CODESRIA

Thesis by
MAGBAGBEOLA,
NELSON
OLALEKAN

UNIVERSITY OF IBADAN,
IBADAN Faculty of the
Social Sciences

Informal Financial Sector and Saving-Investment Process in Nigeria : evidence from five South-Western States

JULY 1998

INFORMAL FINANCIAL SECTOR AND SAVING-INVESTMENT PROCESS IN WESTERN NIGERIA

(A PH.D THESIS)

BY

MAGBAGBEOLA, NELSON OLALEKAN

B.Sc. (Econ.) (Ife), M.Sc. (Econ.) (Ibadan)

A Draft Thesis in the Department of ECONOMICS

Submitted to the

Faculty of the Social Sciences

in partial fulfillment of the requirements for the degree of

DOCTOR OF PHILOSOPHY

UNIVERSITY OF IBADAN, IBADAN

JULY 1998

INFORMAL FINANCIAL SECTOR AND SAVING-INVESTMENT PROCESS IN WESTERN NIGERIA

PH.D THESIS

MAGBAGBEOLA, NELSON OLALEKAN

DEPARTMENT OF ECONOMICS

UNIVERSITY OF IBADAN

IBADAN

JULY 1998

CERTIFICATION

We certify that this study was carried out by Nelson Olalekan MAGBAGBEOLA in the Department of Economics, University of Ibadan

---

Supervisor and Chairman, Thesis Committee
Prof. Afolabi Soyode
B.Sc. (Econ.)(Ibadan), M.A., Ph.D. (Pennsylvania), ITP (London)
Professor of Economics
University of Ibadan

Supervisor
Prof. Adedoyin Soyibo
B.Sc. (Math.)(Ibadan), S.M. (Mgt./O.R.)(MIT), Ph.D.(Ibadan)
Professor of Economics
University of Ibadan

Supervisor
Dr. Olawale Ogunkola
B.Sc.(Econ), M.Sc.(Econ.), Ph.D(Econ.) (Ibadan)
Lecturer in the Department of Economics
University of Ibadan

DEDICATION

TO
The Almighty God
(Jehovah Jireh)
Who Can Make
Somebody Out of a Nobody

Also To
Millions of Nigerians
Especially the Poor People
Whose Livelihood Depends in part
on the Informal Credit Sector

ABSTRACT

This thesis presents an empirical study of the informal financial sector in the old Western Nigeria within the theoretical framework of imperfect information paradigm. It estimates the relative size of the informal financial sector in Nigeria by examining some monetary aggregates. The results of the estimation show that, in monetary terms, the informal financial sector is one-third the size of its formal counterpart.

One of the areas in which this thesis extends the frontier of knowledge about informal finance in Nigeria is the use of Qualitative Choice model (logit model) to examine the role of the informal financial sector in the mobilisation and allocation of domestic resources for capital formation in Nigeria. Other tests used include the general summary statistical tests to examine the characteristics of four particular informal finance agents (esusu collectors, ROSCAs, moneylenders and the general public), ascertain the procedure and channels for informal financial intermediation, and analyse the linkages between the informal and formal financial institutions.

The results of the study represent a significant input to the literature on informal finance in Nigeria as well as a contribution, of great policy relevance, towards an integrated development of both the formal and informal financial institutions in Nigeria.

ACKNOWLEDGEMENT

The study brings to a conclusion a desire to empirically study the 'tickness' of the Nigeria's informal credit sector for a Ph.D. thesis. I will forever remember the scholarly and loving supervision of the Chairman of my Thesis Committee, Prof. Afolabi Soyode, who made himself available at all times for me to discuss with on the progress of this study and other academic assignments. I gratefully acknowledge his invaluable support, encouragement and good wishes for me and my nuclear family.

Also, I am very grateful to Prof. 'Doyin Soyibo for his scholarly contributions towards the success of this study. In fact, in Nigeria of today, he is one of the leading experts on the subject of informal finance. Indeed, he has always been a pillar of support. For this, I am indeed very grateful.

In addition, I am full of thanks to Dr. Olawale Ogunkola for providing intellectual support on this study as well as candid advice on other academic issues. His regular encouragements were most beneficial.

I also express deep gratitude to Professors Femi Kayode, Ademola Oyejide, Sam. Olofin for their contributions towards my maturity in the scholarly environment. Also, special thanks go to Doctors F.O. Ogwumike, Remi Ogun, Mufutau Raheem, Abdul-Ganiyu Garba and Davidson Omole for their keen interest and words of encouragement.

I must not fail to express my profound gratitude to the management of the National Centre for Economic Management and Administration (NCEMA) particularly the Director-General, Professor Mike I. Obadan, for all the unique opportunities and privileges offered me in and outside the Centre. I am also thanking deeply Professor Adeniyi Osuntogun (former Vice-Chancellor, Obafemi Awolowo University, Ile-Ife and current National Programme Director, LEAD-Nigeria), Dr. A.A. Adubi (Head, NCEMA Training Department) and Dr. Bode Olakanmi (in the United States) for their unwaving support throughout the programme.

The contributions (especially in terms of prayer) of my friends and relations shall not go unrecognised. I am very grateful to Old Ife Road Zone worshippers of the House Fellowship Programme of the Gateway Baptist Church, Sanngo, Ibadan for their prayer support for successful completion of this Ph.D. programme. Besides, I appreciate the warm cooperation we enjoyed with our respondents during the field survey.

I hereby acknowledge with gratitude, the financial support provided by the Council for the Development of Social Science Research in Africa (CODESRIA) and the African Economic Research Consortium (AERC) for this study. However, opinions expressed in this study are entirely mine and do not represent the views of CODESRIA or AERC. In other words, I accept responsibility for all the errors contained therein.

Special thanks go to my loving wife, Adesunnbo, and our daughter, Oladayo, for jointly providing some encouragement and the conducive atmosphere necessary for this study.

Finally, and most importantly, I give all thanks to God Almighty who made it possible for me to begin and conclude this programme successfully. I am what I am by the grace of God. To the immortal and invincible God be all glory, adoration and thanks in Jesus' name, amen.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF QUESTIONNAIRES

CHAPTER ONE

The current role of informal financial agents as an important source of credit and saving institutions is now widely accepted. When their transactions are confined to a limited geographic and /or social arena, they have a strong comparative advantage over formal financial institutions in their ability to minimise transaction costs, and to reduce default risk by the use of collateral substitutes.... they enhance this comparative advantage by specialising in particular financial activities.

- Gary Christensen (1993, p. 728)

INTRODUCTION

1.1 Problem Statement

Recent developments in the Nigerian economy have heightened the need for a study on the mechanisms of the informal financial sector. The Nigerian economic crises which reached alarming levels in the early 1980s arose from structural imbalances in the economy, and were characterised by severe stagnation and decline. To solve the crises, the Federal Government of Nigeria embarked upon a Structural Adjustment Programme (SAP) aimed at economic recovery and growth. Some of the policies adopted during the economic reform era include tight fiscal and monetary policies. These were reflected partly in reforms of the formal financial sector and public expenditure policy. These reforms invariably imply substantial real reductions in the amount of credit available to the private corporate and household sectors, and therefore force more and more people to finance various economic activities informally.

The informal sector is basically the entry point to the city for migrants who leave their villages with the hope of availing themselves of an urban income higher than their agricultural income (Chaudhuri, 1989). When they cannot immediately find work in the formal sector, the migrants enter the informal labour market with the hope of getting a job in the formal sector in the future. Whereas the formal sector enjoys the privileges of organised credit market, the informal sector is denied such privileges. It has to rely on its own sources and the unorganised credit (informal) market.

During the late 1980s in Nigeria (after the introduction of SAP) when the formal sector activities reduced drastically, there was no significant urban-rural migration because most of those who lost their jobs in the public and modern private sectors simply entered into the urban informal sector (Ajakaiye and Akerele, 1995: 2). So pervasive and significant is the informal sector that the various incentives designed to initiate and sustain urban-rural migration are rendered ineffective.

In addition, recent state of distress in the formal financial system also contributed to the growth of the informal financial sector. The operating environment for commercial and merchant banks was generally unstable between 1989 and 1997 due to civil disturbances, industrial unrest, high inflation, negative interest rates and low public confidence, mainly as a result of distress[1]. On Monday, 19 January 1998 the Central Bank of Nigeria liquidated 26 distressed banks comprising 13 commercial and 13 merchant banks after realising that those banks were irredeemable and terminally distressed. Before then, five other banks had been liquidated between 1994 and 1995. The distress episode eroded public confidence in the Nigerian banking system, and thereby encouraged a lot more people to patronise the informal financial sector.

The activities of this sector take place outside the control of government regulations. Hence, the activities of the sector are either mis-reported, under-reported or, in some cases, totally omitted (Soyibo, 1995). The literature is replete with synonyms for the informal sector. These include 'underground', 'unofficial', 'economy of the poor', 'backyard economy', 'shadow', 'parallel', 'black', 'irregular', or 'second economy'. Even though some people might refer to this sector as 'unofficial', there is need to exercise caution in its usage in view of the connotation of illegality 'unofficial' usually holds. In many African

---

1 Financial sector distress is a situation in which a sizeable proportion of financial institutions have liabilities exceeding market value of their assets which may lead to runs and other portfolio shifts and eventual collapse of the financial system

countries most informal financial activities are legal. They are simply not officially regulated and are not seriously regarded by policy makers.

For a long time the informal sector has been labelled unproductive and therefore not worthy of support. However, in more recent years a growing interest in the sector (and therefore more calls for its support) can be observed. This change of direction, Hemmer and Mannel (1989) noted, results from the realisation that the informal sector is capable of providing some amount of labour and income as well as essential goods and services for a major section of the population without any financial support, governmental or otherwise.

So broad is the informal sector that we have limited this study to the financial segment of the informal sector. Activities in the informal financial sector involve the use of either local currency or foreign currencies (or both). Thus, activities of informal financial sector (particularly the parallel foreign exchange market) may partly explain the movement of the exchange rate of the naira.

The term 'informal financial sector' describes economic entities and their financial transactions which are not directly open to control by fundamental monetary and financial policy instruments, and are not regulated. There is self-regulator. Informal finance, therefore, consists of borrowing and lending among individuals and firms that are not registered with the government as financial intermediaries and are not subject to government supervision (Von Pischke, 1991:173). The basic feature of the informal financial sector is that market participants engage in the saving-investment (or financial intermediation[1]) process on an informal basis.

There are a variety of people, from widely varying educational and occupational backgrounds, involved in savings in the informal sector. A lot of these people appear to be too poor to generate funds from their internal savings to finance their investment needs. It is therefore necessary to provide external finance to meet the consumption and investment needs of these categories of people. This external finance can be formal, informal[2] or both. This formal credit is provided by institutional financial markets like commercial banks, development banks, other specialised institutions such as the People's Bank and community banks. Unfortunately, much information on informal financial sources of credit to the traders, peasant farmers, artisans and other categories of low-income people is not readily available.

The Nigerian informal financial market consists of rotating savings and

1 Informal financial intermediation is the mobilisation of capital from savers and its simultaneous transformation and allocation to meet the needs of borrowers, as performed by informal financial agents.

2 Formal institutions are those regulated and licensed, often under banking laws. Semi-formal institutions, however, are generally licensed, but under the Companies Act. In Oyo State, semi-formal institutions are registered under the Cooperative Societies Law (Cap. 27 of the Laws of Oyo State of Nigeria 1978).

credit associations, moneylenders, mobile bankers, relatives, friends, neighbours, employers and other private financial brokers. Relatives, friends, and neighbours are often the most important source of informal credit (World Bank, 1989, p.112). But as lending is from equity (lender's pocket) and there are few conditions attached to repayment, loans are usually small, unsecured, short-term and interest free. Reciprocity rather than financial intermediation is the rationale underlying these transactions. Traditional moneylenders in Nigeria are merchants or larger families who use credit to establish patron-client relationships which either enhance the return to other enterprises such as grain trading, or improve access to labour. Thus, moneylending is seldom their main source of income.

In Nigeria, as in many low-income countries, the informal financial sector exists side by side with the formal financial sector. This is known in the literature as financial dualism. However, policy makers in these low-income countries, including Nigeria, do not clearly understand the influence of the informal financial sector. Hence, they view the sector as a 'black box' (Hyuha, Ndanshau and Kipokola, 1993). Nevertheless, an understanding of the economics of this sector is a prerequisite for satisfactory financial policy analysis (Aryeetey and Udry, 1994). What is essential now is for the Nigerian government to obtain a fuller understanding of informal financial operations for the development of policy, especially in view of its growing significance. As noted by Aryeetey (1995, p.4), policy makers need to be aware of the allocative and dynamic effects and the effects on macro-management through money creation of a large informal segment. This requires a knowledge of who is involved, and what roles various actors play. Equally important is a more realistic picture of its relative size to the formal financial sector and the implications of this for the whole Nigerian financial system.

It should be emphasised that the informal financial sector is better positioned than the formal financial sector to resolve the three related problems that face them. The first problem pertains to adverse selection, that is a lender's inability to distinguish a potentially good borrower from a bad one at reasonable cost. The second is moral hazard, in which prohibitive monitoring costs arise from an uncertain environment (for example, random production, a consumption shock, or bad luck) that might negatively affect the returns on a borrower's activities and capacity to repay. Third, the lender faces problems with enforcement, since, in the event of default, the lender must recover the principal and interest either from the borrower's returns or from the collateral specified in the loan contract (Bell, 1990).

In spite of this comparative advantage that the informal financial sector has, the literature is fraught with evidence of connections between the two sectors. However, these connections are not properly understood and yet they provide the key link between macroeconomic policy and aggregate saving and investment. Aryeetey and Hyuha (1991) have expressed the view that financial and monetary policies can only be effective if strong links are established between the formal and informal segments of the financial market. In addition, the view is increasingly being expressed that the continual disregard of informal finance in financial and monetary policy matters is inappropriate for the development of an efficient financial system. Having realised the importance of the informal segment to the Nigerian economy and its effect on the efficacy on the nation's monetary policy, the Central Bank of Nigeria (CBN) and the Nigerian Institute of Social and Economic Research (NISER) in early 1997 started a joint study on the Informal Financial Sector in Nigeria. As the joint research will focus mainly on the parallel foreign exchange market, my thesis will be a modest contribution on the naira-denominated informal financial market.

It is documented in the literature that increasing individual agents' access, such as mobile bankers, moneylenders and traders, to formal credit should enhance their ability to provide seasonal production and consumption credit to low income households. Moreover, linking formal group savings activities to the formal sector has the potential to make saving safer and more remunerative for informal savers, as well as giving the formal sector access to a significant, low-cost source of capital (Aryeetey, 1995). According to Ghate (1990) (cited in Aryeetey, 1995: 132), an emerging consensus from a large number of studies of formal and informal finance in developing countries is that if monetary and financial sector policies are to influence demand and supply conditions within all segments, strong links between the two main segments of the financial market become a pre-condition. Policies are indeed normally transmitted through formal segments. They can only be effective among informal segments if those different segments were strongly linked to formal financial institutions.

Some of the recent studies on informal financial market in Nigeria include Udry (1990, 1994), Olomola (1992), Oladeji and Ogunrinola (1992), and Soyibo (1994). Udry (1990) and Olomola's (1992) contributions strive to apply the concepts of imperfect information paradigm (i.e. the issues of moral hazard and adverse selection) to the study of rural credit in Northern Nigeria. They identify the characteristics of informal finance that Nigerian formal financial institutions can exploit to improve on their loan performance particularly in relation to default risk minimisation. Oladeji and Ogunrinola (1992) attempt to understand the credit demand situation among informal saving and credit associations, and individuals in the South-Western part of Nigeria. The study partly concludes that credit demand in the informal financial sector is interest inelastic. However, the study, conducted in 1989, excludes the supply side of this market which comprises the activities of moneylenders.

Hence, given the deteriorating economic conditions in the country, there is therefore a need to revisit this study and incorporate the credit supply segment since the poor economic conditions and low public confidence in the formal financial sector appear to have prompted the urban population, especially the poor and the wage earners, to resort to informal finance like the rural population.

In a more comprehensive study conducted between 1990 and 1992, Soyibo (1994) attempts to investigate informal finance in nine states in Nigeria. Using a multistage sampling procedure, 81 questionnaires were administered, 64 of which were found usable. An area of improvement is in this study will be to increase the sample size. The study analysed the structural and institutional constraints militating against the integration of the various subunits of the informal financial sector, on the one hand, and with those of the formal sector on the other.

An area for further research in the studies is the estimation of the size of the informal financial sector and a re-examination of the characteristics of the sector with the following proviso: a reduction of the survey scope to a regional level, a fairly representative sample size and inclusion of moneylenders in the proposed study. In addition, another area in which the study hopes to extend the frontier of knowledge about informal financial sector in Nigeria is through the use of logit estimation technique. Besides other analytical results, logit estimation results will be a major contribution to knowledge about informal finance in Nigeria.

Hence, the focus of this study is to examine the role and size of this sector in the mobilisation and allocation of domestic resources for capital formation in Nigeria as well as appraise the links between the formal and informal financial sectors.

1.2 Objectives of the Study

This thesis aims to undertake a regional study of the informal financial sector in order to inform policy on how best to capture its activities within a policy framework. Specifically, this study attempts to:

i investigate and explain the nature, size and role of informal financial sector in Nigeria;

ii examine the characteristics of savers, lenders and borrowers; the nature, terms and conditions of credit; and the purpose for which resources are saved or borrowed;

iii ascertain the procedure and channels for informal financial intermediation, and the relationship between formal and informal financial institutions; and

iv make policy recommendations for an integrated development of both informal and formal financial institutions in Nigeria.

1.3 Statement of Hypotheses

The major hypotheses which the study attempts to verify in the Nigerian informal financial markets are stated as follows:

i that the informal financial sector plays a significant role in financial intermediation;

ii that the size of the informal financial sector has been growing while that of the formal financial sector has been declining over time;

iii that the process of obtaining credit from the informal financial sector is less bureaucratic and time-consuming compared to the impersonal and bureaucratic process in the formal financial market;

iv that the end-uses of informal credit are a mixture of consumption and investment credit with consumption credit more prominent than is usual with formal credit; and

v that moneylenders charge higher interest rates than banks.

1.4 Justification of the Study

The primary reason for the interest in the informal financial sector is the growing evidence that there is great potential for savings mobilisation for small-scale productive activities through the development of the informal financial sector and the strengthening of potential links between the formal sector and the informal financial sector. It has been observed that savings mobilisation and lending by the formal financial system in developing countries are on a declining trend. For sub-Saharan Africa, average savings rose from 13.9% of GDP in 1965-73 to 19.5% in 1974-80 and then fell to 12.9% in 1981-87. By 1992, after several years of reforms in many countries, savings averaged only 12.4%

of GDP.

Reasons adduced for these low saving rates, even after financial sector reforms, include the possibility of errors in measurement of incomes and savings in countries where record keeping and data collection are not satisfactory, as well as the prevalence of low household incomes. Even in countries where saving rates have gone up, Nissanke (1991) notes that savings are dominated by holdings of real assets. The relatively low importance of financial savings in a number of these economies is attributed to a lack of confidence in the stability of financial systems of many countries following years of interference in the operation of those systems by governments. Also responsible is the poor infrastructure for formal savings mobilisation.

Moreover, other reasons have been suggested in the literature for poor resource mobilisation in Africa (Adera, 1995). A great deal of efforts was geared towards credit provision rather than resource mobilisation. These policies were further compounded by the inexpensive rediscounting terms and facilities provided by the central bank and donor agencies which resulted in circumventing financial deepening. Today, Africa's reliance on foreign aid has become too deep-seated and has led it to relax its own resource mobilisation efforts. In the bulk of the developing African countries, external finance constitutes more than 50 percent of the total supply of savings. Debt service payments by African countries grew from less than US $1 billion in 1970 to US $24.1 billion in 1993 and the average debt service ratio from 8 to 24.4 percent over the same period (ECA, 1994).

Second, given the growing interest of OECD countries in providing assistance to Eastern Europe, the external resource famine from which Africa is currently suffering could become increasingly unbearable as competition for external resources becomes severe. Third, the inflow of foreign direct investment (FDI) to developing Africa has virtually dried up. Average annual FDI flows into Africa as a proportion of all inflows in developing countries declined from 13 percent in 1981-85 to 11 percent in 1986-90, and to 6 percent in 1992 (UNCTAD, 1994). Fourth, the export sector which has traditionally been fairly central in any strategy of savings mobilisation in the African countries, is expected to contribute little to the revenue basket. For sub-Saharan African countries, taken as a whole, public savings have been consistently negative during the past two decades: -3.5, -5.9 and -7.2 percent of GDP in 1997, 1981 and 1987, respectively. And between 1987 and 1990, public savings in 29 adjusting sub-Saharan African countries further declined by 1.07 percent (World Bank, 1993, cited in Adera, 1995, p.6). Among the factors accounting for the negative public savings ratios are the reduction of the tax base and therefore of the tax revenue accruing therefrom as a result of the collapse in the commodity market and the consequential heavy losses in export earnings.

Given the above situation, external finance to sub-Saharan African countries is on the decline. Thus, it is therefore necessary to divert attention to the informal financial sector for resource mobilisation. Unfortunately, the potential for the informal financial sector is usually underestimated, and policy makers are, therefore, at a loss with regard to capturing its activity within a policy framework. The sector thrives and affects growth processes in several ways; however, it is either unaccounted for or only improperly accounted for in the national accounts (Aryeetey and Hyuha, 1991).

Due to lack of sufficient knowledge concerning informal financial institutions, these institutions do not appear in the country's plans to promote small and medium-scale enterprises (SMEs) through the provision of start-up and working capital. For the same reason, although informal financial institutions may be playing an important role in financial intermediation, they do not feature in policies for promoting savings and efficient allocation of loanable funds. In addition, it is not considered that the existence of informal financial institutions might impair the effectiveness of monetary control if borrowers are able to switch from the controlled formal market to the uncontrolled informal market and that integrating the two financial markets might be to their mutual advantage.

Although not much is known about this sector, many financial transactions take place within this sector. Hence, in order to enrich the existing knowledge about the sector, this study is therefore attempted.

1.5 Scope of the Study

This study is limited to the informal financial units that trade solely in naira. The informal financial units that deal in foreign currencies, i.e. the parallel foreign exchange market, are not within the scope of the study. Informal financial units covered in this study include mobile bankers, rotating savings and credit associations, money lenders and market participants which include traders, farmers, teachers, civil servants, etc.

