventional banks. Similarly, *Salam* based is very useful for short term financial requirements for farmers. Since, *Salam* financing is an asset based financing and anyone can request for an IFI for the provision of an asset generally used for Halal (lawful) purposes.

ii- Conventional financing provides farm credit facility by charging interest. On the other hand *Salam* based is provided without interest rate through the provision and purchase of the farm input and farm output.

The Difference between *Salam* Based and Conventional Financing

The Islamic commercial law prohibits Riba (interest) as it is an excess demanded by the creditor over the principal amount, from the debtor, without any counter value or compensation (Quran 2:278-2:280). According to the basic philosophy of Islamic law an individual is entitled to profit because of the capital employed (along with risk) and the work carried out. On the other hand, in conventional financing this condition is missing and hence the creditor is not entitled to any profit (Becirovic, 2011).

Additionally, Saqib et al. (2013) and Sardar, Azeem, Hassan and Barkhsh (2013) differentiated between *Salam based* financing and conventional financing based on the summarised financing approaches as follows: *Salam* based is essentially a sale contract for the purchase of farm input and make repayment with the farm output. However, conventional financing is related to a loan transaction that is based on borrowing and repayment of the counter value of the borrowed amount.

In case of a *Salam* financing, there is an involvement of personal labour.While, the lender of a conventional financing becomes entitled to an excess (interest) over the loan amount without any personal effort/work. Khan (1996) reported more differences between the conventional concept of debt financing and the *Salam* concept of financing through deferred sale. In *Salam* financing, debt creation depends on trading in real goods and services. Debt creation is basically a phenomenon of the goods and services market. On the other hand, conventional financing is essentially a monetary phenomenon. Though the creation of debt serves a financial purpose, it cannot be treated similar to debt financing in which debt default is penalized by an automatic increase in interest (Salami, Kamara & Brixiova, 2010).

Furthermore, Saeed, Ashraf, Zaidi, Lodhi, Ahmad, Awan and Malik (2013) differentiated between the conventional and *Salam based* financing in relation to the major practical implications on volatility as follows: Interest rates are observed to be volatile and many conventional banking products are floating-rate products. The rates on such loans are automatically adjusted upwards or downwards in line with changes in interest rates. Differently, *Salam*financing is determined by the contract which is not allowed to float with changes in the interest rates or any other rate.

Conventional financing convert fixed rate facility into a floating rate facility by making the debt rollover at periodic intervals. At the end of a specific time period, a new fixed rate (reflecting current market conditions) replaces the old rate. Meanwhile, *Salam*based does not permit a roll over fixed rate. A rollover in *Salam* based would imply that another separate *Salam* is booked on the same item. This practice, needless to say, is not only counter intuitive, but also inadmissible in *Shariah* (Saeed et al., 2013*)*.

More so, *Salam* financing conforms to the *Shariah* and free from *Riba*, excessive Gharar and other prohibitions. Consequently, the modern Islamic financial institutions used *Salam* based as a modern value of financing agriculture. Since, it is an essential element of control poverty, unemployment, inflation as well as a promoter of Islamic financial discipline in the fields of trade and agricultural production (Siddiqi, 2006; Ayub, 2007).

3.0 **Agricultural Credit**

Agricultural credit can also be seen as a step that lead to control money and goods, as well as services in order to improve agricultural output under agreed repayment conditions (Saibu, 2010; Atagana & Kalu, 2014). Agricultural or farm credit is a very crucial issue in the field of any production in which agricultural production is not different to utilise farm credit initiating and boosting a declining agrarian economy (Ogunbado & Ahmed, 2015). Asogwa and Okwoche (2012) reported a relationship between farm credit and rural farmers in regard to their agricultural activities in Nigerian. Also, Eyo (2008) focus on the micro based determinants in Nigerian agriculture.

Dang, leatham, Mccarl and Ximing-wu (2013) reported a positive and significant relationship between farm credit and agricultural output in United States of America. Moreso, Ugwa and Kanu (2012) reported a relationship between agricultural credit and farm output in Nigeria. Anthony (2010) studied farm credit facilities and economic growth. Equally, Amadi (1989) reviewed the government based in respect of agricultural sector in Nigeria. Anyawu, Ibekwe and adesope (2010) revealed a relationship between agricultural credit and linked the distance between agricultural produce and market areas; this is important in perishable farm output as well as to purchase agricultural inputs, such as fertilizer, insecticides, herbicides and technology.

Thus, the following proposition is framed and developed. Proposition 2: Agricultural credit relates to agricultural output.

4.0 Methodology

The current study proposes the use of Partial Least Square Structural Equation Modelling (PLS-SEM). The paper will also use Smart PLS software during data analysis. This is in line with study of Hair, Black, Babin and Anderson (2010). PLS is a high technique in examining the cause-effect analysis on relationship between research latent variables. Equally, PLS-SEM modelling approach is highly stronger, superior and flexible statistical approach for theory prediction and examining (Ringle, Wande & Becker, 2014).

5.0 Proposed Framework

In the above sections, the study has mentioned and revealed the existence of the relationship between *Salam* based and agricultural credit. Figure 1: indicate the framework of the relationship between *Salam* based financing and agricultural credit as developed in a framework below.

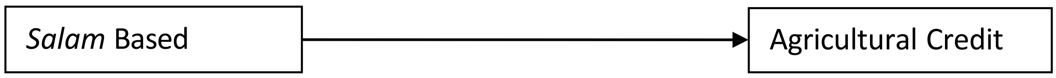

Figure 1.1 *Proposed Framework of Salam Based and agricultural Credit.*

The above framework indicated that, *Salam* based financing relates to the agricultural credit in Nigeria as depicted in figure 1.1 above.

6.0 Conclusion and Implication

The paper discusses the way and manner between *Salam* based financing relates to the agricultural credit as indicated in figure 1. This research model if validated in an empirical approach is hoped to contribute to the literature in relation to Islamic economics and based. It is expected to serve as an alternative to the conventional agricultural credit policy in Nigeria. If the finding of this study is considered, it will facilitate small and large scale farmers, financial institutions as well as poverty eradication and economic growth of Nigeria. More so, the mentioned advantages of *Salam* based financing on agricultural credit is hoping to be a contribution to the farmer's cooperative association for farm credit and disbursement, It will also contribute to the policy makers in relations to agricultural financing in Nigeria.

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