The study makes use of primary data mainly. Secondary data are used in estimating the size of the informal financial sector relative to the formal financial sector. The study is limited to a survey of villages and towns/cities in the old Western region of Nigeria. The old Western region consisted of present day Oyo, Osun, Ogun, Ondo, and Ekiti States. A common feature among these states is that their citizens belong to the Yoruba ethnic group, one of the three dominant ethnic groups in Nigeria. Going by 1991 census figures, out of the national population of 88,514,501 the region's population was 11,914,860 (approximately 13 percent of the national population figure). In addition, some of the towns especially university towns and state capitals, e.g. Ibadan, Ile-Ife, Ado-Ekiti, Abeokuta, Ago-Iwoye, Akure and Osogbo are cosmopolitan. They serve as homes to a lot other ethnic groups in Nigeria like the Ibos, Hausas, Nupes, etc. Also, some of the towns serve as sites for other higher institutions like Polytechnics and Colleges of Education. Examples of such towns include Ibadan, Oyo, Ilesa, etc.

To survey this region, a multistage sampling procedure, as in Soyibo (1994), was attempted. In the first stage of the sampling procedure, 4 local government areas were randomly selected from each of the 5 states. Thereafter from each selected local government area, 3 towns/cities and 2 villages[3] were sampled. Thus, the study was planned to cover 20 local government areas comprising 60 towns and 40 villages. The last stage of the sampling procedure involved selection of 3 moneylenders, 3 ajo collectors[4] and 5 market participants (some of whom are ROSCA members). In the survey, we expected *a priori* to interview within 6 months 1,100 respondents consisting of 300

---

3 More emphasis is based on the towns/cities because less commercial activities take place in the villages. Hence, it is common to find in towns more mobile bankers and weekly or fortnightly ROSCA meetings in towns than in villages.

4 Ajo is a synonym for esusu.

moneylenders, 300 ajo collectors and 500 individual borrowers/savers (including ROSCA members). For the rotating saving and credit associations, we planned to use, when feasible, participant observation approach to garner relevant information during their meetings.

In this study friends, relatives, neighbours, landlords and employers have been excluded. Reciprocity rather than financial intermediation is the rationale underlying the transactions of the excluded group. For the survey there were different questionnaires for the three groups in the market: informal financial market participants, ajo (or esusu) collectors and moneylenders.

1.6 Organisation of the Thesis

This thesis is arranged into six chapters. Chapter one highlights the major problems and hypotheses which the study intends to investigate. It also states the rationale or justification for the study as well as the objectives and scope of the study.

Chapter two is a discussion of the Nigerian financial system comprising the formal and informal segments. In addition, the chapter takes a cursory look at the various types of informal finance, but does an in-depth review of the rotating savings and credit association (ROSCA), which is believed in the literature to be a state-of-the-art financial intermediation. Moreover, the chapter examines the existing linkage between the formal and informal segments of the Nigerian financial system.

Chapter three, on the other hand, is a discussion of the theoretical underpinnings of informal finance as well as a review of the literature on informal finance, especially in developing countries including Nigeria. In addition, the chapter attempts to trace the origin of informal finance, and suggests the various methods employed in the rationing of scarce credit in the informal financial market.

In chapter four, the thesis describes the methodology of the study in terms of the methodological framework used and the survey areas. The chapter further examines the method of collecting the required data and estimating the size of the sector. In addition, it discusses the logit estimation technique, and the limitations of the survey.

Chapter five analyses and presents the results of the study. The chapter estimates the relationship between a qualitative dependent variable (participation in informal financial market) and independent variables (some of which are also qualitative) using logit estimation technique. Using the SPSS (Statistical Package for the Social Sciences) software, the chapter discusses the socio-economic and demographic characteristics of the respondents, and analyses their perception about financial services. Besides, the chapter further examines the informal savings arrangements and characteristics, informal borrowing lending and investment characteristics as well as the use of informal finance by women. The chapter concludes by examining the sector's institutional linkages with formal financial institutions.

Chapter six concludes the thesis by summarising the major findings of the study, and highlighting the policy implications of the study. In addition, the chapter offers suggestions for future research.

CHAPTER TWO

BACKGROUND TO INFORMAL FINANCE

2.1 Overview of the Nigerian Banking System

The Nigerian banking system comprises the regulatory authorities, banks, merchant and retail banks. The regulatory authorities are the Central Bank of Nigeria (CBN) at the apex and the Nigeria Deposit Insurance Corporation (NDIC). The CBN is the principal regulator and supervisor in the money market, with the NDIC playing a complementary role. The money market is made up of the discount houses, commercial and merchant banks, the People's Bank of Nigeria and community banks. This is a market for short-term debt instruments. The major function of the money market is to facilitate the raising of short-term funds for the deficit sectors of the economy from the surplus sectors. The deficit units obtain funds from the market to bridge budgetary gaps by trading in short-term securities such as Treasury Bills, Treasury Certificates, call money, Certificates of Deposits (Cds), and Commercial papers. With the commencement of the Open Market Operations (OMO), the scope of the money market has been expanded. The number of participants in the market also increased with the establishment of four discount houses. Total instruments outstanding in the market amounted to ₦103,326.5 million at the end of 1995.

Money market institutions constitute the hub of the formal financial system. They include the discount houses, commercial and merchant banks, low-income and rural sector-targeted institutions like the People's Bank of Nigeria and community banks which are special purpose banks. The CBN, in collaboration with the NDIC, is the principal regulatory authority in the money market. The National Board for Community Banks (NBCB) gives prior approval for the establishment of community banks, while the final granting of licence is the responsibility of the CBN.

2.1.1 The Central Bank of Nigeria (CBN)

The CBN is the apex regulatory authority of the financial system. It was established by the Central Bank of Nigeria Act of 1958 and commenced operations on 1 July, 1959. Among its primary functions, the Bank promotes monetary stability and a sound financial system and acts as banker of last resort to the banks. The Bank also encourages the growth and development of financial institutions. The promulgation of the CBN Decree 24 and Banks and Other Financial Institutions (BOFI) Decree 25, both of 1991, gave the Bank more flexibility in regulating and supervising the banking sector and licensing finance companies which hitherto operated outside any regulatory framework. However, in the 1997 budget the autonomy of the CBN was jeopardised, as the activities of the Bank are now subject to the control of the Federal Ministry of

Finance.

2.1.2 The Nigeria Deposit Insurance Corporation (NDIC)

The NDIC complements the regulatory and supervisory role of the CBN. The promulgation of Decree 22 of 15 June, 1988 led to the establishment of the NDIC. It took off effectively in February 1989. It was set up to provide deposit insurance and related services for banks in order to promote confidence in the banking industry. The NDIC is empowered to examine the books and affairs of insured banks and other deposit-taking financial institutions. Licensed banks are mandated to pay 15/16 of 1 percent of their total deposit liabilities as insurance premium. A depositor's claim is limited to a maximum of ₦50,000.00 in the event of a bank failure. Since 1992, the NDIC, in collaboration with the CBN, has intensified its effort to resolve the problem of distress in the banking industry.

2.1.3 Commercial and Merchant Banks

Commercial and merchant banks perform a major role of financial intermediation in the economy and facilitate the payments system of the modern exchange economy. The trading banks operate under the legal framework of the Banks and Other Financial Institutions (BOFI) Decree 25 of

1991. Prior to this, the banks' activities were governed by the 1952 Banking Ordinance and the Banking Act of 1969 and amendments.

(i) Commercial Banks

Commercial banks started operations in Nigeria in 1892. They performed three major functions, namely, acceptance of deposits, granting of loans and the operation of the payments and settlements mechanism. Since the Government commenced active deregulation of the economy in September 1986, the commercial banking sector has continued to witness rapid growth, especially in terms of the number of institutions and product innovations in the market. The number of commercial banks and their branches rose from 30 and 2,397 in 1986 to 64 and 2,530 respectively in 1995. Since the enactment of the CBN and BOFI Decrees, commercial banks have been operating under a changed environment which seeks to minimise the risks associated with innovation and deregulation. The commercial banks continue to dominate the banking sector in terms of their share of total assets and deposit liabilities. The total assets/liabilities of the commercial banks increased from ₦315,541.5 million in 1994 to ₦400,292.9 million in 1995.

(ii) Merchant Banks

Merchant banks are wholesale banks in that they cater for the needs of corporate and institutional customers. Their role in the economy is to provide medium to long-term finance by engaging in activities such as equipment leasing, loan syndication, debt factoring and project financing. The first merchant bank in Nigeria, Nigerian Acceptances Limited (NAL), started operations in 1960. As at December 1995, there were 51 merchant banks with 151 branches, while their total assets amounted to ₦70.0 billion in 1994. Since January 1994, merchant banks wishing to undertake commercial banking activities could seek necessary approval from the CBN.

2.1.4 People's Bank of Nigeria

The Federal Government decided, in the 1988 budget, to establish the People's Bank of Nigeria with an initial allocation of ₦30 million. The bank became a legal entity by the promulgation of Decree 22 of 1990. Specifically, the bank is to meet the credit needs of small borrowers who cannot satisfy the stringent collateral requirements normally demanded by conventional banks. Thus, the bank is expected to facilitate access to credit for economic operators at the grassroots and thereby increase their self-reliance. Initially, it granted loans in the range of ₦50 to ₦5,000. The lending floor and ceiling were removed in 1994 and applications were henceforth to be treated on their individual merits. The activities of the People's Bank of Nigeria continued to expand as the number of branches stabilised at 275 in 1995. Also, its total assets rose from ₦928.3 million in 1994 to ₦1,114.1 million in 1995.

2.1.5 The Community Banks

A community bank in Nigeria is a self-sustaining financial institution owned and managed by a community or a group of communities to provide financial services to that community. The National Board for Community Banks (NBCB) is responsible for receiving and processing applications for the establishment of community banks. The first community bank commenced operation in December 1990. Since then, the NBCB has issued provisional licences to 1,355 community banks. Capital and reserves, total assets, deposit liabilities, loans and advances, and investments of the reporting community banks were, ₦866.7, ₦4,448.1, ₦3,344.6, ₦1,366.4 and ₦465.5 million, respectively, in 1995 (CBN, 1996).

2.2 Classification of Informal Finance

2.2.0 Introduction

Finance exists because of heterogeneity among firms and individuals and because of the specialisation and trade that ensues from these differences. This, in turn, results in a variety of financial needs that are partly met by a multiplicity of informal arrangements. Although the stereotyped moneylender receives most of the publicity, a large variety of other arrangements handle most informal financial transaction in low-income countries. Some of these arrangements are centuries old, while other systems of informal finance are constantly evolving as the contours of the society and the economy change. The kaleidoscope of arrangements defies simple classification, and it is unusual to find a substantial number of these arrangements that are identical - a testimony to the flexibility and creativity involved in informal finance.

In general, three broad classifications of types of informal finance are found in Africa. These are:

1. Primarily savings mobilisation units, with little or no lending;
2. Primarily lending units that are hardly involved in savings mobilisation; and
3. Units that mobilise deposits and do a considerable amount of lending, albeit to members of distinct associations or groups mainly, which may

include:

- Self-help financial groups that include different levels of savings and credit associations, including rotating savings and credit associations (ROSCAs) and non-rotating ones;
- Commercial lenders;
- Friends, family and non-commercial lenders;
- Moneykeepers and savings collectors; and
- Licensed cooperatives or unions.

There are more than five types of informal finance, some of which overlap and are intertwined with other production or marketing activities.

2.2.1 Moneylenders

Individuals who spend most of their time lending money - moneylenders - are significant sources of loans, mainly in Africa. Typically, their loans are granted for short periods, are unsecured by collateral, and are extended to long-term clients. Most moneylenders operate on a small scale, extend loans mainly out of surplus income from farming or trading, and restrict lending to less than fifty or so individuals. Moneylenders typically charge interest rates that are high relative to other lenders but extend loans quickly and impose few transactions costs on borrowers. Since credit from moneylenders is often the most expensive available, it is usually demanded by persons without any other options (Aryeetey, 1997). Moneylenders remain the only informal credit source that does not require borrowers to satisfy specific membership obligations. These lenders operate in localised markets and often have highly personalised relationships with borrowers.

The main advantage moneylenders have over formal lenders is the comprehensive information they accumulate about their clients through day-to-day contact which limits the number of clients they can assemble. Timberg and Aiyar (1984) found an extreme example of this when they asked an Indian moneylender how he decided to take on additional clients; he responded that he had never had a new client. Understandably, the proprietary nature of this information causes moneylenders to be cautious about diverging candid information about their operations with researchers.

Some moneylenders are mainly involved in providing small, short-term loans that are seldom backed by collateral and that are made to individuals who often suffer economic reverses. It is this part of informal finance that is a lightning rod for criticism of informal finance in general. Critics often cite exorbitant interest rates as the main justification for condemning informal finance. Cases of lenders charging 10 percent per day on loans, for example, are cited and then generalised as being representative of exploitation and proof of monopoly power. Also cited and generalised are horror stories about evil moneylenders or merchants who, in order to capture the borrower's collateral, extend loans to individuals whom lenders know will be unable to repay, debts that are inherited by the borrower's children, landlords who tie their tenants to land through debt at the company store, and merchants who link loans to repayment in kind and force borrowers to repay with products that are grossly underpriced. It is also rumoured among the Yorubas that some moneylenders use *juju* (evil power) on their clients not to have money to pay the principal. These horror stories illustrate situations that are only possible when the lender exercises a large measure of monopoly power. Also, they report one-time operations that normally do not make economic sense for lenders who benefit from sustained relationships with their clients.

These blanket indictments, moreover, ignore the large number of informal loans made at modest interest rates, the multitude of loans made and repaid without the lender foreclosing on collateral, and the complexities involved in loans tied to marketing and production (Adams, 1992). They also ignore the extensive deposit mobilisation that occurs in these markets, the multitude of informal loans made with no collateral involved, and the large number of people who pay high interest rates on their loans but realise even higher rates of return on investments made with borrowed funds. Critics also fail to mention that moneylenders may make only a few loans at extremely high interest rates, that these credits are often unsecured, and that borrowers paying the highest rates have weak credit ratings. Critics also ignore inflation.

At least three questions must be answered to establish whether lenders are taking undue advantage of borrowers: (1) What are a lender's opportunity cost of funds, transaction costs, and the risks involved in lending? (2) Are most informal lenders in a position to extract monopoly profits? And (3) are credit transactions tied with marketing and production to enhance exploitation?

i. Opportunity Costs and Risk

Much has been asserted about the ubiquitous monopoly power of moneylenders, but little proof has been presented to support this allegation. Several studies show that moneylenders' interest rates are high because the opportunity costs of funds together with lending risks are high (Von Pischke and others, 1983). It is unreasonable to expect moneylenders to charge borrowers less than the rate of return lenders could realise on alternative investments and many moneylenders have business alternatives that yield high marginal returns. The high interest rates in informal markets may largely indicate that funds are scarce and that at least some people realise high rates of return from using borrowed funds.

From the perspective of borrowers in Latin America, it is argued that many managers of microenterprises borrow from moneylenders at high rates of interest because of the low transaction costs involved and the high quality and dependability of the informal financial services and also because high rates of return result from the use of borrowed funds. Many of these return activities are also available to lenders and are further indications of high opportunity costs of lending.

In addition, because of the seasonality of agricultural production, informal lenders may find it impossible to keep all of their money lent during the year. This forces them to charge higher interest rates during the time their money is lent to make up for periods when some of their funds are idle.

ii Monopoly Profits

Because of the lack of barriers to entry, the large number of forms of finance, and the large number of people who are willing to enter markets where high rates of return are realised, it is difficult to see how informal lenders can regularly extract substantial monopoly profits. All of the many forms of informal finance, as well as formal lenders, partially compete with each other. In addition, anyone with money or easily transferable resources can become a lender. Effectively, there are few barriers to entry into informal finance.

Likewise, borrowers can compete with informal lenders through substitution of equity for debt, barter, and sale and repurchase of assets. The conditions necessary to realise monopoly profits exist only with barriers to entry and a highly differentiated product, conditions seldom encountered in informal financial markets.

If traces of monopoly power exist in informal financial markets they can be moderated by expanding formal lending. To be fully effective, however, the expansion in formal finance must compete with those elements of the informal system that have too little competition. An expansion of cheap formal loans that goes largely to well-to-do individuals does not compete with informal lenders who are largely serving the poor (Gonzalez-Vega, 1984).

iii Loans Linked with Marketing

It is often difficult to establish clearly the charges that are applied to loans when the loans or the repayment are in kind, as is often the case with loans linked with marketing. For example, a merchant in Ibadan may agree to lend a farmer two baskets of tomato and require the repayment of three baskets at harvest time in only two months. On a commodity basis, this amounts to a monthly interest rate of 25 percent or an annual rate of 300 percent. On a financial basis, however, the rate is much lower, even ignoring inflation.

Usually, the market price of tomato between harvests is significantly higher than the price during harvest. If the interharvest price ranged from 25 to 50 percent higher than harvest prices, the interest rate on the loan would range from 0 to 120 percent on an annual basis. When loan repayment is in kind, the merchant assumes all of the price risk, something that is of additional value to the borrower. If a merchant, in fact, consistently realises a monopoly profit on his tomato-credit transactions, the cause may be imperfections in the tomato market rather than monopoly power exercised in credit transactions. The merchant may own the only truck in his area that is needed to haul tomato to central markets, but it is less likely that the merchant will be the only person in the area who has funds or resources to lend. If monopoly power lies in other markets linked to informal finance, that power will not be directly affected by finance activities or their regulation.

2.2.2 Esusu Collectors and Groups

It may be noted that the expression 'esusu'[5] is used for both *esusu* groups and *esusu* collectors, who are really individual mobile bankers. This is because both arrangements are known by that name. The latter is believed to

[5] Esusu is also known as ajo among the Yoruba people. A mobile banker is known as alajo.

have evolved out of the former (Aryeetey and Gockel, 1991). The major difference between them is that, in the latter case an individual 'operator' or 'collector' manages and controls the arrangement without reference to anybody, while in the former, arrangements for collection and payment are organised collectively.

Thus, we can have individual *esusu* collectors or group *esusu* collectors. The individual esusu collectors can also be classified by their mode of deposit mobilisation: daily mobilisation or periodic mobilisation. Periodic mobilisation of deposits is more common in rural areas where individual clients take their deposits to esusu collectors in their houses either weekly, fortnightly or monthly. However, daily collection of deposits is more common in urban centres among traders, artisans like mechanics, plumbers and other tradesmen. The individual esusu collectors are referred to in the literature as mobile bankers, individual savings collectors, or money collectors. The collector moves from one client to the other, sometimes using a bicycle or a motorcycle. Clients of individual collectors tend to be more common in market places. The usual length of deposit before withdrawal is allowed is a month in the case of daily collectors, while for periodic collectors the length of deposit before withdrawal can sometimes be up to a year or more.

The depositors contract to a minimum specified sum at regular intervals which is held in safe-keeping for an agreed period (usually a month). Depositors have the choice to withdraw their savings at the end of the month or retain it with the collector. Normally, savers with the intent to borrow in future refrain from making these monthly withdrawals. However, most contributors withdraw their savings, but maintain their savings contract and keep repeating the cycle.

Typically, the collector charges a monthly fee per depositor equal to a daily contribution[6]. Esusu collectors collect the first period's (or day's) deposit as commission. Thus, in a 31 day monthly deposit, the depositor will be entitled to withdraw at the end of the month, the value of 30 daily deposits. The 1st day deposit is the commission charged by the esusu collector.

Interest is not paid on deposits but participants sometimes receive access to an interest-free line of credit. The amount deposited by each client to the individual esusu collector varies, depending on the financial capacity of the depositor. Esusu collection activities are mostly documented amongst market women (Aryeetey & Gockel, 1991). For the savers, this is an extremely cost-effective way to save, as it avoids the high opportunity costs incurred by daily trips to banks. The esusu collectors at times use the accumulated funds as a

---

6 This commission is to take care of the costs of card issued to each client, the ledger used, as well as other costs involved in doing the service for the client.

low-cost source of finance for their own businesses. However, due to the short-term nature of deposits, the only activity on the money is the small interest-free loans given to their clients as an inducement to continue saving.

Esusu clubs can be categorised into two: loose esusu and organised esusu associations (Soyibo, 1994, p.14). While the organised esusu associations have written rules and regulations as well as bye-laws, the loose esusu associations do not have written rules and regulations but operate on the basis of trust. However, the latter category of esusu clubs is more prominent. Esusu clubs are known in the literature on informal finance as Rotating Savings and Credit Associations (ROSCAs). The most basic form of esusu combines savings and credit arrangements as follows: members make regular, fixed amount contributions to a common pool of funds which is then given to each member in turn. Slots for receiving the amounts are decided by negotiations or by lottery. After each member has had access to the fund once, the group disbands or starts over again. The esusu cycle therefore depends on the number of participants and the unit for collection (weekly, bi-weekly, or monthly). For example, a seven-member esusu group with a weekly collection time period will disband or start another cycle after seven weeks.

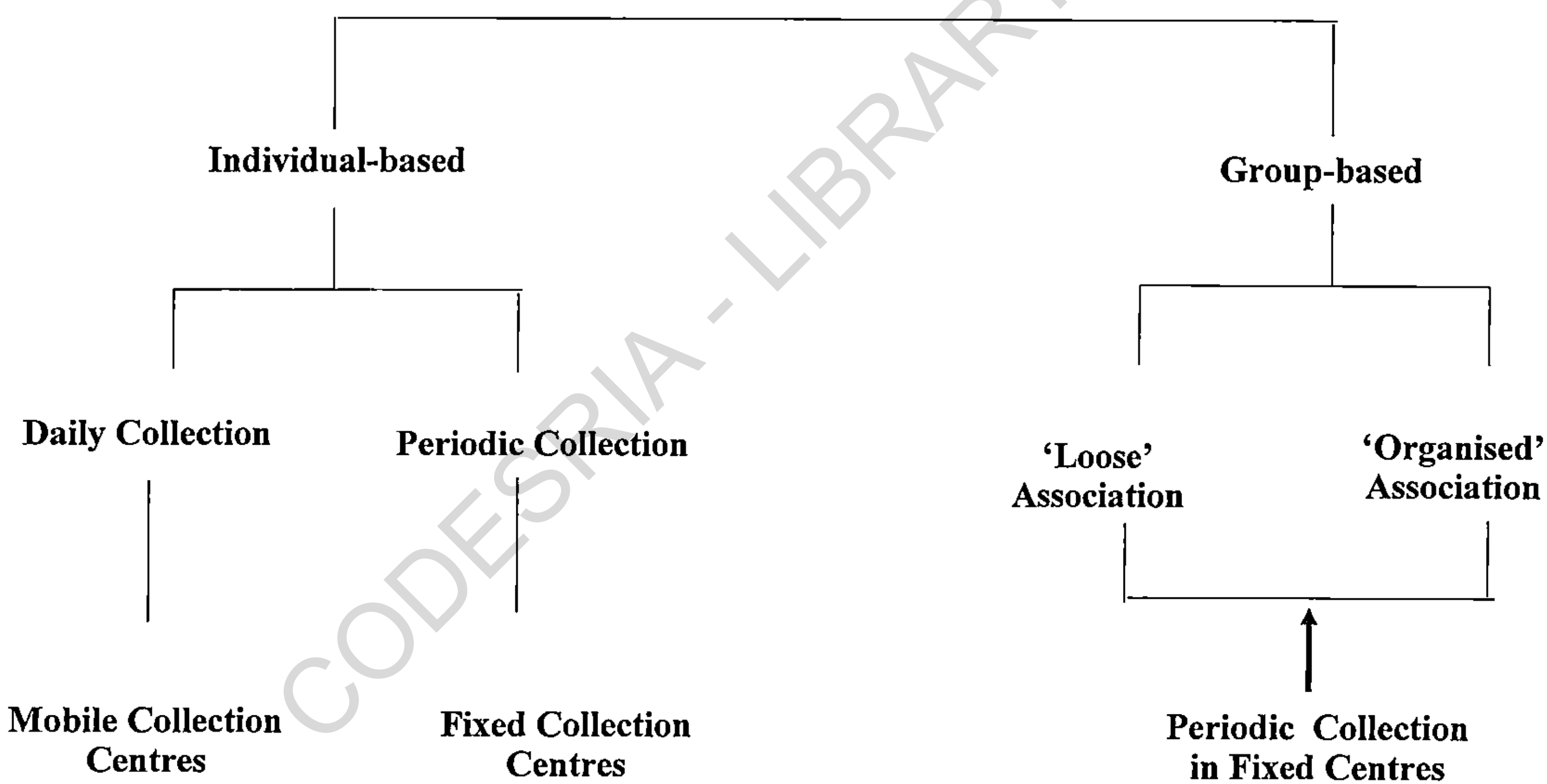
The underlying framework for esusu is derived from time-honoured traditions of close ties and solidarity within the family, village or community. In urban areas where such ties might be weaker, bonds are forged around common occupation or activity. Esusus are therefore closed groups and their savings scope is limited. Esusu features include rules and procedures that are easily understood by participants, a minimum of administrative formalities and low transaction costs.

In a number of areas more individuals participate in ROSCAs than have dealings with formal financial institutions, and large amounts of money may be involved. In a research on neighbouring Cameroon, Schreider (1989) suggested that the volume of deposits moving through ROSCAs there may be larger than the amounts held in banks. In some countries, especially among ethnic minorities, ROSCAs are a primary way of raising funds to make large business investments.

These associations are particularly interesting because they explicitly pool savings and tie loans to deposits. ROSCAs also resolve the loan collateral and borrower information problems by enrolling only members who have mutual confidence in each other or by having organisers who guarantee the performance of individuals they enroll. Loan recovery is seldom a problem in ROSCAs because a defaulting member not only loses the opportunity to remain in the association but may also be shunned and experience the loss of social and business ties that accompany membership.

It is surprising how often ROSCAs are found among employees of formal financial intermediaries: numerous employees of central, commercial, merchant, community and development banks in Nigeria; and in 1987 there was even a ROSCA operating among employees of the International Monetary Fund (IMF) in Washington, D.C., USA, all of whom had doctoral degrees in economics or finance! (Adams, 1992, p. 14). The organisation and operation of esusu or ajo are shown schematically in Figure 2.

Figure 1: A Schema of the Organisation and Operation of Esusu (or Ajo) in Nigeria.



Source: Soyibo, A. (1991) 'Financial Linkage and Development in Sub-Saharan Africa: A Study of the Informal Financial Sector in Nigeria' Mimeo., Overseas Development Institute, London, July, P. 15.

2.2.3 Merchants

A closely related and much more common form of informal credit is provided by individuals who are primarily merchants but who also extend loans linked to the sale or purchase of commodities. Typically, lending is only a minor part of the merchant's activities, loans are repaid in relatively short periods of time, many of the loans carry no explicit interest charge, and the lender may adjust the price of the commodity involved in credit transactions as compensation for the loan. Economies of scope are the main advantage that a merchant realises in providing loans. Merchants can generally sell more of their products, for example, if they also offer loans to their customers. Like the moneylender, merchants have the advantage of possessing inexpensive information about the borrower that is accumulated through purchases and sales of commodities. Under normal conditions the volume of loans provided by merchants increases as commerce expands.

At Gbagi cloth market in Ibadan, traders provide small, short-term loans to fellow traders. The traders sell cloth of various types and prices to other traders and agree to collect the money installmentally. Similarly, merchants extend their hawking business to schools and offices where they sell to teachers and office workers diverse items as cosmetics, clothing, shoes, umbrellas. They collect part payment on the day of purchase and come back to collect installment payments on the previous purchases. This practice was also discovered in the Philippines (Adams, 1992) and rural areas of Indonesia (Fruin, 1937).

2.2.4 Pawnbrokers

Pawning is one of the oldest forms of lending. Some pawnbrokers work full-time at this occupation, whereas others pursue it as a sideline to money lending or marketing. In several countries, Indonesia and Sri Lanka, for example, pawnshops are affiliated with some banks.

Distinctive features of pawnshops are that they typically make small loans for short periods and resolve the loan collateralisation problem inexpensively by requiring borrowers to exchange collateral physically for loans. Unlike banks, moneylenders and traders, pawnbrokers need almost no information about their borrowers unless they are wary about receiving stolen goods. The pawnbroker realises revenue from interest on loans and from the difference between loan amounts and sales receipts from items received as security on defaulted loans. Contrary to conventional wisdom, Bouman and Houtman (1988) argue that most pawnbrokers prefer to have individuals redeem the items they pawn, as this improves the chances of their continuing as clients.

Some individuals in the Philippines make their living primarily by conducting informal pawning operations combined with peddling items door-to-door that are not redeemed. These individuals may have loose working relationships with formal pawnshops or with relatively wealthy people who occasionally provide them operating funds. They may also combine their pawning activities with selling nonpawned goods door-to-door and offering installment arrangements on these sales (Adams and Sandoval, 1989).

2.2.5 Farm Pledges

Farm pledging is quite common in cocoa growing areas like the old Western Nigeria (Adegboye, 1969). This is because cocoa is a cash crop and (unlike food crops) yearly earnings were guaranteed with a good price. This was before the scrapping of the Cocoa Marketing Board which ensured that farmers' earnings from cocoa sales did not fluctuate too widely due to slump in world cocoa market. The farm pledging arrangement is as follows. A farmer pledges a cocoa farm as collateral for a loan amount. Ownership is transferred temporarily on average 5-10 years to the lender. Such lending activity usually involves large amounts of money. Farm pledges take place when a borrower is in need of colossal sum to pay medical costs, funeral expenses, and higher education costs. Normally, this type of borrowing is not for consumption and it involves farm owners who generally are credit worthy in the society.

"Pledge" in this case has the same meaning as an article pawned with a pawnbroker. However, the transactions in this case are patterned almost like a lease. The lender will maintain the farm (including weeding), harvest and market the crop for the agreed period before returning the farm to the owner. Perennial crops are normally suitable for these arrangements because they have longer life spans. The amount and interest are calculated based on the yields from the farm per year. The yields per year are calculated from sale receipts from previous years[7]. The yield per year therefore determines the loan period. There is therefore goodwill from both parties - the borrower presents the true value of the farm and the lender is able to ascertain future earnings. In certain situations local cocoa marketing board officials were involved in the valuation of the property. The terms of borrowing can be renegotiated. The borrower can regain the farm within the period if total repayments are made before the date. Due to the capital intensive nature of transactions and the loan period involved, records are kept and involve whole families who act as guarantors or

---

[7] The authenticity of sale receipts can be cross-checked from the local cocoa purchasing clerk.

witnesses[8].

2.2.6 Loan Brokers

Another type of informal finance is carried out by loan brokers who facilitate contacts among people with money to lend and borrowers by trading on inside information about potential clients. Typically, loans handled by brokers are relatively large and for a longer term than are most informal loans. Virtually anyone can enter the business who is able to assemble information about potential clients. Because borrowers of these brokered loans usually do not qualify for additional bank credit, interest rates applied to these loans may be relatively high. As Larson and Urquidi (1987) point out, some lenders in Bolivia insist on collateral such as real estate before making a brokered loan. The broker is usually not a principal in the transaction but merely arranges contacts between lenders and borrowers. Some brokers may also provide collection or guarantee services and thus become more like principals than agents.

According to Maloney and Ahmed (1988), a different form of loan broker

[8] The involvement of families in this type of transactions is important because of the usufruct rights - whereby cocoa trees are owned by individuals but the land still remains a common property for the family or clan. Cocoa farms are also supposed to be passed on to descendants.

operates widely in rural areas of Bangladesh. These brokers obtain loan application forms from banks, help illiterate people fill them out, obtain necessary signatures and guarantees, and also allocate bribes necessary to overcome barriers to borrowing. The broker is commonly rewarded through a share of the bribe or a share of the loan and acts as a legal buffer between the payer and receiver of the bribe.

2.2.7 Landlords

This is a common arrangement among cocoa farmers in South-Western Nigeria and Ghana whereby landowners who borrow money transfer to a lender usufruct[9] rights over land, orchards, or fishing facilities for a time until all loans are repaid (Adegboye, 1969). It is also found in the highlands of Ecuador and the Philippines, where farmers may pawn the title to some of their land and transfer use rights to the lender for a time to obtain relatively large loans to finance employment abroad by a family member (Sacay and others, 1985 cited in Adams, 1992).

---

[9] In one form of usufruct loan, a lender occupies and uses the borrower's land until the principal is repaid. In Nigeria, the practice is to procure loans by transferring to the lender the right to harvest the borrowed trees. The harvest provides the interest on the lender's loan. Such transactions, which are called tree pledging, occur with cocoa, oil palm and rubber trees (Adegboye, 1969). In Thailand however, such loans are transacted to finance migration for work abroad. They are viewed as low-risk loans (Siamwalla and others, 1990).

2.2.8 Friends and Relatives

Perhaps the most common form of informal finance, both in terms of number and value of transactions, is loans from friends and relatives. In some countries these credits make up half or more of all informal loans. Many of these loans involve no interest or collateral, they may be large or small, and many have open-ended repayment arrangements. The most important feature of many of these loans is reciprocity: the expectation that the borrower is willing to provide a loan to the lender sometime in the future. In cases where the individuals involved have scant access to other forms of finance, the reciprocity may be an important way of managing uncertainty and risk through establishing and strengthening interpersonal ties. In many parts of South-Western Nigeria loans between father and son, wife and husband, and between brothers and sisters are common.

2.2.9 Money Guards

Another form of informal finance recorded in the literature are money guards. A money guard is a responsible person who agrees to safeguard cash for individuals. Graham and others (1988) report finding money guards in neighbouring country of Niger. Almost the entire reason for money guards is that they offer a secure place to deposit funds. In most cases these deposits earn no interest, although money guards may give depositors token favours or gifts. There are no restrictions on the uses money guards may make of deposited funds. In some cases depositors feel money guards are doing them a favour by holding their money, and the amount of money deposited by each individual is usually small.

2.3 Informal Finance In Traditional Yoruba Land

2.3.1 Esusu Group

As recorded by Johnson (1897), esusu is a universal custom for the clubbing together of a number of persons for monetary aid. A fixed sum agreed upon is by each at a fixed time (usually every week) and place, under a president; the total amount is paid over to each member in rotation. This enables a poor man to do something worth while where a lump sum is required. However, this system is what is known as ROSCAs is the literature on informal finance today.

2.3.2 The *Iwofa* System and the Laws Regulating It

The term **Iwofa** denotes one who serves another periodically in lieu of the interest on money lent. In short, it is one in service for interest. It has been mistranslated a "pawn" by those who fancied they saw a resemblance to it in that system, and are trying to identify everything native with those that are foreign, and consequently, as in other similar cases, much mischief has been done thereby.

The Yoruba man is simply shocked to hear of "pawning" a man as is done with goods and chattels; to pawn in Yoruba is **fi dogo** which term is never applied to a human being. It has also been compared to slavery by those ignorant of the legal conditions ruling the system; but an **Iwofa** is a free man, his social status remains the same, his civil and political rights are intact, and he is only subject to his master in the same universal sense that "a borrower is servant to the lender".

Iwofas are held quite distinct from slaves; the verbs applied to each system mark the distinction e.g. *ra* to buy is applied to a slave, *ya* to lend or engage (a hand) to an **Iwofa**; consequently you can buy a slave, but engage an **Iwofa** or service man. The derivation of the term is probably from **Iwo** the entering into, and **Efa** a period of six days; hence an **Iwofa** is one who enters into a recurrent sixth day service.

The **Iwofa** system is a contract entered into in the presence of witnesses called **Onigbowo** i.e. sponsors, the money-lender is termed **Oluwa** i.e. master, and the worker **Iwofa**, i.e. a service man. It is a legal transaction recognized and protected by the laws of the country. Whatsoever the amount of money lent, it is the law that the service rendered goes for the interest, and only the principal is paid back whenever payment is made whether after a few days or after many years.

An **Iwofa** lives in his own house and plies his own trade, but he is required to clean a piece of land equal to 100 yam heaps or an equivalent in his master's farm once a week, the Yoruba week consisting of five days. The people being mainly agricultural, farm-cleaning is the work of their daily life, and is the recognized ordinary system of labour.

Cleaning three hundred heaps is the ordinary amount of an average man's day's work, consequently a strong man often found it possible to work in three different farms on the same day, for different masters, or to do three week's work at a time in one farm, and have 14 off days at a stretch, in which he is free to follow his own trade without interruption. Special arrangements can also be made if a longer period is desired, but the Iwofa is bound to make up for the number of days lost.

This is the original law, but it is subject to slight modification or variation in various places, according to the local value, or the amount of money lent' e.g. amongst the Egbas, a whole day's work is required instead of a morning's work. But whatever modification of the original law is made in any particular locality, the law for that tribe is always fixed by authority, and never subject to the whims and caprice of an individual money-lender.

The master is to treat the service man as his social rank demands, he mingles freely with his equals in the house or in the field as a member of the household. A kind master often allows him his breakfast before he quits the field although he is not bound to do so, and if a master be too exacting or disagreeable, he may be changed any day without any previous notice, once the money lent is paid back in full.

Where the master is a great chief or a rich man, the service man may live under his protection and own him his feudal lord; hence some men never troubled themselves to pay back the money, but may rather incur further obligations, being safe and free under the protection of a great name. some men there are, who are better able to do another man's work than their own.

An **Iwofa** is never a subject to punishment physical or otherwise, if he fail in his weekly service, the sponsors are called upon to make good the deficiencies. In fine an **Iwofa** differs from a slave in that a slave must live with his master, an **Iwofa** in his own house. A slave can be compelled to work for his master every day, an **Iwofa** for a limited amount of work for half a day in the week, and that not by compulsion but from obligations of honour. A slave can be punished, an **Iwofa** cannot be. A slave has lost his independence and political rights, an **Iwofa** retains both. A slave has no one responsible for him, an **Iwofa** has two at least. In fine an **Iwofa** can go and come as he likes, a slave cannot.

For women the same law holds good generally but with some modifications on account of their sex; they work generally as char-women once a week, and have a meal in the house before returning home. In some cases they may live among the women folk in their master's house, carrying on their own work, and lending a helping hand in the house work and in harvest time do their own share of the day's work in the field along with the other women.

Some are engaged in trade, in which they sell for their master at the same time, and bring him the proceeds of his own articles as the allotted service rendered. When the trade is done in the home market, payments are made every nine days which are market days; when out of town, at the return of the caravan. If a service woman is tampered with by the master, the money is thereby considered absolutely paid, and the debt discharged. If forced against her will, not only is the debt cancelled, but he is also liable to prosecution and heavy fines besides to be paid both to the woman's husband as damages and to the town authorities as court fees.

If a young unmarried woman is tampered with, not only is the debt *ipso facto* discharged, but the master has to repay the *fiancé* all the money he has spent on her and also a betrothal "dowry" to the parents besides. If the matter is not arranged amicably and the case has to go before the town authorities, the master has to pay, and heavy fines are inflicted on him besides. Often has a rich man been reduced to poverty by this means and consequently they are always very careful.

If a betrothed girl becomes marriageable whilst in service and her *fiancé* wishes to get married at once, he has only to pay back the loan and lead his intended bride away. A woman cannot be married whilst doing service work. A boy or a girl in service has to live entirely with the master or mistress as a domestic servant, inasmuch as their services are not worth much and they have to be trained besides, and the parent or whoever placed him there is supposed to have his whole time to ply his trade and withdraw his child as soon as possible; therefore, the boy must give the master his whole time whatever that may be worth. The master is bound to feed him but not necessarily to clothe him, although many kind masters do that as well. They have a fixed time to visit their parents, usually once a week.

The boys generally tend horses and run errands, and the girls engage with the house-wives in domestic affairs. They are always with the boys and girls of their own age in the family. The law protects such children very strongly. If the child refuse to stay any longer with the master or mistress for any cause whatever, they are never forced against their wish, but the parent or guardian must provide a substitute, or perform himself the weekly task.

If a child dies during his or her service, the master must prove to the satisfaction of the parents and (if need be) of the town authorities that it was not due to any act of carelessness or neglect on his part, and that he provided ample medical aid for him. The troubles accruing from young **Iwofas** are often a deterrent to the acceptance of them for service; some folks would expect and demand more comforts for their children in service than they can provide for them at home. Marriages and funerals are the two great causes of money borrowing.

But this system is not limited alone to the business of professional money-lenders, it enters much into other transactions of their everyday life. The system of engaging domestic servants for service with a monthly wage is unknown in this country, the **Iwofa** system is what is resorted to for that purpose. A parent will even put his child into service that way when there is no debt to pay in order to train him into habits of discipline and industry, and return the money when they feel that the child has been sufficiently trained. Some would do so and put the money into trade and when satisfied with the profits made, return the principal and bring the child home.

The system is used also for apprenticeship. A man who wants his son to learn a particular trade would put him under the craftsman for the purpose, and obtain from him a certain amount of money; the master, wishing to get his interest out of the boy will see that he learns speedily and well, so as to be of some use to him. In this way both are benefited.

A chief or a well-to-do gentleman with a wild and unruly son whom he wishes to tame, or who is indulged at home, would also resort to this method for training and discipline; in such a case the boy will remain with such a handicraftsman until he is able to earn his own livelihood by his craft, then the money is paid back and the boy returns home. This method of lending money is the only one known for investment and is therefore resorted to as their banking system. So the **Iwofa** system may be regarded at one and the same time as one for banking, apprenticeship, and domestic services.

Since the establishment of the British Protectorate there has been more than one attempt made to abolish the system as a "species of slavery!". The Yorubas themselves never at any time regarded it as such; to so regard it must be due either to an ignorance of the laws regulating it, or because an exact equivalent cannot be found in any European system. It can, however, be imagined what chaos will result in any European country if the banking system, apprenticeship, and domestic service were abolished at a stroke-if that be possible. Like any other system it may be reformed if given to abuse, that is more reasonable and statesmanlike. But to abolish it outright because it has no foreign analogue would be to disorganize the social life of a people with no compensating advantage to borrower or lender. If such were done in this case the greatest sufferers will be those it was intended to benefit, viz; the service men themselves. But with the country now settled, and everyone free to prosecute his business, there must be less of money borrowing and service for interest, and thus a gradual change or modification is naturally effected in this system, with no tendency to abuse.

2.3.3 Distraining for Debt

The Yorubas have a peculiar method of forcing payment out of an incorrigible debtor. When a creditor who has obtained judgement for debt finds it impossible to recover any thing out of the debtor, he applies to the town authorities for a licensed distrainor. This individual is called Ogo, he is said to **d'ogo ti** i.e. to sit on the debtor (as it were). For that purpose, he enters the premises, seeks out the debtor, or ensconces himself in his apartment until he makes his appearance, and then he makes himself an intolerable nuisance to him and to the members of the house generally until the money is paid.

The distrainor is a man of imperturbable temper, but of a foul tongue. He adopts any measures he likes, sometimes by inflicting his presence and attention on the debtor everywhere and anywhere he may go, denying him privacy of any kind, and in the meantime using his tongue most foully upon him, his own person being inviolable, for touching him implies doing violence to the person of the authorities who appoint him the task. He demands and obtains whatever diet he may require, however sumptuous and may help himself if not quickly served. If he thinks fit, he may lay hold on any poultry or cattle he finds in the premises, and prepare himself food, and all at the expense of the debtor. He must not take anything away but he may enjoy the use of anything he finds in the house.

Loud in his abuses, intolerable in his manners to all in the house whilst going in and out with the debtor, he goes on in this way all day, and from day to day if needs be, until even the inmates of the compound get tired of this, and then means will quickly be found of getting rid of the distrainor by paying off the debt.

2.3 ROSCAs: Innovative Financial Intermediation

Ardener (1964) defines a ROSCA as "an association formed upon a core of participants who agree to make regular contributions to a fund which is given in whole or in part to each contributor in rotation" (p.201). This definition suggests that the regularity of the contributions and the rotation of the fund are main features of a ROSCA. In general, each member of a rotating financial group contributes the same amount. For this reason, each member's contribution and financial take-home are identical. However, there exist groups where the participants may contribute varying amounts per meeting. In this case, the group has to ensure that the contributions from each individual correspond with each member's financial benefit for each cycle (Ardener, 1964).

Nzemen (1988) extended the concept of rotating savings and credit associations by contributing a mathematical framework for their financial transactions. Therefore, rotating financial groups are subdivided into four subtypes according to their specific financial features. The subtypes are defined as: ROSCAs with an interest free primary fund and no emergency fund, ROSCAs with an interest free primary fund and an emergency fund, ROSCAs with an interest charged on the primary fund and no emergency fund, and ROSCAs with interest charged on the primary fund and an emergency fund.

On the contrary, a non-rotating savings and credit association is defined as an organisation wherein participants agree to save regularly on a contractual basis (Schreider and Cuevas, 1992). The savings might be used for member and /or non-member loans on an interest or interest-free basis.

Another interesting aspect of a non-rotating savings and credit association is the direct correlation between the subscribed amount, the individual's savings capability, and credit worthiness. Non ROSCAs can be divided into three groups: savings associations, savings and credit associations, and credit associations.

Savings associations are based on regular contributions of fixed or variable amounts from members to the group fund. This fund is either kept by the treasurer at home, deposited in a savings account, or a combination of both. At the end of a specified period, the group members receive their deposits.

Savings and credit associations work exactly like the nonrotating savings associations and, in addition, the group savings fund is also used to allocate loans to members and possibly to nonmembers. An emergency fund might complement the savings fund. Usually, debtors of the emergency fund must pay interest on their loans. Debtors of the main savings fund might or might not have to pay interest. Money that is not lent is kept by the treasurer at home and /or deposited in a savings account. Interest revenues of nonrotating financial associations are either equally distributed among the group participants or in proportion to their accumulated savings according to commercial bank practices.

In contrast to the savings associations, in which a time period of operation is specified, the participants in the credit association agree to contribute variable amounts for an unspecified time period. Normally, the group participants subscribe once at the foundation of the group or at their entry. However, individual members might subscribe additional funds to their group share. A money lending group uses its fund exclusively for nonmember loans. Interest is charged in advance and loan terms seldom exceed one month. The interest is reinvested in nonmember loans until the end of the business year. At the end of the business year, the group members receive a dividend out of the interest revenues based on their subscriptions.

The suitability of the ROSCA as the credit or financial sector project design benchmark arises from three important features. One is its *ubiquity*, as suggested by the variety of its local names, which signifies its general viability and applicability in many developing countries[10]. Second, it unambiguously

[10] The Ibos call it Isusu or Otutu; Edos call it osusu, Nupes call it Dashi, Ibibios call it Efe, Ijaws call it Oku, Hausas call it Adashi while the Yourbas call it Ajo.

intermediates. Third, it is a *collective* activity, signifying popular, voluntary acceptance and congruity with the norms and expectations of the diverse cultures in which it operates. Other informal financial arrangements appear not to combine these three characteristics in the high degree and profound form exhibited by the ROSCA (Von Pischke, 1992).

The qualifications of the ROSCA as a standard for project design are demonstrated by a review of the functions and operations of the most simple form of ROSCA. The classic ROSCA consists of not more than a dozen members who know each other, usually as a result of social, employment, or locational bonds; who have little or no access to formal finance; and who agree to contribute a fixed sum periodically to a pool or 'hand' that is assembled and distributed by lot at meetings on agreed dates. One member receives the hand at each meeting. When each member has received a hand the cycle is completed, and the ROSCA disbands or reorganises. Classic ROSCAs are typically established by an organiser who presides over meetings and takes the first hand. More complex forms of ROSCAs only serve to emphasise ROSCA's advantages, including flexibility.

ROSCAs meet three key tests of financial performance in a stunningly simple and elegant way: they economise transaction costs, they lengthen term structures, and they manage risks effectively. Even more exciting is their ability to do so within diverse social contexts by creating incentives for good performance and responsible behaviour, which accounts for their continued popularity and existence in several places in Nigeria and the world at large. Finally, they are essentially private and voluntary and enjoy high levels of immunity from rent-seeking behaviour by non-members.

2.3.1 ROSCAs Economise Transaction Costs

Deposits and lending often involve high transaction costs for poor people. Deposits may be difficult to make and maintain, for example, because of pressing uses for funds among the relatively large but intimate social groups into which their society is organised, such as extended families, age groups, and villages. Most members of the group are aware of each other's income and wealth, and asking for and giving assistance are normal parts of daily life. Within the group, at least one person may be sick or need help at any time. There are lots of children to be clothed and educated, and rites of passage require gifts and other expressions of participation. Reciprocity is important, and implies transaction costs.

Borrowing also requires transaction costs. Where no one is particularly wealthy, obtaining funds for a major purchase requires soliciting a number of people. Each loan acquired bears its own terms and conditions, some of which may not be specified in detail but constitute relatively open-ended obligations. These types of obligations involve risks, and soliciting assistance may subject the applicant to gossip and speculation concerning motives and behaviour.

ROSCAs create pools of funds that are usually difficult for each member to assemble individually, which is an incentive to become a member. ROSCAs permit accumulation because of the contractual nature of membership. Some individuals who might not be disciplined savers on their own will make regular deposits in a supportive social environment, swelling the stock and flow of intermediated funds. Membership is generally taken very seriously: to default on a payment is a stigma. Reported cases of ROSCAs failure are infrequent, and suicides by defaulters have been recorded. Accordingly, accumulating funds to meet ROSCA obligations is recognised as important by the community. This gives the ROSCA a senior claim over the myriad of other purposes that enable kin, friends, and neighbours to dip into each other's meager savings. Information about who has how much money and when, which otherwise tends to deplete and possibly even discourage individual and communal savings through social pressure, is transformed through ROSCAs into a means to accumulate funds and protect members.

ROSCAs are organised so that transaction costs are minimised. No one except the organiser has to visit a number of people in order to form a group.

Terms and conditions are relatively few, straightforward, and applied consistently. Everyone's share can be equal, preserving social balance. The hand is assembled and awarded in full view of all members, making written records unnecessary. Each hand is distributed in the meeting at which it is gathered, leaving no group assets requiring management or offering temptations between meetings. This makes the ROSCA perfectly matched, as inflows and outflows are precisely synchronised. Perfect matching also permits ROSCAs to operate without any permanent capital. Distributions of the hand by lot, among nonprized members, those who have not yet received a hand, greatly economises an organisationally difficult and hence, potentially costly, aspect of ROSCA transactions, which is determination of the order of rotation.

The frequency of meetings is fixed with reference to members' cash flows. Office workers paid monthly in Nigeria have monthly meetings. Market women in Western Nigeria have *ajo* meetings when markets are held, often on 4, 7, or 14 day cycles depending on locations and goods traded. Meeting times and locations obviously have to be convenient for members.

Speculation about members' motives or behaviour can be muted by giving the ROSCA a specific purpose shared by participants, for example, an esusu among market women in Ibadan enables them to replenish their inventories periodically.

2.3.2 ROSCAs Intermediate

ROSCAs perform the intermediary functions of transforming future payments into immediate hands and accumulating small payments into larger pools. The number of members is identical to the number of hands, and each member receives one hand during the life of the classic ROSCA. At any point before the final hand, members who have not received hands are net savers, while those who have received a hand are net borrowers. Some members typically want early hands and may be called "borrowers", while "savers" seek later hands. As the ROSCA moves through its cycle, these savings and borrowing positions rotate.

2.3.3 ROSCAs Lengthen Term Structures

ROSCAs' basic financial feature is that they accelerate access to funds - all members except the recipient of the final hand receive the cumulative contractual amount of their contributions in the form of a hand before they could have accumulated it by acting alone, by saving the amount of their contribution each period. This results in more long-term financial behaviour by more people. Some who might not bother to make regular deposits for a year, for example, are willing to do so if they can obtain the end result, a lump sum withdrawal equal to their years' deposits, in less than a year. This mechanism equates each member's debt capacity and deposit or saving capacity, which amounts to the sum of a member's periodic contributions.

2.3.4 ROSCA Incentives Reduce Risk

The major credit risk is that a winner of an early hand may fail to make subsequent contributions. Accordingly, an interesting aspect of the ROSCA is how it sustains members' incentives to complete the cycle. While debt capacity equals deposit capacity, at no point before the last hand does any member's net position equal either. A nonprized member's net position is the sum of his or her contributions, while the amount of the hand minus contributions made equals the net position of a prized member. At the outset all members other than the organiser are net savers. In a ROSCA in which 10 members contribute ₦100 at each meeting, for example, the organiser obtains a hand of ₦1,000 against a payment of ₦100, yielding a net position of ₦900 borrowed. The member who receives the second hand has deposited ₦200 and receives a hand of ₦1,000, giving a net position of ₦800, and so on through the final member who receives ₦1,000 after having contributed ₦1,000.

In the first half of the cycle the majority of members have an incentive to continue contributing so that they can obtain a hand. At this early stage the burden of the obligation to contribute is highest; as periodic payments are made the obligation to make future payments lightens. In the latter half of the cycle winning members have an incentive to continue contributing because the people who could be hurt by their not doing so, the minority of nonprized members and the organiser, are a diminishing number who are increasingly identifiable. During this phase members' burdens in the form of promised future payments become relatively small; most of their obligations to contribute have already been met, making it easier to contemplate continued participation. Also, the claims of members on each other are quite complex, creating solidarity that fosters continued payment.

ROSCA credit is clearly saving-based, within a closed system of intermediation funded entirely by members' contributions. This closed circular structure helps maintain clarity among members regarding their organisation's objectives and their personal responsibilities, and creates solidarity that makes the ROSCA immune from intervention by outsiders.

The juxtaposition of tension and resolution illustrated by ROSCA relationship is common to successful financial contracts. In this respect the ROSCA is intricate, yet fundamentally simple and elegant.

2.3.5 Risk Management and Transaction Costs

ROSCAs' risk management strategies are applied first in organisation. Who should belong? How large should each member's contribution be? How many members should the ROSCA contain, or how long should the cycle be? These are financial decisions that require information about the character, motives, and financial performance of prospective members. Members will be especially interested in the status and reputation of the organiser. In return for this trust, the organiser has control over who is admitted, and may even be expected to make good on any defaults arising from the failure of other members to make contributions in full and on time. Organisational transaction costs and risk are borne most heavily by the organiser. For this service the organiser usually receives the first hand, which constitutes an interest free loan repaid over the life of the ROSCA.

The fixed cycle or term of ROSCAs permits exclusion of poor credit risks from future cycles. This simple exit mechanism is balanced by easy entry: anyone with some friends who have congenial cash flows can form a ROSCA. ROSCAs require no tangible collateral and are purely cash flow lending operations that do not require supervision of members' use of the hands they receive. ROSCAs work entirely on promise, trust, and consent, before other members as witnesses having intimate knowledge of each other. They create or confirm relationships among members that permit the application of certain sanctions. Participants clearly recognise that their relations with other members are the basis for transactions, and that their worth in the eyes of others depends significantly upon their performance under their shared promise.

The member receiving the hand is often responsible for refreshments at the meeting at which the hand is received, especially where ROSCAs meet in restaurants or bars. This transaction cost helps maintain group cohesiveness through eating or drinking together, and impresses on members the importance of continued loyalty to each other. Members can observe each other's health and moods, and gain indications of each other's current financial status. While many transaction costs are an annoyance to those who pay them, the obligation to provide hospitality for one's friends at ROSCA meetings is usually regarded as an honour or as an opportunity for fun, something to be enjoyed.

2.3.6 Lessons Learned from ROSCAs

First, ROSCAs offer insights into institutional features that are attractive to, and work successfully for, the poor. These include voluntary participation and organisational autonomy and self-sufficiency. These features enable members to include and exclude whomever they wish, and permit anyone to attempt to form a ROSCA. Each group can organise and manage its own affairs, following its own rules. Intervention is not needed or welcome when institutions are devised that the poor can manage themselves.

Second, ROSCAs are modes of financial service delivery attractive to the poor. Savings and credit are provided at transaction costs that are low in the eyes of the participants, or perceived as hardly being costs at all. Services are available at times and places clearly convenient to their users, and in a format that offers scope for flexibility through negotiation among the parties concerned.

Third, ROSCAs provide the terms and conditions governing access to and use of financial services that attract participation by the poor. Savings-based credit requires a commitment from the saver-borrower, which is made voluntarily. Saving and other behaviour supporting group objectives are encouraged by the prospect of credit access. Information is used as a basis for managing credit risk. Service delivery mechanisms tap and construct information systems to ensure member satisfaction and organisational survival. Where inflation is a problem and where a ROSCA performs more than primarily a social function, ways are devised to maintain equilibrium and a sense of fair treatment between savers and borrowers, offsetting hidden transfers created by inflation.

Fourth, ROSCAs demonstrate types of relationships between users and providers of financial services that are acceptable to and supported by the poor. Credit relationships are built on bonds, behavioural norms and sanctions that prevail outside the ROSCA. These provide the trust and confidence that underlie all successful financial relationships.

Discipline is also essential. It is provided by periodicity and by contracts. Commitments are made that have to be honoured on time and in the amount agreed in advance. Accountability is required routinely of all parties concerned and is incorporated into the operations of the organisation. Accountability is assisted by face-to-face relationships among individuals who are equal and by procedures understood by all concerned. For the system to work, bad risks must be excluded, which requires enforceable exit mechanisms. The ROSCA as a provider of financial services establishes and enforces senior claims on members. Yet, members, are not accountable to the ROSCA for the use of the funds they obtain when they win a hand.

Finally, the ROSCA affirms financial strategies found in successful financial markets generally. One is the matching of flows as a risk and liquidity management tool. Matching is demonstrated by the determination of debt capacity by savings capacity in the form of periodic deposits and loan repayments. A second strategy is conservation of capital and liquidity. The ROSCA does not require capital and liquidity separate from that of its members to manage risk. Capital and liquidity separate from that of members could create rather than reduce risk, yet more complex informal financial arrangements include simultaneous participation in both ROSCAs and fixed funds. This demonstrates another feature of successful financial structures, which is the capacity to innovate spontaneously. A third strategy, characteristic of auction ROSCAs, is reliance on market processes to determine interest rates. Auction ROSCA rates are determined by bidding among members, and there is no evidence that bids are often rigged.

Free bidding is a powerful signal, as is the voluntary and democratic operation of ROSCAs generally. These features permit individual expression, as in the free use of hands and in bidding, mutual accommodation in the form of acceptable group norms and enforceable sanction. The essentially liberal principles of ROSCAs enable participants to empower and protect their relationships collectively and themselves individually.

As benchmarks, ROSCAs challenge developers who attempt to assist poor people through credit projects. ROSCAs provide valuable, efficient, and sustained financial services to large numbers of low-income people around the world, while formal credit projects often do not. Careful examinations of ROSCAs show conditions and the high levels of precision and balance that are required for financial institutions to be successful in serving large numbers of poor people. Insights gleaned from studying ROSCAs may force would-be interveners to recognise the demanding conditions that have to be met for successful, sustainable interventions at the small end of financial transactions in low-income countries.

ROSCAs provide a new perspective on the seemingly intractable conditions that so often stand in the way of success and sustainability for donor-supported initiatives in financial markets. This may lead to diminished enthusiasm for credit programmes and a heightened search for alternative means of addressing poverty problems.

2.4 Linkages Between the Formal and Informal Financial Institutions

A great deal of informal credit originates in the formal sector. Likewise, banks are the major custodians of funds that flow in from ROSCAs, mutual aid associations, money lenders, etc. In most parts of West Africa, for instance, the 'esusu' operators deposit at the end of each day the total savings mobilised from the markets in one of the banks near the market [Aryeetey and Gockel(1989)]. In Ethiopia, 'edir[11]'and 'equb[12]' funds are kept in a bank for

[11] A mutual aid association known as 'edir' is most common in rural and urban Ethiopia. Its principal function is to help people during bereavement. Besides monetary assistance, members of 'edir' tend the cattle of the deceased, work on his farm and bring food and firewood to his family sometimes for as long as two months after his demise [Pankhurst (continued...)

reasons of safe custody and reasonable rates of return. In 1986, the National Bank of Ethiopia (the Central Bank) in formulating its interest rate policy guidelines announced relatively higher rates of interest for 'edir' and 'equb' deposits with the Commercial Bank of Ethiopia. In Malawi, the 'katapila' money lenders 'store liquidity in bank accounts [Bolnick (1962) p.64].

---

[11](...continued)
and Eshete (1958) cited in Adera (1995)]. In addition, the safeguards of a modern welfare state in places such as Addis Ababa are almost non-existent. There is practically no scheme of social insurance to cover sickness or disability and no pension scheme for widows, orphans and old people,nor is there any appreciable national assistance to provide for the destitute or the unemployed . 'Edir' is a scheme devised to alleviate these problems to a degree. Owing to the rapid urbanisation of Addis Ababa and its surroundings, the number of community and institutional 'edir' has risen very rapidly in the past two decades. The presence of contracts already in urban areas, the rapidly rising urban wage rates for unskilled workers in the modern sector and the relative stagnation of the agricultural sector partly explain the drift of the population from the countryside to capital cities such as Addis Ababa. And with a marked increase of population growth of about 2.6 percent per annum between 1965 and 1973, the poor is finding it extremely difficult to find a refugee in agriculture, and Addis Ababa is increasingly being swamped, with people fleeing from rural poverty [Abebe (1974)].

[12] 'Equb' is a ROSCA which is mainly concentrated in the urban conglomeration. What makes equb distinct from formal sector financing is that it caters to the less privileged strata of the Ethiopian society - weavers, potters, carpenters, shoeshine boys, 'tela' and 'tej' traders (local drinks made of barely and honey respectively, etc. This ROSCA is thinly spread in the rural hinterland. In a situation where not just a few but all farmers have an urgent credit need at the same time to meet planting and harvesting expenditures, it becomes difficult to meet the credit needs of all farm households simultaneously. Moreover, in a setting which is basically subsistence, the irregularity and low per capita income precludes the effective functioning of ROSCAs in rural areas. The most common form of equb is the one where payment is effected in monetary terms. However, contributions can also be arranged in kind [Mauri et al(1988)].

The complementarity between the formal and informal financial markets also has a considerable significance for monetary policy. An expansion of the formal sector implies a corresponding expansion of the informal sector; a contraction of the formal financial sector similarly connotes a contraction of the informal financial sector. This in essence suggests that government monetary policy would not only affect the formal sector of the economy but would have a far-reaching impact on the informal sector too. As reported in Adera (1995, p. 15) a restrictive credit policy in the formal sector creates excess demand for funds which spills over to the informal sector and bids up the cost of funds in the informal sector too. Thus, monetary policy is effective in restricting the total supply of credit and not just the supply of credit in the formal sector.

Extrapolating from the Thai experience, one study shows that the contraction of bank credit in 1983 not only increased the demand for ROSCA credit, it also decreased the supply of informal credit flowing to ROSCAs. Hence, the effect of linkages was to reinforce the demand forces in raising interest rates and increasing the effectiveness of monetary policy [Ghate (1992)]. Furthermore, in the same study, the author argues that in periods of inflation, the tendency to engage in speculative activities such as investment in real estate and stock building rises sharply. Since central banks impose selective credit controls for these purposes, demand pressures have to be accommodated almost exclusively by the informal financial sector. Thus, the continued and increasing interaction between the formal and informal financial sectors suggest that there are many possibilities for achieving interlinkage. But the question is: How is this daunting undertaking to be achieved?

To begin with, the prevailing *modus operandi* of the formal financial sector shall have to be radically revised. As it is, a broad spectrum of the rural population in Africa regard banks that cater for the well-being of rich people. In the Gambia, for example, 'farmers perceive banks as remote, intimidating, and not fully trustworthy, and by and large they do not go to them [Shipton (1990) p.39]. The conventional financial institutions do not regard poor people as bankable. In fact, it is the rules and regulations of the formal financial institutions that have created the myth that the poor are not bankable. According to this point of view, since the poor cannot afford collateral, they are not credit-worthy. This myth has now been refuted by institutions such as the Grameen Bank of Bangladesh, Badan Kredit Kecamata Programme (BKK) of Indonesia, and ACCION in many Latin American countries, which have drawn worldwide attention [UNDP(1989), Riedinger (1994)].

In the case of Nigeria, the People's Bank and Community Banks schemes which were designed to improve access of the poor to banking facilities in Nigeria deserve careful study. The community banks which commenced business in December 1991 increased in number from 66 to 401 in 1995 (Central Bank of Nigeria, 1996). The Community Bank is expected to operate as a single unit office bank without branches or affiliates. Its main feature is that it will be closely tied to the economic fortunes of the community where it is located. This linkage is in turn expected to encourage the community bank to carry along the community it serves, thereby contributing to the overall development of the banking system and the economy.

CHAPTER THREE

THEORETICAL FRAMEWORK AND LITERATURE REVIEW

3.1 Introduction

Three major views have dominated the literature on informal financial markets. According to the traditional view, informal financial markets were characterised by monopolies, with inordinately high interest rates as the consequence. This view led to many heavily subsidised credit schemes in developing countries.

This traditional view of informal financial markets was strongly criticised in a series of papers, later collected in the volume by Von Pischke, Adams, and Donald (1983). The critique was enlivened by observations of credit policies in developing countries. Even a cursory look revealed a rich crop of disasters induced by poorly designed policies. This critical literature stressed the distortions introduced by government policies and, in doing so, tended to idealise the informal credit markets that did exist or that might have existed in the absence of the massive government intervention in the credit market. There was a presumption that an intervention-free informal financial market would approximate the perfect competition model.

A third view, much represented in this thesis, emphasises the informational problems tht make credit markets inherently imperfect, even in the presence of competition among a large number of lenders. This view stresses the contractual aspects of the market under imperfect information, but maintains the notion of a 'credit market' as an arena where strangers meet to borrow and lend. Lenders cannot observe or monitor the behaviour of borrowers in certain respects, which leads to moral hazard and adverse selection. The lenders' solution to these problems may give rise to credit rationing in competitive equilibrium.

3.2 Theoretical Underpinnings

A conceptual basis for analysis of the informal financial market can be anchored around the classical model of the competitive economy (Hoff and Stiglitz, 1990) and the theory of economic behaviour under conditions of incomplete information (Aryeetey and Udry, 1994; Herath, 1996). The market for funds is conceived to be like the market for any good or service, with the supply of savings constituting the supply curve for loans, and the demand for funds for investment and consumption purposes constituting the demand curve for loans. There is no explicit role for financial intermediation, as the market smoothly transfers funds from savers to investors and consumers.

Intermediaries do exist between producers of goods and the ultimate consumers. One way they have been explicitly considered is by imagining a good at the producer's location as a different one from the one available to the consumer. Wholesalers, retailers, etc. are then seen as transforming goods from one form into another. For most purposes this is a reasonably satisfactory solution where ordinary goods and services are concerned. For an informal financial market, acting as a financial intermediary, and receiving deposits and making loans at the same location, this seems a patently contrived solution. It does however alert us to the fact that there are really two markets here, not one as postulated by simple savings-investment model. On one side is the market for deposits, with a supply curve given by the traditional savings side of the market, and a demand curve constituting the demand for loanable funds. On the other side is the market for loans, with a supply curve depending on informal credit markets and a demand curve aggregated over individual borrowers.

There is a fundamental difference between either of these two markets for funds, and the corresponding market for a good. In any goods market there is a simultaneous exchange of value, the payment for the good is made at the same time as the supply of the good. It is a fundamental feature of the credit market, that the payment for the good is made at a later date than that at which the good is supplied. On the deposit side of the market, the good consists of the savings or other deposits and the payment consists of interest plus principal. On the loan side, the good is the loan amount, the repayment is the principal plus interest. In both cases the good is exchanged for a commitment to pay a specified sum or sums in the future. Clearly the actual realisation of the commitment depends both on the ability and the intentions of the individual or firm making the commitment. Uncertainty about these aspects therefore plays a fundamental role in the credit market. The view of this school of thought is that credit markets work as classical competitive markets. The high interest rates are a reflection of the risks of default the market bears. The policy conclusion of this line of argument is not to intervene in informal financial markets, at least not on efficiency grounds.

In the literature, it is hypothesised that interest rates in the informal financial sector are higher than those of the formal sector (Soyibo, 1994; Aryeetey, 1994; Bagachwa and Naho, 1994). The higher interest rates charged by moneylenders relative to rates in the formal sector are attributed to the monopoly power of the moneylender. It is asserted that the market is characterised by monopolistic competition. Each lender faces a downward-sloping demand curve from borrowers tied to him, so that he can price at above marginal cost, but entry of new moneylenders keeps pure profits close to zero by driving the price down to the average cost. Thus, in the usual way of monopolistically competitive markets, each lender operates on too small a scale;

he spreads his fixed costs over too small a clientele. It is therefore contended that exploitation through credit terms is pervasive and highly oppressive. This contention has provided a rationale for government-controlled cooperative credit and for government-owned credit systems and programmes in many countries (Von Pischke, 1991, p. 174).

However, as Von Pischke (1991) points out, there is a basic flaw in the malicious moneylender myth. The myth interprets quoted lending rates of interest, often of gigantic heights, as evidence of monopolistic practices. High prices do not prove monopoly, however. How many observers would conclude, for example, that because a car costs more than a bicycle that the manufacturer or retailer of the car gouges consumers? The economic test of monopoly is net return. Net returns to lenders may be difficult to identify precisely in credit markets because lending is often conducted in conjunction with other activities on the part of the lender and other relationships between borrower and lender[13].

As noted by Hoff and Stiglitz (1990) neither the perfect market nor the traditional monopoly view can explain the following features of the rural credit

---

13 The problem of joint costs and interrelated benefits also makes it difficult for bankers to know the exact costs of many services they provide, although overall net returns earned by banks are routinely reported.

markets which are at least as important and equally puzzling as high interest rates.

- The formal and informal sectors co-exist, despite the fact that formal interest rates are substantially below those charged in the informal sector.
- Interest rates may not equilibrate credit supply and demand: there may be credit rationing, especially in periods of bad harvests.
- Credit markets are segmented. Interest rates of lenders in different areas vary by more than plausibly can be accounted for by differences in the likelihood of default; and local events - a failure of a harvest in one area - seem to have significant impacts on the availability of credit in local markets.
- There is a limited number of commercial lenders in the informal sector, despite the high rates charged.
- In the informal sector interlinkages between credit transactions and transactions in other markets are common.
- Formal lenders tend to specialise in areas where farmers have land titles.

An alternative conceptual basis for understanding the workings of the informal financial sector, which helps us to design appropriate interventions, is the theory of economic behaviour under conditions of incomplete information. This is also known as the Imperfect Information Paradigm. Herath (1996) contends that failures of credit market intervention resulted from an incorrect perception of the nature of the rural credit markets. Classical models of monopoly or competitive markets do not adequately explain features of rural credit markets, such as the co-existence of formal and informal lending, credit rationing, interlinking and market segmentation. The characteristic that makes credit markets unusual is the high degree of imperfect information, and hence a high degree of risk, that prevails. Risk is generally not so important in markets for other goods. It is because credit markets involve a contract between two parties to be executed over time that imperfect information and risk are important.

Imperfect information paradigm is a step ahead of the simple paradigm of competitive equilibrium and provides a new theoretical foundation for policy intervention in efforts to correct market failure. Dominated by the important work of Stiglitz and Weiss (1981), a large number of theoretical papers have explored the implications of imperfect information and incomplete markets for contractual forms in credit markets in developing countries.

Of course, an observation that a credit market is subject to moral hazard or adverse selection in itself does not provide an economic rationale for intervention to correct a market failure because the incomplete information equilibrium may be constrained Pareto efficient. Nor does economic theory generally provide sufficient guidance to predict the distributional or efficiency consequences of a proposed policy change. A rich set of empirical knowledge is required before such conclusions can be drawn. Besley (1992), as cited in Aryeetey and Udry (1994, pp. 3-4), ends his review of the literature on credit market interventions with the conclusion that

> there may be good arguments for intervention and some are based on market failure. However, as one begins to unpack each argument, there is a gradual realisation that given the present state of empirical evidence on many relevant questions, it is difficult indeed to pinpoint when a credit market intervention is justified. There can be little doubt that empirical work which can speak to these issues is the next challenge if the theoretical progress is to be matched by progress in the policy sphere. (Besley, 1992:34)

It should be emphasised that imperfect information in credit markets creates adverse selection and moral hazard problems for lenders. These problems increase lenders' risks and can affect the way the market for credit operates (Herath, 1996:24; Hoff and Stiglitz, 1990: 235-50). Credit markets involve an advance of funds in exchange for a promise of repayment later. Thus there are risks for both lenders and borrowers. The lender faces the possibility that the borrower will not repay as promised, while the main risk for the borrower is the possibility of being unable to meet the interest and repayment obligations. A lesser risk for the borrower is that the investment will remain less than the loan costs, so that the borrower's net income is reduced. The relative risks faced by the two contracting parties are related to the level of information possessed by each.

Moreover, there is information asymmetry between the borrowers and lenders, with the borrower possessing more information than the lender. A borrower may plan to default on a loan, but the lender may not know this. Lending is risky because borrowers differ in the likelihood that they will default, yet lenders seldom know the true circumstances and intentions of a borrower. Because collecting information to screen all borrowers is costly for lenders, information asymmetry may result in an externality imposed on honest and reliable borrowers when the lender sets interest rates to cover costs of default by other borrowers.

Adverse selection occurs when borrowers who obtain loans are more likely to default than other potential borrowers - either those refused a loan or those who do not apply. This may occur, for example, if dishonest borrowers seek loans more often, or in larger amounts, than honest borrowers. Moral hazard occurs if the fact that a loan has been advanced given an incentive to the borrower to give less attention to risk management than he or she otherwise would, or if a borrower is otherwise encouraged to default. Both adverse selection and moral hazard increase these risks for lenders, who need to take actions to protect themselves from these risks, or to recover the costs of defaults.

The risks for an informal lender arising from adverse selection and moral hazard are not independent of the interest rates charged. High interest rates increase adverse selection and moral hazard for at lease two reasons. First, potential borrowers will need to have available investment opportunities yielding high return in order to justify higher loan costs. But investments with high expected returns are usually more risky than less rewarding opportunities. Second, the higher the cost of finance, the greater the incentive for borrowers to elect to default, *ceteris paribus*.

Because raising interest rates increases risks for lenders through greater adverse selection and moral hazard, total revenue to the lender will at first rise with increase in interest rates, but at a declining rate as the default rate also rises. There will be an interest rate at which the lender's revenue is maximised, known as the bank-optimal rate. A rational lender will not wish to raise the interest rate above this level. The consequence may be that, if the demand for credit is strong, interest rate may not serve as an equilibrating price to bring credit supply and demand into alignment. In such circumstances, lenders may have to turn to other devices to ration available funds.

Other theoretical underpinnings used in the study of informal finance are the theories of market segmentation and dualism. In a segmented market many suppliers put 'similar' products on the market but at different prices. Some of these may have more in common than others and can therefore be given common labels. Subsequently, there are such diverse lenders as banks, finance companies, credit unions, moneylenders, savings and credit cooperatives, savings and credit associations, esusu collectors/ mobile bankers /money guards, friends and relatives. They form segments of the financial market because there is relatively little interaction between categories and the prices of each category have little or no bearing on the operations of others. f their creation had been fostered by repressive official policies, one could have labelled all the non-official units as forming a *parallel market*. Where the number of segments is relatively large and interaction among them is relatively nil, one might describe the market as fragmented. In the situation where the segments are perceived to be falling within the frontier of either formal or informal financial markets, the market is described as dualistic[14].

3.3 A Model of a Perfectly Competitive but Highly Personal Informal Credit Market

In this model, it is assumed that lenders can, at a cost, acquire complete information about a borrower's resource endowment, tastes, and investment opportunities. Moreover, the lender can prevent the borrower from acquiring credit from other sources.

A Fisherian analysis based on the borrower's opportunity set and tastes will yield a borrowing requirement per year denoted $b(r,\alpha)$, where r is the rate of interest and α is a shift variable. Let subscripts denote the partial derivatives and define α so that $b_\alpha > 0$. Assume $b_r < 0$, that is, the desired transaction level between borrower and lender falls as the interest rate rises.

The lender's costs consist of two components: the cost of funds, denoted i, and the cost of the lender's effort to obtain full information about the prospective borrower. His/Her cost of efforts depends on the number of borrowers that he/she has to deal with (the size of his clientele, denoted n) and

[14] For more discussion, please see Aryeetey, 1995.

the total number of lenders in the market, denoted N. We assume the cost funtion to be:

$$C = C(n, N) \text{ with } C_n > 0,\ C_{nn} > 0,\ C_N > 0,\ C_{nN} > 0 \qquad \text{(Eqn 2.1)}$$

The larger the clientele, the higher the lender's marginal cost of effort. Diminishing returns set in faster the more numerous his competitors are, so that he has to range further afield to obtain the same number of borrowers.

The lender's problem is to solve:

$$\max_{n}\ n\,[r-i]\,b(r,\alpha) - C(n,N) \qquad \text{(Eqn 2.2)}$$

The first term in the maximand is the gross profit that the lender can make from a clientele of n borrowers. The informal interest rate, r, is here considered a parameter for the lender, as is N. This framework assumes that all borrowers are identical, so all loans are characterised by the same size (b) and interest rate (r).

Two interpretations can be given of the lender's maximand. The first points out that his cost function consists of two parts: the cost of his efforts, captured by the C(.) function, and the cost of funds, captured by the term $nib(r,\alpha)$, where the supply of funds to the lender is perfectly elastic at the rate i. Another interpretation would emphasise that the function of the lender is to arbitrage between the formal and informal markets, and the extent of the arbitrage is limited by the cost of his effort invested in lending.

The first-order condition from the maximisation problem is:

$$[r\text{-}i]b(r,\alpha) = C_n(n, N) \tag{Eqn. 2.3}$$

The market equilibrium is given by:

$$nN = B \tag{Eqn 2.4}$$

where B is the total fixed number of borrowers. Entry or exit will occur unless the zero-profit condition is met:

$$n[r\text{-}i]b(r,\alpha) - C(n, N) = 0 \tag{Eqn 2.5}$$

Equations 2.3, 2.4 and 2.5 together are the conditions for a perfectly competitive market equilibrium, with r, n and N as the endogenous variables.

A conventional comparative exercise on the three equations yields the following results, where ϵ_{br} denotes the elasticity $\delta \ln b/\delta \ln r$:

$$\delta r/\delta i = \frac{1}{1 + [1 - i/r]\epsilon_{br}} \tag{Eqn 2.6a}$$

$$\delta n/\delta i = 0 \tag{Eqn 2.6b}$$

$$\delta N/\delta i = 0 \tag{Eqn 2.6c}$$

$$\delta r/\delta \alpha = \frac{-r[r\text{-}i]b_\alpha /b}{1 + [1\text{-}i/r]\epsilon_{br}} \tag{Eqn 2.6d}$$

$$\delta n/\delta \alpha = 0 \tag{Eqn 2.6e}$$

$$\delta N/\delta \alpha = 0 \tag{Eqn 2.6f}$$

To obtain clear comparative static results, we use the requirement for stability that

$$1 + [1\text{-}i/r]\epsilon_{br} > 0 \qquad \text{(Eqn 2.7)}$$

which is a slightly weaker condition than $|\epsilon_{br}| < 1$.[15] This requirement means that a rise in the interest rate charged will increase the lender's arbitrage profits(before transaction costs). Thus, an exogenous increase in transaction costs can be passed on to the borrower.

The surprising and important result (from equations 2.6d and 2.7) is that an increase in the size of the credit transaction (captured by a shift in α) leads to a decline in the rate of interest. Please recall that the cost of the lender's effort

---

[15] The stability conditions arise from the following dynamic specification:

$$\delta n/\delta t = k_1 [r\text{-}i]\ b(r,\alpha) - C_n(n,N)]$$
$$\delta r/\delta t = k_2 [B - nN]$$
$$\delta N/\delta t = k_3 [n[r\text{-}i]b(r,\alpha) - C(n,N)]$$

where all the k_i's are positive. For this system to be stable, it is required that the principal minors alternate in sign(Ammar Siamwalla and others, 1996, p. 183) from which we obtain:

$$b + [r\text{-}i]b_r > 0$$
$$- N\ C_n - n^2C_{nn} + nNC_{nN} < 0$$

A sufficient condition for the second inequality is $-n^2C_{nn} + nNC_{nN} < 0$ or $n[nC_{nn} - NCnN] > 0$, meaning that the marginal transaction cost is more sensitive to the departure of a client than to the entry of a new competitor.

per borrower does not depend on the size of the loan. Hence, as the amount of transaction between borrower and lender increases, the cost of that effor can be spread over a larger loan. Competition ensures that cost saving will be passed on to the borrower. Another surprising result is that the number of lenders N and the size of the clietele n are unaffected by the change in credit requirements.

A second result (from equations 2.6a and 2.7) is that $\delta r/\delta i > 1$: changes in the interest rate in the informal credit market will magnify any change in the cost of funds to the lender. Neither of these results depends on the assumption of identical borrowers. Allowing for g different classes of borrowers changes the specification of the model as follows. The lender's problem becomes

$$\underset{n_1,\ldots,n_g}{\text{Max}} \ \Sigma n_j \ [r_j - i] \ b_j(r_j,\alpha_j) - C(\Sigma n_j, N)$$

for which the first-order conditions are

$$[r_j - i]b_j(r_j,\alpha_j) = Cn(\Sigma n_j, N) \ j = 1, \ldots, g.$$

The two equilibrium conditions become

$$n_jN = B_j \qquad j = 1, \ldots, g$$

$$\Sigma n_j[r_j-i]b_j(r_j,\alpha_j) = C(\Sigma n_j, N)$$

where B_j is the total number of borrowers in class j.

Comparative statics are exactly the same as when identical borrowers are assumed, except for the addition of the relevant subscripts. A strong result is that an increase in the demand of a particular class of borrowers does not affect the rate of interest charged on the remaining borrowers, that is

$$\delta r_j / \delta \alpha_k = 0 \text{ for } j \neq k$$

At first sight, this is surprising inasmuch our explanation of the results of the identical borrower case relies on the fixed cost argument. One would therefore expect economies of scale arising from a demand increase of one class to benefit the other classes of borrowers. This is not so. Competition forces the lenders to segment the market completely so that the demand of each class of borrowers affects the interest rate for that class only.

This heterogenous borrower model can also be used to explain the observed inverse relationship between loan size and interest rate and, with some modifications, it could also explain the inverse relationship between loan duration and interest rate.

Under a conventional flow-of-funds analysis of the informal credit market, the apparent stability in informal real interest rates over the past twenty years would be explained by offsetting effects of (a) commercialisation (increasing the demand for loans) and (b) new sources of loans through the community banks and commercial banks (decreasing the demand for informal loans). However, under a conventional flow-of-funds analysis, it is difficult to explain the persistence of the huge gap between informal and formal interest rates, even if we allow for a higher rate of default on informal loans. The gap, of course, arises from a rationed credit system that accompanies a controlled interest rate structure. But such a rationed system would in turn give rise to widespread arbitrage between the formal and the informal sectors. Whiel some arbitrage undoubtedly might exist, one is surprised by its limited extent. In any case, the arbitrage would not be costless, but would involve the very same transaction costs between the would-be arbitrageur and the final borrower.

This model, based on a transaction cost analysis of the informal credit market, provides a framework for explaining the persistence of the gap between informal and formal interest rates, as well as of the stability of the informal rate. Within this model, (a) commercialisation would increase the size of the transaction between the borrower and his sole source lender in the informal sector (and the increase in b will in turn reduce the informal interest rate r); (b) provision of loans from the community banks would reduce b (and this would increase r); and (c) provision of loans from commercial and community banks to lenders at low interest rate i will reduce r. The differential between formal and informal sectors would persist as a reflection of the real resource costs incurred by informal lenders in obtaining information about borrower, and the fact that the formal sector does not appear to have the transactions technology to be able to process the general credit needs of the rural households. The only specific areas where it has been able to create this technology is in working capital loans (community banks) and in collateralised loans (the commercial banks).

3.2 Origin of Informal Finance

The origin of informal finance is the debate of two schools of thought: The financial repression school and the neo-structuralist school. The financial repression school (or the McKinnon-Shaw School) which developed from the seminal work of McKinnon (1973) and Shaw (1973) theorises that the defining feature of underdevelopment is fragmentation - i.e. a situation in which agents face different prices and do not have access to the same technology. The immediate cause of this fragmentation is government policy which is designed to favour certain activities or classes of agents at the expense of others. In turn, intervention has often been justified by the pursuit of social goals that are inhibited by the improper functioning of capital markets. In the absence of private finance public policy has relied on transfers of income to targeted activities. Since fiscal constraints have often precluded direct income transfers through the budget, governments have resorted to less direct and more inefficient means of redistributing income - that is, by altering the structure of relative prices.

McKinnon perceives self-financing to be the rule in many low-income countries because financial intermediation is inadequate; there is no one to intermediate between savers and those with profitable investment opportunities. In addition, McKinnon assumes that wealth holders in the low-income countries resist holding financial assets other than money. Such financial intermediation as does exist, therefore, is conducted by the banking system. However, the banking system performs inefficiently as a financial intermediary because of financial repression. In other words, administratively-imposed ceilings in interest rates and strict collateral requirements force banks to concentrate their portfolios on safe, low-yielding assets. In addition, large reserve requirements are imposed to shift the allocation of investible funds from the financial market to the government, thus reducing the flow of funds into banks while also creating excess demand for credit at official rates. As a result of the ceilings on interest rates and the imposition of large reserve requirements, banks pay low interest rates to savers. The resulting disequilibrium in the official credit market tends to generate a parallel market, thus giving rise to and perpetuating an informal financial sector (McKinnon, 1973; Shaw, 1973; Fry, 1988).

Financial repression is perceived by McKinnon-Shaw school to have a number of adverse consequences. It reduces both the quantity and quality of new investment, and thereby also the economy's rate of growth. In low-income countries, money is held as a store of value, rather than simply for transactions purposes. Consequently, the real return on money represents the marginal return to saving, and a low real interest rate on money, consisting of a low nominal interest rate on deposits, often combined with a high rate of inflation, tends to depress private saving. Because the accumulation of money balances and physical investment are complementary, the reduction of saving reduces investment in physical capital. Moreover, low administratively-determined interest rates on bank loans ensure that credit will be rationed by non-price means, implying that many low-return projects will be financed, artificially depressing the aggregate rate of return on investment.

The financial repression school acknowledges the emergence of informal financial markets to fill the credit gap and serve as an alternative vehicle for saving. However, the school of thought perceives the markets as inefficient, limited in scope, and not central to the transmission of shocks from the financial to the real sector.

By contrast, informal financial markets occupy a prominent place in the Neo-structuralist school of thought. The school views the existence of informal finance as products of other forces other than economic forces (Soyibo, 1995). According to this school, informal financial markets are subordinate to the formal financial markets. Market segmentation occurs not because of regulation but because informal financial markets exist to serve social goals rather than simply to make the highest profits. According to Soyibo (1995) informal financial system redistribute income among community members and provide a form of social security by meeting members' fluctuating liquidity needs. They express solidarity based on kinship, ethnicity or religion.

The markets play two important roles in the Neo-structuralist models. In commodity markets, they are taken to determine the marginal cost of funds relevant for private spending and saving decisions. In financial markets, they represent an alternative mode of financial intermediation available to private savers.

The reason why the prevailing interest rate in the informal financial markets is accorded an important commodity-market role is that when interest rates in the formal market are administered at below market clearing levels, agents cannot borrow and lend without a limit at such interest rates. The marginal cost of funds, therefore, is given by the informal financial market rate.

Nevertheless, several structural features of the macroeconomic models used by proponents of the Neo-structuralist framework are held in common with the McKinnon-Shaw framework. These include the specification of the formal financial sector as consisting essentially of the banking system, and the role of working capital in determining the supply-side response of the economy to changes in monetary policy instruments.

It is common knowledge in Nigeria that the origin of informal finance predates the origin of formal banking system. Prior to the colonial era, and much before the banking crisis of 1935, informal financial activities had been going on in the Nigerian heterogenous societies. The most common type of informal finance in all pasts of Nigeria in the esusu/ajo. This involves transfer of cash among economic agents but no interest payments are made. Among the Yorubas, apart from being called esusu, it is also known as ajo. The Igbos call it Isusu or Otutu while among Hausas it is known as Adashi. It is known as Dashi among Nupes, Efe among Ibibios, Oku among the Kalabari, Ijaws and Osusu among Edos (Soyibo, 1994).

From the foregoing, it can be inferred that the neo-structuralist framework (and not the financial repression hypothesis) is the theoretical framework on which informal finance in Nigeria is anchored. In other words, the existence of informal finance is a product of forces other than economic forces.

A number of studies on informal finance in Africa suggest that the activity thrives under both repressive and liberal financial sector policies (Aryeetey, 1994; Chipeta and Mkandawire, 1994; Soyibo, 1994; Bagachwa, 1994). Their performance in many African countries indicates that they will do well so long as the level of economic activity within the economy calls for increasing financial services from groups that cannot be reached by existing financial institutions. Whenever a demand for short-term credit, particularly among traders, farmers and consumers, emerges an informal but is likely to emerge also to meet that demand.

3.3 Typology of Informal Financial Units

Aryeetey and Udry (1994) identified three types of informal financial units found in Africa. These are the savings mobilisation units that do little or no lending, lending units that seldom engage in savings mobilisation, and units that combine deposit mobilisation with some amount of lending, though to members of distinct associations or groups mainly. The institutions that take in deposits and lend at the same time have been described by Siebel (1989) as "self-help organisations". The emergence of these institution in less than fifty years is a response to the need for some form of direct financial intermediation. The first category of deposit mobilizers includes savings collectors while moneylenders including relations and friends do not generally accept deposits and therefore fall into the second category. In the third category are Savings and Credit Associations, credit unions/credit cooperations. These financial units take in deposits and also lend in rather varied forms.

Each informal financial unit is purpose-oriented thus depending on the socio-economic goals of communities, institutions are developed to meet the demand for specific financial services. These units respond to the demand of a distinct clientele using various geographical and/or socio-economic criteria. While institution names and size may differ, informal financial units always operate on the common principle of stepping into a particular niche in the market whenever possible.

In Nigeria, there are two major types of informal finance: cash and kind. A common feature of these two types of finance is that they make available pools of resources for individual use. The in-kind type of informal finance which often involves pooling of labour, is used in agricultural projects like land clearing, planting, harvesting and so on, or for building a new village house.

Among the Yorubas, this labour-pooling informal finance approach involves two types: *aaro* and *owe*. Aaro pools together the labour of two or more people, usually friends or members of the same age-grade to work, often on a farm, for a given period. This has to be 'repaid' to other members of the pool on rotational basis, for the same number of periods. The member on whose farm the pool works may provide food and other refreshments on days when the group works on his farm. Whatever is provided is expected to be 'repaid' when other members benefit from the work of the pool (Soyibo, 1995).

Owe, on the other hand, has more people in the pool than the aaro. Owe is employed in agricultural projects like land clearing, planting and harvesting. A day or two is usually set apart for this type of labour-pooling technique. As many people as possible in the village or other adjoining settlements are invited. Guests would meet on the farm to do the required work for as long as it takes to finish. The host usually provides his guests with food and drinks only. Cash compensation is not used at all. Of course, courtesy demands that if the host is invited to any other owe, having benefited previously, he is obliged to attend.

The most common type of informal finance in all parts of Nigeria is the *esusu/ajo*. This involves transfer of cash among economic agents but no interest payments are made. Among the Yorubas, apart from being called **esusu**, it is also known as **ajo**. It is known by various other names among other

Nigerian ethnic groups. Among the Igbos, it is called **Isusu** or **Otutu** while Edos call it **Osusu.** It is known as **Adashi** among Hausas, **Dashi** among Nupes, **Efe** among Ibibios and **Oku** among the Kalabari Ijaws. However, it needs to be emphasised that reciprocity rather than financial intermediation is the rationale underlying the in-kind finance.

Another important group of informal finance operators that have existed in Nigeria for a long time are the money lenders. The belief that money lenders extract economic surplus provided by peasant labour, capital and possibly land (Von Pischke, 1991) holds also in Nigeria. It is not uncommon for farmers to pledge their economic trees like cocoa, kolanut, rubber, oil palm tree and even entire farmlands as collateral for money borrowed from money lenders (Soyibo, 1994). In days gone by, children were pledged as collateral and such children would live and work with the money lender until such a time that the amount borrowed is repaid in full. These are examples of usufruct loans in which a lender occupies and uses a borrower's economic resources like land until the principal is paid (Hoff and Stiglitz, 1990).

Besides, other types of informal finance include moneylenders, mutual assistance groups, landlords, friends, neighbours, relations, employers, and co-operative savings associations. In co-operative savings associations (or rotating savings and credit associations (ROSCAs), as it is popularly called) however, the procedure is as follows. Each member of the ROSCAs contributes an equal sum of money at the end of every month or whenever income is earned. The pooling may, therefore, be regular or periodic. The contributions are given to members one at a time, hence the term co-operative savings association or rotating savings and credit association. No interest is charged for using the funds raised in this way. Members are fully compensated by receiving from others what they paid to them. The striking aspect of ROSCAs is that credit and savings processes are interwoven. Members save to obtain credits of sizeable sums from the group. The first collector in the group receives an interest-free loan while the last collector extends credit to other members. Others in the group alternate between debtor and creditor positions (Oladeji et al, 1992: 96). Thus, in ROSCAs both credit and saving positions rotate among the members.

3.4 Credit Rationing in the Informal Financial Market

The most basic tenet of economics is that market equilibrium entails supply equalling demand. If demand should exceed supply, prices will rise, decreasing demand and /or increasing supply until demand and supply are equated at the new equilibrium price. So if prices are effective, rationing should not exist. However credit rationing does in fact exist. It seems to imply an excess demand for loanable funds.

Credit rationing is associated with short or long-term disequilibrium (Stiglitz and Weiss, 1981:393). In the short term it is viewed as a *temporary disequilibrium* phenomenon; that is, the economy has incurred an exogenous shock, and there is some stickiness in interest rate so that there is a transitional period during which rationing of credit occurs. On the other hand, credit rationing is explained by governmental constraints such as usury law and reserve requirement enforcement. These conditions therefore help to enhance the movement of people into the informal sector for financial survival.

Similar to the formal financial sector, credit is also rationed in the informal credit market. Because of the insufficient supply of credit to the market, and for other reasons, a moneylender charge high interest rates which are a device to maximise the current income of the lender who is more concerned to maximise and ensure payment of interest than to amortize the principal. The constituents of the nominal interest rate are: liquidity premium (i.e. the pure rate of interest), the risk premium (i.e. to cover the risks of default, shortage of collateral and costs of administration), and the residual comprising various institutional factors such as lender's monopoly, combination of lending and trading, market imperfections, etc. The residual would outweigh the aggregate of the first three factors (Chandavarkar, 1985: 137).

Rationing of credit may be done in a number of ways. Formal government lenders may have a mandate to allocate credit according to prescribed criteria, for example, favouring the small-scale borrowers. However, experience shows that such criteria can be difficult to apply and the rationing procedure is easily corrupted.

Another form of rationing is for the lender to require the borrower to provide collateral before a loan is advanced. This shifts the risks associated with default from lender to borrower to an extent depending on the nature of the collateral and its value relative to the size of the loan. The margin of safety in case of default is determined by the realisable market value of the pledged asset, net of selling costs, relative to the loan amount.

One explanation for the high interest rate charged by moneylenders is the problem of asymmetric information with lenders expending resources to screen applicants and passing on the costs to borrowers. The paradigm asserts that lending activity entails the exchange of consumption today for consumption in a later period, insurance against default risk, information acquisition regarding the characteristics of loan applicants and the actions of borrowers and an enforcement element to increase the likelihood of repayment by individuals who are able to do so.

A resolution of the problems of adverse selection and moral hazard is anchored on the hypotheses of Direct Mechanisms and Indirect Mechanisms.

3.4.1 Indirect Mechanism Hypothesis

Indirect mechanisms rely on the design of contracts by lenders such that, when a borrower responds to these contracts in his own best interest, the lender obtains information about the riskiness of the borrower and induces him to take actions to reduce the likelihood of default and to repay the loan whenever he had the resources to do so.

Those contracts may be in the credit market itself (in loan terms such as the interest rate and loan size), or they may rely on contracts in related markets (in rental agreements, for example) that will influence behavior in credit markets. Because the interest rate serves the dual function of a price and an indirect screening and /or incentive mechanism, the equilibrium interest rate need not clear the market - there may be credit rationing. Interest rate in this market serves as both a price and an instrument for regulating the risk composition of the lender's portfolio (Hoff and Stiglitz, 1990; Stiglitz & Weiss, 1981). A risky project is one with high probability of default. Because of default, lenders, even in situation of limited competition, cannot raise interest rates so high as to extract all the surplus associated with a loan.

The indirect mechanisms used to solve adverse selection and moral hazard problems are:

1. Interest rates which, in many occasions, are higher than those charged

by formal lenders.

2. Threat of cutting off credit to induce desired borrower behaviour. Borrowers want to avoid defaulting on loans because to do so tarnishes their reputation and curtails their access to future loans. For this incentive to be effective, of course, interest rates cannot be too high, and borrowers must enjoy some surplus from obtaining the loan. This is another way in which markets with imperfect information are fundamentally different from markets with perfect information: competition does not drive rents to zero. Those who are lucky enough to get loans get a consumer surplus, and that consumer surplus, being denied the unlucky, is in effect a rent.

3. Lenders who are landlords or merchants may use the contractual terms in these other exchanges to affect the probability of default e.g a trader-lender may offer a farmer who borrows from him lower prices on fertilizers and pesticides because the probability of default is reduced when such inputs are used.

3.4.2 Direct Mechanisms Hypothesis

Direct mechanisms rely on lenders expending resources to screen applicants and enforce loans. It follows from this that high interest rates may reflect the high costs of these activities. Perhaps more important however, these direct mechanisms (through personal relationship, trade-credit linkages, usufruct loans, etc) lead to a monopolistically competitive structure with interest rate spreads between different segments of the rural credit markets.

Moreover, this suggests that the money lender's power is unlikely to be broken by the entry of institutional credit, unless the new institutions themselves find substitutes for the direct mechanisms used by moneylenders to overcome the problems of screening, incentives and enforcement.

The direct mechanisms used include:

1. Geography and kinship: these reduce costs of screening and monitoring of applicants who happen to come from the same clan or within the same or nearby geographical location. Information asymmetries between borrower and lender are reduced significantly if the credit markets are segmented along geographic lines and kinship groups.
2. Interlinkages with other markets: Interlinked credit contracts may provide means to increase information, improve contract enforcement, and adapt to the moral hazard implicit in many loan transactions.

3. Collateral Pledges.
4. Use of intermediary agents to reduce the costs of monitoring credit and gathering information.
5. Use of quantity rationing to allocate credit funds according to differing criteria for credit worthiness.

3.5 Review of Other Related Studies

Recent literature has shown that at least five manifestations of savings occur in informal financial markets. First, and most importantly, the large volume of informal loans reported in a number of low-income countries is the mirror image of an identical large volume of savings. When informal lenders utilise their own funds, they are merely channelling their savings into informal finance. Second, some informal lenders accept deposits and relend funds and thus act as financial intermediaries. Most informal lenders use only their own savings, but studies over the past three decades indicate that many of them are increasingly becoming financial intermediaries by also seeking and accepting deposits (U Tun Wai, 1992: 345).

Third, the popularity of various types of informal savings groups around the world are further manifestations of informal savings. Rotating and non-rotating savings and credit associations are a mechanism for mobilising funds that are saved and then collected before they are lent to members. Fourth, savings also emerge when individuals such as merchants, notaries, lawyers, solicitors or doctors accept money for safe keeping or for investment on behalf of clients. If they relend these funds they become financial intermediaries, if they only hold the funds they are moneykeepers. Fifth, substantial growth in deposits collected by semi-formal organisations such as credit unions are further indication of the latent savings capacity that is being tapped outside formal financial markets.

Studies on the apparent failure of many modernisation models adopted for the rural poor have shed light on the structure and operation of rural communities in developing countries. Besides the studies mentioned above, other notable studies are by Nisbet (1969, 1971) for rural Chile and Columbia, Samson (1970) for the Upper Delta in Vietnam, Harris (1980) and Chinnapata (1977) for the North-Ascot district of Southern India; Burton (1973) for the Mekong Delta of South Vietnam; Roberts (1973) for the southern province of Zambia; Lele (1975) for the Digela and Yeloma areas in Ethiopia; Ahmed (1975) for Sudan; Sharpe (1977) for the Jaida Arriba area in the Dominican Republic; Tapsoba (1981) for Eastern Upper Volta (present Burkina Faso); Pillard and Hefferman (1983) for the districts of St. Catherine and St. Elizabeth in Jamaica; Bouman (1984) for the district of Kandy in Sri Lanka and Stringer (1984) for the reformed Campensios in Honduras[16].

Five major insights can be drawn on the nature and the role of rural informal financial institutions from the literature. First, credit sources in the informal financial sector are heterogenous. Besides institutional credit sources, peasant farmers and small-scale business firms obtain credit from landlords, moneylenders, crop buyers, shopkeepers, traders, alajo or esusu, relations, and friends. Second, the terms and conditions attached to the informal loans are very simple and free from red tape. Applications for credit are considered promptly unlike in the formal sector where lending procedures are time-consuming and bureaucratic.

Third, informal credit sources appear to complement formal sources, rather than act as their substitute. The studies by FAO (1974), Amani et al (1987) and Ndanshau (1990) on Tanzania appear to support this view. Fourth, credit in the informal sector is not entirely used on 'provident expenditures' or 'wasteful consumption' alone. A large part of the credit goes into financing productive agricultural expenditures and even real investment. Fifth, informal financial markets appear to be used by both small-scale and large-scale farmers; and there is a good interaction between the formal financial sector and the

[16] For detailed review of each of the studies, please see Hyuha, Ndanshau and Kipokola (1987).

informal financial sector.

It has been argued in the literature (Hyuha et al, 1993) that formal and informal financial institutions are sister business organisations supplying essential financial services to the economy; they complement each other in the saving-investment process. In fact, in many countries such as Ghana, Malawi, Senegal and Zaire, there are interflows of customers and funds between the two (Aryeetey and Gockel, 1991; Chipeta and Mkandawire, 1989; USAID,1989; and Hyuha, Ndanshau and Kipokola, 1987; among others). For instance in Ghana, the moneylenders deposit their mobilised savings with formal banks (Aryeetey and Gockel, 1989).

Studies on informal finance in Nigeria have been extensively conducted by sociologists, anthropologists and agricultural economists. Examples include Okorie and Miller (1976), Nwoko and Ajayi (1990) and Olomola (1992). Very few studies by economists have been conducted on the subject. The few studies by economists include Udry (1990), Oladeji and Ogunrinola (1992) and Soyibo (1994). As reported in Soyibo (1994), Udry (1990) and Olomola (1992) applied the theory of economic behaviour under conditions of incomplete markets and imperfect information to analyse informal finance in rural areas of Nigeria. They emphasise that because moral hazard and adverse selection are prevalent in credit transactions, credit markets are likely to incorporate organizational features that serve to mitigate or accommodate the problems caused by these information asymmetries. Udry (1990) reported the findings of a detailed survey of 198 households conducted between 1988 and 1989 in four randomly selected villages near Zaria in North-Central Nigeria. The study established that kinship was an important factor in loan transactions within the sampled villages; and that the loan transactions were extremely informal in nature. In addition, there was no reported evidence of adverse selection or moral hazard. Only 3 per cent of loans reported used collateral, especially land. Besides, interlinkage of the credit market with land, labour or products was adduced unimportant.

In his study of the nature, role and effectiveness of interlinked credit transactions in the Nigerian rural informal sector, Olomola (1992) sampled 159 small-scale farmer borrowers and lenders randomly selected from five villages of Kebbi State. The study identified three types of credit interlinkages in the study area. These are labour-credit, marketing-credit and draught-animal-power credit interlinkages. Factors which make borrowers to be involved in interlinked credit transactions include inadequate working capital, inadequate income to meet consumption expenses and previous debt obligations. Thus, 73 per cent of the average loan obtained was used for the acquisition of farm inputs, 16 per cent for household consumption and 11 per cent was used for the settlement of old debts.

The study supports the view that credit interlinkage arises as a device for mitigating the problems resulting from information asymmetries. Thus, the willingness of the borrowers to repay their loans as reflected by their compliance with loan terms is an indication that lenders are not faced with serious problem of asymmetric information. The lenders mitigate the asymmetric information problem by extending credit to those who ware well-known and whose ability to repay, based on agreed terms, is less difficult to predict. As suggested by Stiglitz (1990), formal financial sector can adopt the use of peer monitoring to mitigate the problem of asymmetric information.

In Oladeji and Ogunrinola (1992), the focus was on the demand for credit in the informal financial sector of South-western Nigeria. The study used primary data obtained from a sample of ajo/esusu associations, craft unions, social clubs and mobile bankers; those they referred to as the informal savings and credit associations (ISACAs), and individual savers selected from the then five states in the South-western part of Nigeria - Oyo (now Oyo and Osun), Ogun, Ondo, Bendel (now Edo and Delta) and Lagos States. The surveys were conducted between October 3 and November 20, 1989.

Using the questionnaire approach, they were able to interview 617 officials of the informal savings and credit associations and 2,507 individuals.

In analysing the data collected, they made use of summary statistics such as frequency distribution, percentage, mean, mode and cross-tabulation. Also, the ordinary least squares estimating technique was used to estimate the parameters of the factors influencing the demand for informal credit (i.e. interest rate, individual level of income and the socio-demographic characteristics of the individual borrower) as well as the credit probability functions.

The survey results revealed that patrons were mainly low-income earners in self employment, private or public-paid employment. The mean income was about ₦500 per month while the income of the modal group was about ₦100 per month. Over 67 per cent of the respondents were in self-employment while the rest were in paid employment. In terms of occupation, about 37 per cent were traders, 27 per cent were artisans, 9 per cent were teachers while some others were farmers.

The study established that the search for informal finance cuts across socio-demographic groups and thrives in both the rural and urban economies. However, both in terms of disposition and of demand for informal credit, the rural residents ranked higher than those in towns and cities. To a large extent, this might be a reflection of the fact that modern banking facilities are not easily accessible to rural dwellers.

The ISACAs provided small loans with repayment periods rarely exceeding one year. It is striking that despite the inadequacy of loanable funds relative to credit demand, the lending rate in the informal financial sector remained low and credit terms were generous; in particular, it was not commonplace to require collateral. The fact that these associations were in most cases social organisations that have good control of their members removed the fear of default, which was minimal, and probably kept down the lending rate. No wonder that observed credit demand in this sector was interest-inelastic.

The validity of the above conclusion needs to be verified empirically. Besides, an area of improvement of this study is the inclusion of moneylenders in the target population, and the use of logit technique (instead of linear regression technique) to estimate the relationship between the qualitative dependent variable (does an individual apply for credit from the ISACAs or not?) and the independent variables, some of which are also qualitative.

Soyibo (1994, 1997) investigated the workings of the informal financial sector in Nigeria. The study analysed the structural and institutional constraints militating against the integration of the various subunits of the informal financial sector on the one hand, and with those of the formal sector, on the other. As part of its objectives, the study sought to provide information (by rural-urban dichotomy) relating to types of institutions in the sector, extent of their savings mobilisation and financial intermediation activities, cost characteristics of their savings and lending activities, and the differences between practices, costs and the products of the sector and those of the formal sector, among others.

The study adopted a multistage sampling procedure to study informal finance in Nigeria. For the survey, Nigeria was divided into three zones (based on a purposive cluster of ethno-cultural and religious zones of Nigeria): Southwest, Middle Belt and Core or Far North. From these three zones, nine states were purposively selected. These were Lagos, Oyo, Ogun, Edo, Kwara, Kogi, Kano, Ondo and Kaduna States. The second and third stages of the sampling process involved selection of towns/villages and operators from the selected towns/villages. A total of 81 questionnaires were administered out of which 64 were found usable, giving a response rate of 79 per cent. The method of analysis was basically descriptive using frequency distributions, proportions and means to make judgements about the characteristics of the different operators in the informal financial sectors. The relationships between each type of informal financial sector unit, location of the unit and other relevant variables were also established using cross tabulation.

The results of the study show that only four of the identified informal finance units are present in the rural areas. These are moneylenders, savings and credit associations, savings and credit cooperatives and esusu collectors. Savings and loans companies and credit unions, which are semi-formal in nature, are located in urban areas. The average number of deposits mobilised by savings and credit associations (ROSCAs) rose from 52 in 1990 to 66 in 1991 and further rose to 101 in 1992. Within the three-year period, the average number of deposits mobilised was 73 with the urban and rural areas accounting for 56 per cent and 44 per cent of the deposits mobilised respectively. Similarly, the average number of deposits mobilised by esusu collectors rose from 250 in 1990 to 374 in 1991 and jumped to 438 in 1992. The urban-rural proportion of the number of deposits mobilised by esusu collectors was 71 per cent in favour of urban areas and 29 per cent in favour of rural areas. The jump in the average amount of deposits mobilised by esusu collectors in 1992 by more than four-fold of its value in 1991 suggests that this unit of the informal sector is still growing fast in the rural areas. This indicates that in spite of the liberalization of the formal financial sector, the informal sector still thrives.

In addition, the study established that informal finance business witnessed steady growth in the number of loan applicants and loans granted between 1990 and 1992 both in rural and urban areas and among all units of the sector. Increase in growth was observed in number of both male and female applicants/loanees. However, generally in both rural and urban areas, there are usually more male applicants/loanees. For example, for the urban esusu collectors, while the average number of male loan applicants varied between 37 and 76 during the period 1991 - 1992, the corresponding female applicants varied between 34 and 59.

The study concluded that informal finance operators lend in small amounts and for very short maturity periods ranging between 3 months and 8 months, on average. There is no evidence of flow of funds between the different sector units confirming the hypothesis of fragmentation. In addition, there is little or no funds flow between the sector and formal sector implying the existence for segmentation of the financial market. The operators of the sector lend mostly to traders who use the funds for increasing working capital and also to others for consumption purposes. There is little or no lending for investment purposes in small and microenterprises.

However, there is evidence to show that default rate in informal finance business is relatively low. There is therefore a lot that the formal sector can learn from the informal sector particularly on how it goes around the problems of moral hazard and adverse selection. Integration of both sectors can, therefore, start with a good knowledge of the workings of the informal sector.

Contribution can, however, be made to existing knowledge of informal finance in Nigeria if attempts are made to estimate both the absolute and relative size of the sector. In addition, the scope of the study can be reduced to regional level but with a fairly representative sample size of the villages and towns/cities in the region. Results from such a survey will be expected to give a more revealing picture about the workings of informal finance in Nigeria, in general and the region, in particular.

CHAPTER FOUR

RESEARCH METHODOLOGY AND DATA COLLECTION

4.1 Methodological Framework

This study is designed to investigate the various factors that affect informal financial sector development in the process of economic development. In examining the determinants of informal financial sector participation, we have therefore used a combination of methods. The analysis is therefore based on interpretation of qualitative as well as quantitative findings. This is in line with the thinking that financial development has social, economic and political undertone.

The research methodology we have chosen was able to bring out rich data grounded in the socio-cultural aspects of finance in Nigeria. The methods of gathering data helped us to understand what respondents think about informal finance and how they came to develop their perspectives. This chapter, therefore, explains the procedures employed in selecting the survey sample and collecting the desired data. The first part describes the sampling process and the second part deals with the instruments and techniques used in data collection. Both primary and secondary sources of data have been used to obtain the necessary information for the study. The primary data were gathered through survey questionnaire and personal interview schedule from a representative sample of residents in both rural and urban areas in the five states, namely Oyo, Osun, Ogun, Ondo and Ekiti States.

Three questionnaires for different populations (individual borrowers/savers, esusu collectors and moneylenders) were provided to elicit information on the workings of the sector. Questionnaire on individual savers/borrowers garnered information on each respondent's saving behaviour, mode and source of financing, his/her trading activity, whether he/she has access to banks, and his/her participation in ROSCAs, if a member. The questionnaire for the ajo (esusu) collectors, however, sought to know the start-up capital of the business, usual period of savings, average monthly collection and number of clients, income from ajo collection and the collectors' interaction with the banks. In addition, information was sought whether a collector engages in lending activity, the limit to a regular ajo depositor's borrowing capacity, and measures of retrieving debts from defaulters.

Moreover, the questionnaire for the moneylenders wanted information on whether the moneylending business is a part-time or full-time activity, the composition of a lender's clients, whether the lender is also a deposit keeper (alajo), highest amount and average duration of loan granted, the purposes of loan, the collateral preferred, interest rates charged and measures undertaken to forestall defaults. Furthermore, information was sought to know if the moneylenders deal with banks. Other questions for the three groups of respondents are contained in the appendix.

The questionnaires were analysed through the SPSS and STATA computer software packages. Much of the data analysis was descriptive. Summary statistics such as frequency distribution, mean, median, mode, percentiles and cross-tabulation were used to describe the characteristics of the sample. In addition, cross tabulation was used to establish correlations among each type of informal financial unit observed, the location of institutions (both urban/rural and region) and all other variables of interest.

Besides the summary statistics, a **logit model** was used because it permits estimation of the relationship between a **dependent variable with binary response categories** and a set of **ordinal independent variables with categorical responses.** The logit model is a modified version of the OLS (Ordinary Least Squares) multiple regression approach. It is suitable for describing and predicting the relationships between categorical variables, whereas OLS models deal with continuous dependent variables. The logistic approach rather than OLS regression is used to analyse the survey data because the logit model is more suitable for summarising the results of categorical variables with the aid of two-way frequency or contingency tables. That is, the survey data used in this study satisfy all the basic assumptions required for the analysis of contingency tables using logit techniques.

4.2 The Survey Areas

In this survey, a multistage sampling technique was employed, as discussed in section 1.5. The survey areas include Oyo, Osun, Ogun, Ondo and Ekiti States. They all formed the old Western region of Nigeria during the First Republic of 1960 - 1966. A common feature among these states is that their citizens belong to the Yoruba ethnic group, one of the three dominant ethnic groups in Nigeria. Going by 1991 census figures, out of the national population of 88,514,501 the region accounted for 11,914,860 (approximately 13 percent of the national population figure).

In the first stage of the sampling procedure, 4 local government areas were randomly selected from each of the 5 states. Thereafter from each selected local government area, we sampled 2 villages and 3 towns/cities (which include the state capitals). In October 1996, a pilot exercise was carried out on respondents resident in Ibadan. The aim was to use their responses to refine the questionnaires. The major exercise, however, started in November 1996. Thus, between November 1996 and April 1997, the enumerators[17]

[17] The enumerators used were 6 graduate students who were familiar with the states they were posted to for the assignment.

(including myself) were able to cover the identified 20 local government areas comprising 60 towns and 40 villages. In all, 1,365 questionnaires were administered. 930 questionnaires were returned giving a response rate of 68 percent. However, only 608 questionnaires were found usable. The distribution of the 608 questionnaires received is as follows: 361 - market participants, 131 - esusu collectors, and 116 - moneylenders.

Besides, another set of 200 questionnaires (complimented with interviews) were administered on some women traders in Ibadan metropolis based on a purposive cluster of population density. The goal was to assess the impact of informal finance (or micro-credit) on their businesses and its impact on their economic status. The findings are contained in Section 5.3.3 (iii) of the thesis while the questionnaire administered is found in the appendix.

4.3 Data Collection

The six field interviewers were given an induction course before embarking on the field work. This involved the basics of sampling procedure, questionnaire design, and interviewing. As a part of the preparations for the main field work, all the 6 enumerators participated in a pilot survey that was conducted in October 1996 at Ibadan. For the purpose of the pilot survey, a random sample of 50 people (30 of whom were women) was selected in

Ibadan. The enumerators administered the questionnaires under my direct supervision.

The results of the pilot survey were used to clarify ambiguous questions and eliminate illogical ones; rephrase certain questions and streamline the order and sequence of questioning; refine and streamline response categories; and determine the length of time taken to go through the questionnaire without causing respondent boredom and fatigue. The questionnaire was revised accordingly to obtain a more complete, effective, and efficient final version used in the survey.

The questionnaire format was preferred in this study to other types of instruments because it allows for a relatively large number of people to be sampled; it is quick and cost-effective relative to other methods; it lends itself more readily to organised data gathering procedures; it is suitable for obtaining information on sensitive items such as finance; and it is amenable to relatively fast transfer of response categories that are appropriate for quantification and computer analysis. The questionnaires were administered by enumerators to collect the desired data from the field.

4.4 Description and Measurement of Variables

As mentioned earlier, besides the questionnaire administered on Ibadan women traders, three types of questionnaire were administered, namely market participant, ajo collector and moneylender questionnaires.

For the market participant, the **dependent variable** is the use of informal financial service by the respondents. It is a dichotomous dependent variable which consists of the following categories of use:

1. Uses informal sources of finance
2. Does not use informal source of finance

This means that a categorical dependent variable may be appropriately measured by two or more response categories. Thus to operationalise the dependent variable, respondents were asked specific questions about their usage of certain financial services. First, general questions were asked about respondents' awareness of the existence of financial institutions in their localities; whether they used existing savings and credit facilities; whether they borrowed funds from different sources; and if they belonged to any informal financial group, particularly *ajo (or esusu)*. Then, the following more specific questions were asked:

(a) Do you save with an *alajo* (mobile banker)? Yes = 1 No = 2

(b) Do you belong to an *ajo* group (esusu)? Yes = 1 No = 2

(c) Have you ever borrowed money from any informal financial source? Yes = 1 No = 2

(d) Do you have a bank account? Yes = 1 No = 2

(e) Have you ever asked for a bank loan? Yes = 1 No = 2

Responses to each of these questions were followed by a series of probing questions in order to elicit further information from the respondents. These variables are discussed in more detail in Chapter 6.

Independent Variables

A number of independent or explanatory variables were investigated in this study to determine their effects on the use of various sources of finance or types of financial services by the respondents in the survey areas. These variables are grouped into three categories: demographic characteristics, household factors and contextual variables. The measures for the demographic variables are described in the following section.

Demographic Characteristics

Demographic characteristics studied in the survey include respondents' age, marital status, gender, religion, level of education and occupation. Respondents' **ages** (AGE) were measured by a multilevel variable that is coded

1 for less than 18 years and 7 for 68 years and above. **Marital status** is a multilevel variable which takes a value of 1 if respondent is married, 2 if he/she is single, 3 if he/she is divorced/separated, and 4 if he/she is widowed. **Gender** was measured by a dichotomous variable that is coded 1 for a male respondent and 2 for a female respondent. For **religion**, there were three options namely, 1 for Christianity, 2 for Islam and 3 for other types of religion. **School** attendance and **occupation** were measured by dichotomous variable that is coded 1 for Yes and 2 for No. If respondents answered in the affirmative that they went to school, they were then required to indicate the highest level of education they had attained in one of the following categories: primary school, secondary school and tertiary institutions. From a human capital point of view, education represents an endowment of human knowledge and skills which the bearers can use to take advantage of opportunities that exist in the financial market.

With respect to **occupation**, respondents were asked to tick their occupations from the identified nine options (please see appendix for the questionnaire).

Household Factors

Important factors that affect use of financial services at the household level include family size, religion, marital status, assets, income and perceptions about the use of financial services. Family size (**FAMSIZE**) is defined in this study as the total number of dependents the respondent has plus one (i.e himself/herself).

Religion (**REL**) is a variable that represents the respondent's choice of religion. Religion does affect borrowing from a moneylender or working as a moneylender. Marital status (**MAR**) is a dummy variable which takes a value of 1 if respondent is married and 0 if otherwise. It is closely associated with the respondent's gender.

Contextual Factors

The contextual factors (or intervening variables) used in this study include state, location and type of economic activity the respondent is engaged in. **LOCATION** is a dummy variable coded 1 if survey area is a rural settlement (village) and 2 for an urban settlement (town or city). It was used to determine the impact of rural-urban differences on respondents' use of financial services.

4.5 Methods of Analysis

4.5.1 Size of Informal Financial Sector

The financial sector is assumed to be an identity which consists of the formal and informal financial sectors[18]. There are three measures of the relative size of the informal financial sector. The first two measures are ratios which indicate the size of the formal sector. Any decline in the ratios over time would suggest a growing relative importance of the informal financial sector, both in terms of size and influence on the money market (Aryeetey and Gockel, 1991). The third measure of estimating the relative sizes of the two financial sectors i.e. formal and informal would be to multiply the average deposit size by the total number of participants. However, as a result of the non-wide acceptance of this measure, we did not make use of this measure.

Specifically, the first measure suggests that the ratio of deposit money to money supply, M2, is a good indication of the size of the formal financial sector, i.e.

$$Z = \frac{X}{Y} \qquad \text{.................................(1)}$$

[18] We assume negligible impact of the semi-formal sector.

where:

Z = Size of the formal financial sector

X = Total deposit money

Y = Money Supply, M2.

It is believed that much of the money supply is in form of currencies in circulation, and that they are either deposited with the institutional financial markets or with the informal financial units. We assume that the proportion of currencies kept by individuals is small. Equation (1) therefore measures banking development of the money market from the liability point of view and gives an indication of the strength and size of the operational practices and the success of formal financial management. As mentioned above, any decline in the ratio over time suggests a relative importance of the informal financial sector in terms of size and influence on the money market.

The second measure is the ratio of the banking system's claims on the private sector to national income (Wai, 1957, Aryeetey, 1994) i.e.

$$Z = \frac{A}{B} \qquad \text{.................................(2)}$$

where:

Z = size of the formal financial sector

A = Loans and advances to the private sector

B = GDP (Gross Domestic Product)

A decline in the ratio in equation (2) shows a relative size importance of the informal financial sector.

In addition to the two suggested measures of the relative size of the sector, data on two other monetary indicators were also examined. The monetary indicators are Currency-Deposit ratio (CC/Deposit) and Currency-Broad Money ratio (CC/M2).

It is assumed that activities in this market avoid the use of cheque and rely on currency for making payments. Therefore, a rise in the CC/Deposit and CC/M2 ratios reflects the reliance on the use of cash[19] for transactions and therefore shows an increase in the size of the informal financial market.

[19] Transactions in the Nigerian informal financial markets are mostly on cash basis because bank payments can be monitored by tax authorities.

4.5.2 Maximum-Likelihood Logit Estimation Model

A logit model was chosen for this analysis because it permits estimation of the relationship between a dependent variable with two outcomes and a set of ordinal independent variables with categorical responses. The logit model is a modified version of the OLS (Ordinary Least Squares) multiple regression approach. It is suitable for describing and predicting the relationships between categorical variables, whereas OLS models deal with continuous dependent variables. The logistic approach rather than OLS regression is used to analyse the western Nigerian survey data, because the logit model is more suitable for summarizing the results of categorical variables with the aid of two-way frequency or contingency tables. That is, the survey data used in this study satisfy all the basic assumptions required for the analysis of contingency tables using logit techniques. These assumptions are summarized as follows:

First, the random sample of 361 respondents is large enough to permit the use of logistic regression to analyze the data that were collected from these respondents through a household survey. As such, the variables on which the data were collected represent random responses to survey questions. Second, the dependent random variable is binary or dichotomous and takes on one of two possible responses or values. The dependent variable is influenced by a set of observable independent variables or predictors. The values of these predictors vary across observations, accounting for the variation in the response probability of the dependent variable. In general, the mean response value E(Y) of a binary dependent variable (Y) represents the probability that Y = 1 for the given levels of the independent variables (X_i).

$E(Y_i) = \beta_0 + \beta_1 X_i = \pi(\pi_i)$,

and then $1-\pi_i$ is the probability that Y = 0 .... (3)

Third, the individual observations on the dependent variable are assumed to be linearly and statistically independent of each other without perfect correlation between any two or more of these variables, ruling out multi-collinearity. Fourth, the predictors are not continuous variables with a finite number of response levels, but are categorical variables. To satisfy this assumption, the continuous variables used in the survey were transformed into categorical variables before using them in the analysis. Finally, the response categories of the predictors were fixed by the sampling design used in the study.

Apart from describing the relationship between the dependent and independent variables, logistic regression enables us to predict the response of the dependent variable with the independent variables. The results obtained from the statistical analysis are used to make predictions about the use of certain financial services by the target population.

The use of informal financial service can be influenced by some variables. Notationally, the model can be specified as:

IFS = f(Educ, Loc, Gender, MS, Age, EthG, Occup) ....(4)

where **IFS** is a dichotomous dependent variable indicating that:

1 = Uses informal sources of finance

2 = Does not use informal sources

The explanatory variables are as follows:

Educ = Level of Education (primary, secondary or tertiary)

Loc = Location (urban, rural)

Gender = Sex (male, female)

MS = Marital Status (Married, Single, Widow, Separated/Divorced)

Age = Age of the respondent

EthG = Ethnic Group of the respondent

Occup = Occupation

4.6 Types and Sources of Secondary Data

This study is based on information from both primary and secondary data sources. Primary data were derived from the questionnaires administered and person-to-person interviews in the field with the informal units both in the rural and urban areas.

The secondary data were sourced from the various issues of the Central Bank of Nigeria Annual Report and Statistical Bulletin. Specifically, the data cover the following variables:

1. Total deposit money (in ₦ million).
2. Money Supply (M2) (in ₦ million) (M2 = M1 + Quasi-Money)

   M1 is defined as currency outside banks plus privately held demand deposits with the commercial banks and merchant banks. Quasi-Money, on the other hand, is defined as Savings and Time deposits with commercial banks plus total deposit liabilities of merchant banks.
3. GDP (Gross Domestic Product) in ₦ million.
4. Loans and advances from the formal financial sector to the private sector.
5. Currency In Circulation (in ₦ million).
6. Demand Deposit (in ₦ million).

CHAPTER FIVE

ANALYSIS OF DATA AND RESULTS

5.0 Introduction

This chapter presents the analytical findings of the survey. It consists of four sections. The first section examines the results on the estimation of the relative size of the informal financial sector in Nigeria. The second section discusses the analytical findings from the logit model, especially the odds and odds ratios computed. Section three, however, examines the characteristics of the various informal financial agents in terms of their socio-economic and demographic characteristics and perception about financial services. In addition, this section investigates the savings, borrowing, lending and investment arrangements and characteristics of this sector; and the use of informal finance by women. Section four, finally, probes the institutional linkages that exist between this sector and the formal financial institutions, particularly the banking sector, in Nigeria.

5.1 Size of the Informal Financial Sector In Nigeria

Using secondary financial data obtained from the Central Bank of Nigeria's (CBN) Statistical Bulletin (1995 issue) for the whole of Nigeria, the relative size of the informal financial sector in Nigeria was estimated through the following four indicators. The results are as presented in Table 5.1.

Table 5.1: Relative Size of the Informal Financial Sector in Nigeria

S/N	Indicator	1970-1980	1981-1990	1991-1994	1970-1994	Size of IFI[20]
1	Deposit/M2	0.71	0.77	0.74	0.74	1/3
2	Credit/GDP	0.01	0.20	0.13	0.14	n.a
3	CC/Deposit	0.42	0.3	0.35	0.36	n.a.
4	CC/M2	0.29	0.23	0.26	0.26	1/3

Source:
Computed from: CBN (1995a) Statistical Bulletin

Note:
Deposit/M2 Ratio of Deposit Money to Broad Money Supply, M2.
Credit/GDP Ratio of banking system's claim on the private sector to GDP
CC/Deposit Currency-Deposit ratio
CC/M2 Currency-Broad Money ratio
n.a. not applicable

A decline in indicators 1 and 2 suggests a decrease in the influence of the money market and thus a growing relative importance of the informal financial sector. However, an increase in indicators 3 and 4 will reflect an increase in the use of cash for transactions and therefore an increase in the size of the informal financial market.

Indicator 1 (ratio of Deposit Money to Broad Money Supply, M2) shows that over the 25-year period, deposit in the banking system, on the average,

[20] This is an estimated size of IFI relative to the Formal Financial Sector

accounted for 74 percent of the broad money supply (M2) in Nigeria. Between 1970 and 1980, total deposit accounted for 71 percent and jumped to 77 percent possibly as a result of interest rate deregulation in the money market. This era of interest rate deregulation witnessed interest rates climbing up to 40 percent on deposits with some commercial banks and finance houses. Besides the interest rate argument, another factor that contributed to increase in banking deposit was the growth in the number of rural branches. The number of rural branches of commercial banks in Nigeria rose from 13 in 1977 to 765 in 1990, a 5,784.6% increase. Similarly, total deposits mobilised from rural branches of commercial banks rose from N111.7 million to N8,360.1 million in 1990 (7,049.9% increase) [CBN, (1995b), p.37]

This situation was however shortlived as deposit took a 3 percent plunge to 74 percent between 1991 and 1994 as a result of distress in the nation's banking system. Although the distress in the banking sector resulted into loss of confidence as shown by astronomical decline in deposits[21], the indicator estimates the money market to be 3 times as large as the informal financial sector in Nigeria.

Indicator 4 gives a similar result to that of indicator 1. On the average

[21] Between 1991 and 1994, deposits mobilised from Nigeria's rural areas declined by 54.1 percent from N10,580.7 million to N4,855.2 million.

(over the 25-year period), cash accounts for about one-quarter (1/4) of the entire monetary transactions in Nigeria. Although its percentage to the broad money supply (M2) during the 1991-94 period was not as high as the 1970-80 period, it was nevertheless a 3 percent improvement over the 1981-1990 period. The 26 percent estimate therefore shows that the money market may account for the remaining 74 percent and thus may be 3 times bigger than the informal financial sector[22].

Using the GDP as base, indicator 2 may not be able to correctly estimate the size of the informal financial sector. This is because the GDP encompasses many other activities that are not captured by money supply. What indicator 2 therefore connotes is that a fall in the indicator over time implies a decline in the relative importance of the formal financial sector and possibly a rise in the informal financial sector. Loans and advances from the banking sector to the private sector as a proportion of the GDP fell, on the average, from 20 percent in 1981-90 to 13 percent in 1991-94 period. The 7 percent drop signifies that there is a decline in the relative importance of the money market in terms of loans and advances.

Indicator 3, however, examines the ratio of currencies to total deposits

[22] This is just an estimate as some of the cash might have been transferred to the semi-formal sector.

in the banking system. A rise in this ratio reflects more reliance on the use of cash relative to bank deposits. During the 1970-80 period, the ratio was 0.42. However, due to increased banking activities especially rural banking schemes of many commercial banks, this ratio was reduced to 0.30 during the 1981-90 period. Nevertheless, as a result of the distress in the banking sector, the ratio moved up to 0.35 reflecting the people's desire to hold more of cash than deposits in the bank. It is believed that a greater percentage of the cash held is deposited with the informal financial sector.

5.2 The Logit Model (Computation of Odds and Odd Ratios)

In the logit model, the criterion to be analyzed is the odds of the expected cell frequencies for the dependent variable as a function of the independent variables. In other words, the logit is the natural logarithm of the odds or the conditional log odds. The value of the odds is simply calculated by the formula:

$$\pi / (1 - \pi) \qquad (5)$$

The odds indicate the conditional probability of random responses falling into one of two categories on the variables of interest. That is to say, the logit is the conditional log of the odds of being in one or other category of the dependent variable.. The value of the conditional log odds of the dependent variable is expressed as a linear logit response function of a set of independent variables:

$$\pi = \beta_0 + \beta_1 X \qquad (6)$$

This logit means response function is used to analyze the relationship between the dependent and independent variables under investigation. Thus, logit analysis provides an interpretable linear model for categorical response variables. Also, the logit model permits the use of various tests to be used in the analysis. For this purpose, odds ratios were computed. The computation of odds ratios begins with estimation of simple empirical probabilities for the different dependent variables. These probabilities are then used to calculate odds which are, in turn, used to compute odd ratios. A probability is simply a point estimate for a categorical dependent variable. It is a relative frequency derived by dividing a given cell frequency by the total cell frequencies. The relative cell frequencies together form a probability distribution which represents all the theoretically possible values of the random variable of interest. All the probabilities in the distribution sum to 1.0. The probabilities are then used to compute odds and odds ratios whose values are more useful both in terms of the statistical and substantive interpretations of the results of this study.

5.2.1 Estimating Simple Odds

It is more advantageous to interpret the results derived from logistic regression of the survey data in terms of odds rather than conditional probabilities. The reason is that the odds can be used to compute an expected (β) value or an odds ratio which is a single summary statistic representing the partial effect of a given predictor on the odds, while holding other independent variables constant. Such a statistic cannot be obtained for a given probability, as it impossible to summarize the impact of a unit change in a predictor of interest on the probability in question. This is because the probabilities are non-additive due to the non-linearity of the logistic model (Pyndick and Rubinfeld, 1993).

Odds may be computed either from the observed conditional probabilities or observed cell frequencies. The odds are a ratio of conditional probabilities, computed for different levels of the dependent variable by the formula $\pi/(1-\pi)$. This enables us to obtain the relative sizes of the conditional probabilities. To illustrate with an example taken from the data, the odds of a rural dweller joining an Informal Financial Group (IFG) is obtained by dividing the probabilities, or more simply, the expected cell counts or frequencies for membership of an IFG and rural location:

$$\frac{142/361}{190/361} = 142/190 = 0.75 \qquad \text{.....................(7)}$$

This means that a rural respondent is 0.75 times more likely (than an urban dweller) to join an informal financial group as to not join one. The odds of a rural person not joining an IFG is similarly computed by inverting the previous odds:

$$\frac{190/361}{142/361} = 190/142 = 1.34 \qquad \text{.....................(8)}$$

The interpretation of this result is that a rural person is 1.34 times more likely not to join an IFG as to join one. The odds of an urban dweller not joining and IFG is similarly computed to be 1.53 i.e. $\frac{171/361}{112/361} = 171/112 = 1.53$.

Clearly, the values of odds are more useful than the probabilities from which they have been calculated. However, odds still do not provide adequate information on the variable under analysis in that they only relate the ratio of probabilities, and not the actual probabilities themselves.

An odds ratio is simply obtained by comparing the relative sizes of two odds; that is, by dividing the values of the odds to get a ratio. In other words, the odds ratio is simply the ratio of two odds. This ratio is estimated by the formula:

$$Exp(b_1) = Odds_2/Odds_1, \text{ or } Odds_1/Odds_2 \qquad \text{.................................... (9)}$$

Thus, in the above example, to obtain the odds ratio we simply divide 1.53 by 1.34 to get 1.14. An odds ratio of 1.14 suggests that a rural person is 1.14 times more likely to join an IFG than a person in an urban area. If, on the other hand, we are interested in obtaining the odds of, say, an urban person joining an IFG as opposed to not joining one, we compute the odds ratio as follows:

The odds of a rural person joining an IFG is computed as follows:

142/190 = 0.75 ....(10)

The odds of an urban person joining an IFG:

112/171 = 0.65 ....(11)

Then, the odds ratio for an urban dweller:

0.65/0.75 = 0.87 ....(12)

This is the same number as the one above, except that it has been obtained by simply inverting the two odds.

Thus, a rural person is 1.14 times more likely to join an IFG than a person in an urban setting. Therefore, in a two-way table such as this one, if a person living in a rural area is 1.14 times more likely to join an IFG, his or her counterpart in the urban area is 1.14 times more likely not to join one.

In comparison to conditional probabilities and simple odds, odds ratios are statistically more robust than the simple odds themselves, because they do inform us as to whether the classification across an independent variable is useful or not. The interpretation of the estimated regression coefficient (β) in terms of an odds ratio makes the logit model quite suitable for analyzing categorical data.

The **odds ratio** is analogous to the partial slope in multivariate regression, because the ratio represents the influence of predictors (independent variables) on the dependent variable. It is a summary statistic called the expected (β) that measures the effect of a given independent variable on the dependent variable. It provides a global test for the significance of a given independent variable, while holding other independent variables in the model constant.

5.2.2 Membership of Informal Financial Groups

As revealed in Table 5.2 below, the independent variables (**Gender, Marital Status, Age, Farmer, Trader, Transporter, Ethnic Group and Level of Education**) exert statistically significant influences upon respondents' membership in IFG, while holding the effects of other independent variables constant at 5 percent level of significance.

Table 5.2 Estimates of Odds Ratios for IFG Membership (N=361)

S/N.	Independent Variables	Odds Ratios
1	Gender: Female Versus Male	1.84
2	Marital Status: Married Versus Single Married Men Versus Married Women	1.94 0.83
3	Age: Less than 18 Versus > 37 years 18 - 37 years Versus > 37 years	 - 3.21
4	Ethnic Group: Yoruba Versus Others	3.26
5	Education: No formal Versus Primary Education No formal Versus Secondary Education No formal Versus Tertiary Education Primary Versus Secondary Education Primary Versus Tertiary Education	 3.21 7.42 8.35 2.4 4.3
6	Farmer	1.94
7	Transporter	2.02
8	Trader	1.84
9	Location: Rural Versus Urban	1.14

Source: Author's Computation from Survey Data

From Table 5.2 above, **Gender** has a positive significant influence on the membership of both male and female respondents in IFGs. The odds of a female respondent being a member of an IFG are about twice as high as for a male respondent. This means that women are twice likely to join IFGs than men. This finding lends support to the literature on informal finance that IFGs comprise both male and female members. It, however, contrasts the hypothesis that no gender differences exist in membership of IFGs. More women patronise the IFGs than men because of their averagely low level of literacy. In the past, in a traditional Yoruba home, a girl was not allowed to attend school because of the belief that all her education would eventually end up in another man's kitchen. As shown in Table 5.6, more than 50 percent of the women interviewed did not have more than primary/adult education. In fact, only 5.5 percent have education beyond tertiary education.

The variable **Marital Status** shows that a respondent's membership in an IFG is positively associated with the respondent's marital status. Results reveal that a married respondent is twice more likely to belong to an IFG than a single person, irrespective of the respondent's gender. In addition, finding from the survey does not support the hypothesis in the literature that married men tend to participate more in informal financial transactions than married women.

Age influences significantly a respondent's membership of an IFG. Hence, respondents aged 18-37 years are three times more likely to be members of IFGs than respondents who are older than 37 years (Table 5.2). This finding thus supports the hypothesis that younger people are more likely to belong to IFGs than older people.

The results for **ethnic group** reveal that a respondent who is Yoruba is 3 times more likely to belong to IFG than a respondent from any other group. This is in line with the hypothesis that ethnicity is positively associated with a respondent's membership of an IFG.

The results for **educational level** show that the odds of belonging to IFGs are greater for respondents with no formal education than those who have acquired formal education. In addition, the lower the level of education the greater the odds of belonging to IFG. For instance, a person with no formal education is 3 times more likely to belong to an IFG than a person with primary education. The odds of respondents being members of IFGs are much greater for respondents with no formal education than those with secondary or tertiary education.

Thus, a respondent who has no formal education is 7 times more likely to be a member of an IFG than someone with secondary education. Similarly, a respondent without formal education is 8 times more likely to belong to an IFG than a respondent with tertiary education. Thus, the odds of a person being a member of an IFG tend to increase for respondents with primary education vis-a-vis people with secondary and tertiary education respectively. The results, as shown in Table 5.2, lend support to the hypothesis that more educated people make less use of informal financial services while people with little or no formal education will make greater use of them. Thus, the hypothesis in the literature on informal finance that less educated people tend to become members of IFGs (since they are less able to use formal financial services) is supported.

Finally, holding all other variables constant, the odds of a respondent belonging to an IFG are also significantly affected by whether a respondent is a **farmer, transporter** or **trader.** Results in Table 5.2 show that a farmer is twice likely to belong than a non-farmer. The odds of a transporter belonging to an IFG are twice as high as for a respondent whose occupation is not transport business. Like a transporter, a trader is twice more likely to be in an IFG than a respondent who is not a trader.

5.3 Descriptive Results

5.3.1 Socio-economic and Demographic Characteristics of Respondents

As shown in Table 5.3, 90 percent of the persons interviewed are engaged in savings either with the formal financial sector or the informal financial sector or both, although the results indicate that a higher percentage of the savers come from the rural areas (92%). The respondents in the urban areas earn, on the average, N5000 weekly, more than 25 percent of which is saved. While about 30 percent of the income saved is kept with the informal financial group

(IFG), only 12.6 percent is kept in banks. On an urban-rural dichotomy, less than the sample average is kept at banks by the rural respondents. This is not surprising as 16 percent of the rural respondents do keep records about their income - an evidence of low level of literacy among the people.

Although the rural banking scheme commercial banks were mandated by the CBN to operate brought about the establishment of many commercial banks in the rural areas of Nigeria, the numbers were not sufficient. As indicated in Table 5.3, the average distance from nearest bank to a rural depositor is 7 km. The reason, put forward by some bankers, is that it is not economically viable to operate formal banking in the rural areas of the country as total deposits mobilised in a rural bank branch may not be sufficient to settle all the overhead costs of the branch. Hence, the low number of rural branches of commercial banks.

In addition, over 50 percent of the sample indicated that in spite of the on-going attempts to sanitise the banking system (e.g. inauguration of Failed Banks Tribunal), they would prefer to save with the informal financial sector because of its perceived advantages over banks. On the one hand, the services of the formal sector are wrapped in bureaucratic procedures, such as the need for mortgageable collateral security, time-consuming processes and the impersonal processing of applications. On the other hand, services from the informal financial sources are characterised by an absence of red tape, a relatively higher degree of access to the institutions by their users, little or no need for mortgageable collateral security and the existence of the human factor in credit allocation.

Table 5.3: Some Savings and Borrowing Characteristics of Respondents by Location in 1997

S/N	Characteristics	Urban	Rural	Sample
1	Percentage of respondents who save	85	92	90
2	Percentage of respondents who keep records about income	65	16	49
3	Average approximate weekly earnings (naira)	5000	n.a.	5000
4	Average percentage of monthly income saved	25.6	n.a.	25.6
5	Average percentage of total savings at home	36.5	64.3	57.2
6	Average percentage of total savings at bank	14.3	6.3	12.6
7	Average percentage of total savings with *ajo* collector / *Esusu* Group	49.20	29.4 0	30.20
8	Average distance from nearest bank	1.5 km	7 km	5.3 km
9	Average distance from bank used (if applicable)	1.5 km	7 km	5.3 km
10	Percentage of respondents who save with banks	65	12	43
10	Percentage of bank depositors who save with nearest bank	61.7	95.6	87.6
11	Main reason for never saving in bank	Low income, bureaucracy		
13	Percentage of respondents that had borrowed from bank	66.7	5.2	43.0

S/N	Characteristics	Urban	Rural	Sample
14	Percentage of respondents who did not borrow from the bank			
15	Main reason for never borrowing from bank	No collateral		
16	Main use of credit from bank	Expand business		
17	Percentage of respondents who had borrowed from moneylenders	15	6	12
18	Percentage of respondents who borrowed from moneylenders for planned investments	3	7	4
19	Percentage of respondents using *ajo* savings accounts / participating in *esusu* Group	89.8	98.5	95.6

Source: Survey

5.3.2 Membership, Size and Eligibility of ROSCAs

Esusu groups (ROSCAs) have varying sizes both within and among countries (Aryeetey, 1995). Bouman (1977) noted a membership of between 10 and 30 persons for associations in rural Cameroun. Among ROSCAs in Ghana, Aryeetey (1994) observed an average membership of 12.

In the survey, it was revealed that over 85 percent of the ROSCAs sampled have between 2 and 10 members. For membership ranging from 2 to 10, the sample reveals that Oyo State reported 74 ROSCAs followed by Ekiti State with 69 ROSCAs. Ondo State had 48 ROSCAs with such membership.

In addition, only 13 percent of the ROSCAs sampled had more than 10 members. In fact, 10 percent had membership ranging from 11 to 20 while only 3 percent had membership above 20. 5 ROSCA groups had more than 20 members in Ekiti State while Oyo State and Osun State had 2 and 3 ROSCA associations with greater than 20 members respectively. However, none of the ROSCA groups sampled in Ogun and Ondo States had more than 20 members.

Table 5.4: Size Membership of ROSCA BY State

S/N	Size of Membership	ROSCA						
		OYO	OGUN	ONDO	OSUN	EKITI	TOTAL	Percent age (%)
1	2-5	27	38	22	31	35	153	44
2	6-10	47	21	26	22	34	150	43
3	11-20	5	8	7	11	4	35	10
4	> 20	2			3	5	10	3
		TOTAL					348	100

Source: Survey

5.3.3 Bond of Membership in ROSCAs

As shown in Table 5.5, community (or closeness) accounts for almost half of the factors respondents took into consideration before joining ROSCAs. This is known as the principle of homogeneity. Homogeneity provides members with a sense of familiarity that engenders mutual trust. Usually, ROSCA members attach importance to homogeneity in the socio-economic status of members.

Ethnicity, which is often assumed to be an important factor in association membership, ranks third in the selection procedure (see Table 5.5). Since ROSCAs are often in offices and market places where there are higher levels of ethnic diversity, this tends to make them quite 'cosmopolitan' in character. It is worth acknowledging, however, that the founder of a ROSCA may initially attract mostly his or her kinsfolk. However, religion and gender do not appear to matter much in the formation of ROSCAs as they respectively account for about 4 and 6 percent of the common bonds of membership of ROSCAs.

The closeness of the relationship among *iqqub*[23] members in Ethiopia deserves some attention. 'A person in financial difficulties can ask friends to set up an iqqub for him and surrender the first lot to the requester. A person refusing to cooperate with a needy friend or workmate may incur rejection by the community' (Aredo, 1993, p.15; cited in Aryeetey, 1995, p.56).

[23] This is a savings and credit association in which withdrawals from the common pool are often on the basis of lots drawn.

Table 5.5: Nature of common bond of membership in 1997

S/N	COMMON BOND	ROSCA						
		OYO	OGUN	ONDO	OSUN	EKITI	TOTAL	Percentage (%)
1	Community	45	27	34	38	26	170	48.85
2	Occupation	27	24	14	18	17	100	28.74
3	Ethnicity	4	6	3	8	10	31	8.90
4	Gender	2	4	2	2	12	22	6.32
5	Religion	3	4	-	1	5	13	3.74
6	Other		2	2	-	8	12	3.45
		TOTAL					348	100.00

Source: Survey

5.3.4 Informal Financial Intermediaries (IFIs)

There are a lot of reasons people save and borrow in the informal financial sector. The preference towards informal financial institutions stems from people's perception of their reality. The *ajo* and moneylending systems are perceived as being indigenous. The financial arrangements are seen as products of the people's own efforts and therefore good vehicles for rural development. Informal financial institutions are closer to the people geographically and socially. The ajo and moneylending system and arrangements foster and operate where the customers live and work, making transaction costs low.

This can be seen n the manner informal finance operators are able to adapt their services to their customers' needs. Lower income urban and rural households, peasant farmers, and small and microenterpreneurs save in little amounts. The informal financial mode allows for low daily savings and withdrawals. Unlike formal banks, savers in the informal mode need very little literacy and numeracy skills. The arrangements which these institutions offer are clear, easy to understand, and very transparent. They require very minimal procedures for savings and withdrawals. Their methods of insuring credits and savings are customary as compared to formal financial sector arrangements.

5.3.4i Informal Savings Arrangements and Characteristics

I Informal Savings Arrangements

A Attitude Towards Thrift

Available evidence in the literature shows that people in the informal sector in Nigeria do save (Soyibo, 1997; Magbagbeola, 1996). Informal sector savers have the same universal attitudes towards savings: as a store of value, saving for future contingencies, and to accumulate capital. Savings behaviour is further determined by the need to transfer assets to kin, attitude towards risk, and demonstration effect. The saving as a store of value is observable as a preference for storing produce in much of rural Nigeria. People also save to purchase personal and household items, to meet expenses for school fees, taxes, health care and other purposes.

The motivating factor for saving is generally a way to self-generate capital towards socio-economic development. Virtually all financial needs of small and microenterprises are met through personal savings supplemented by borrowing from other individuals. Since credit is scarce through formal banks, most business start-ups come from self-finance (see Table 5.6). Capital formation is very important to microentrepereneurs. Therefore, anyone interested in starting a new business has to save. The same applies to those interested in expanding their businesses. Further, traders have to save towards emergencies and to off-set losses. For low income Nigerians, saving characteristics differ. Some prefer daily savings to accumulate capital, while others prefer to save in real assets - jewelry and houses.

B Saving for Credit

Informal savings and lending mechanisms are quite extensive in Nigeria. Savings and borrowing are for both productive and consumption purposes. Most ajos (or esusus) require members to save for extended periods before lending facilities are extended. The compulsory savings component demonstrates the credit-worthiness of the borrowers and the mobilised savings act as a collateral substitute.

Esusu collectors lend only to trustworthy customers. Loans and advances are given to savers who have demonstrated consistency and have accumulated some funds with the collector. Loans in this case are set between 10-50 percent of deposits. Loans are set to reflect the saving patterns and the type of economic activities engaged in by borrowers. In most instances, loans are interest free. It is difficult for esusu collectors to expand their loan base because of the short -term nature of deposits. Maintaining a loan portfolio is therefore very difficult for the esusus.

Lending is a mine field for esusu collectors because borrowers default. Consequently, majority of collectors have reduced their lending activities due to past defaults. Friends and relatives fail to repay loans resulting in loss of funds. When borrowers default, the ajo collector is unable to refund depositors' money. In instances when loan losses have been very high, esusu collectors run away rather than face angry depositors.

C Savings in Real Assets

Most of the savings that take place in Nigeria are in physical assets. In particular, the rural sector saves very little in financial forms. In rural areas, savings are often held in farm assets considered to be productive. Stored produce is a very popular form of savings. Storage costs are low, and it is normally done on a farmer's own property or a neighbour's (who may benefit from a similar gesture in future). Stored produce can be kept till the next season. Foodstuffs like maize, rice, beans, cassava and yam are predominant forms of saving. During the harvest time, prices of foodstuffs are quite low and as a result most farmers store their produce to sell when prices increase in the lean season. Farmers know that food prices increase as the time moves towards the lean season. In effect, higher income earned from off-season sales is a return on postponing consumption. Part of the stored produce can be used for household needs or can be sold in case of emergency. Rural farmers prefer this kind of flexibility and the fact that they exercise control over this form of savings.

In recent times, non-monetized saving forms have increased in urban areas. Holding of real assets in land, buildings, unfinished houses and building materials have become popular[24]. Until recently, the building sector was one of the booming sectors in the country. Non-financial savings are held as inflation hedges.

Real savings, including stored produce, building materials, tools and crops form a large part of rural savings. Rural people put their savings in forms that are conducive to their needs. These types of savings are controlled by the owners and are preferred over savings with formal sector institutions which may carry fixed deposit terms. Traditional attitudes toward security and secrecy obscure more information on the type of savings that take place. It is therefore difficult to determine what proportion of savings are held in real assets.

II Informal Savings Characteristics

Ajo Savers

The popularity of the ajo system is predicated on the idea that people want to save. Belonging to an ajo system provides a forced savings habit. Savings patterns and characteristics reflect different aspirations and ambitions of

[24] Similar to what obtains elsewhere abroad, past experiences of government confiscation of assets from corrupt politicians, failed bank executives and public sector officials have increased the tendency of investing the wealth in assets (especially houses)under different ownership.

people. Most of the savers with the informal savings mechanism we identified during the survey include timber-log owners, market women, transporters, meat sellers, bus and taxi drivers, and newspaper vendors. The majority of the savers in the system are women. As revealed in Table 5.7, 89 percent of the 200 women interviewed engaged in daily contribution. The major contributors in urban informal financial sector were petty traders, fruits and vegetables sellers, confectioneries sellers and sellers of 'pure' water. The lowest age of a contributor recorded was 15 years and the oldest was 63 years.

People save for productive and consumption purposes. Some save to start a business, to buy inventory or to expand existing trading activity. Others save to buy durable goods. Quite a number of savers who engage in ajo system collect their bulk savings at the end of the month and use it to buy stock of goods or assets like radio sets, fans, refrigerators, etc. Others save to accumulate funds that can pay for rental advance or for paying loans from friends, relatives or loans from money lenders.

Discussions with some of the depositors revealed that they engage in ajo to gain access to loans from the collectors. Depositors are attracted to the informal savings mechanism because of the 'promise' of credit facilities. Part of the willingness to submit to enforced discipline results from the desire to raise basic capital or to set aside funds for future consumption. This is one of the reasons why they pay alajos (ajo collectors) to keep their money. Members of ajo group develop good savings habits. By contracting to contribute a set amount every day, depositors cannot renege on their contract. Furthermore, depositors will not want to disappoint the collector who might have travelled quite a distance to their door-step or shops.

Savings Collectors (Alajos)

Most of the ajo collectors engage in the job on a full-time basis, although some school teachers were discovered to be doing the business on a part-time basis. The full-time ajo collectors start their rounds at 9:00 am and end at 5:00 pm. The hours of operation are set to fit the daily patterns of traders. The daily routine is to visit every contributor. However, some of the collectors we interviewed indicated that due to the economic recession in the country only about 50-80 percent contribute each day. Every alajo sets by-laws, which include a minimum contribution per day. The minimum contribution recorded per depositor is about ₦10 per day. The highest per day contribution recorded is ₦3,500. The collector charges a monthly fee equal to a day's contribution of each member.

The average number of contributors per each collector was 480. A membership of 500 or more in the pool is quite large for a single collector. The collector at this point tries to limit the operation by discouraging new members. The issue is that if the membership increases beyond a certain number the collector will need the services of assistants. But finding assistant collectors is very difficult because of the issue of trust. Nevertheless, there are a few senior ajo collectors who do exceed the 500 membership point. These are experienced collectors who have apprentices that help in the collection exercise. It was therefore observed that the ajo collection system has a maximum scope.

New collectors normally undertake apprenticeship for a period of 2 years with an experienced collector. Ajo collectors generally choose their niche in terms of location, geography and socio-economic group. Many of the ajo collectors concentrate on the markets while a few others concentrate on residential areas - targeting households- moving from door-to-door[25].

[25] It needs to be stressed that ajo collectors are currently facing stiff competition from semi-formal type institutions such as Cooperative Societies which are seen as mini-banks and legitimate and therefore becoming more popular with traders.

III Risk, Loss of Savings and Security of Deposits

There are risks involved in informal savings, both to the depositors and collectors. Depositors have lost their money in the past and some of the participants sampled mentioned their bad experiences with ajo collectors. Traders recounted several incidents in the past whereby alajos (ajo collectors) have absconded with savings. The issue of collectors carrying large amounts is a risky enterprise and several collectors have been attacked by armed robbers, especially at month end[26]. Some collectors try to keep large amounts at home (which they deem safe) rather than at the bank. Their reasoning is that they are more exposed if they try to withdraw and carry large amounts away from the bank. The week-ends and month-ends are the days that depositors request for the deposits and therefore collectors have to withdraw large amounts on Friday or month-ends.

Deposits in the informal financial sector do not attract any protection from the government. Depositors save within the informal financial circuits at their own risk. Nevertheless, recent attempts to 'formalise' the ajo system

[26] To buttress this point, an incident happened in late 1997 in Gate area of Ibadan where an elderly woman ajo collector was robbed by armed robbers who came to rob the area in broad daylight. Unfortunately, all the money and the ledger books where the contribution of each collector was recorded were forcefully snatched by the robbers.

have resulted into failed institutions[27]. These failures have somehow affected confidence in the ajo system, although no data exists on the number of deposits lost within a year. With no interest paid on informal deposits, and high inflation, retaining the value of deposits becomes an issue. Despite such concerns, informal financial networks have been able to innovate and survive various economic and political upheavals, for instance, the June 12, 1994 crisis during which banks were closed.

5.3.4ii Informal Borrowing, Lending and Investment Characteristics

I Borrowing Characteristics

Borrowing from moneylenders is not usually done by people needing long-term investment. In view of the fact that the lender usually cannot make term credit available at acceptable rates, the demand for credit from money lenders is often left to people without any other acceptable options in making payments. Soyibo (1994) observes that the moneylender's clientele in Nigeria is wide ranging including farmers, market women, other traders, both senior and junior public servants, self-employed craftsmen as well as large businessmen. Stranded travellers or other people in dire need also use the services of

[27] A case in point is the dismal performance and subsequent closure of many community banks within the last three years.

moneylenders. Farmers usually borrow money from moneylenders during the planting season to maintain their households until the next harvest. They may also borrow for expenditure on funerals and other social events (Adegboye, 1969).

Similar to the results in Aryeetey (1992) and Soyibo (1997), microentrepeneurs turn to a moneylender only as a last resort. Even though 57% of the respondents failed to secure any bank loans, only 4 percent of them used credit from moneylenders to finance planned investments. Among the moneylenders we interviewed, 55% of the credit they advanced went to traders. Credit to government employees (civil and public servants) accounted for 17% of the credit advanced in 1997. Borrowing by government workers was to meet social needs like funeral and naming (christening) ceremonies. Similarly, traders approach moneylenders to meet social needs as well as either to restock trading inventories or to settle consumption bills. This in effect shows that generally moneylenders are not interested in financing relatively large fixed investments or even working capital expenditures, hence their focus on borrowers with less price elastic demand.

II Lending Characteristics

There seems to be a strong correlation between number of applications received by each moneylender and the location of lender, suggesting that for a given year rural moneylenders would receive money lending applications than their urban counterparts. From the survey, loan applications went from an average of 60 per lender in Oyo State to 93 per lender in Ogun State (see Table 5.6). However, not all the loan applications were honoured. On the average, the number of persons granted loans per State went from 46 in Oyo State to 70 in Ogun State. In addition, the number of applications varies extensively between men and women. Out of every five applications, three were from male applicants. In other words, 60% of the applications came from men.

The interest rate charged varies from 10% to 25% depending on the location and the size of the loan. The moneylenders' rates are usually for relatively short periods, usually one month. Moreover, the rates and terms for lending vary from one moneylender to another, even though the variation is often not significant within a given locality. In cases of default, the most common method adopted by moneylenders is to make personal threats, and then confiscate collateral, if threats fail. It was observed in Ijebu-Ife of Ogun State that a borrower who approaches a lender for money to buy a commercial vehicle buys the vehicle in the name of the lender. The ownership of the vehicle is transferred back to the borrower when he has finished paying the lender. As noted by Ghate (1990), there are four components of interest rates. These are the risk-free element in the rate of interest - the opportunity cost of funds, a premium for risk, a premium to cover transaction cost, and an element of monopoly profit. The relatively high interest rates of moneylenders are often explained by their overestimating the risk element in giving credit, and therefore charging a high risk premium.

Similar to what Soyibo (1994) observed, there are interest rate differentials in lending to new and old customers. From the survey, in some cases, new customers pay as much 10% more than the old customers on loans. This is because loan administration (which involves loan screening, monitoring and contract enforcement) is cheaper with old clients than new clients. In screening loans emphasis is placed on the character of the borrowers who are either known to the lender or presented by another person. Unlike in the formal financial system, studies of the feasibility of the proposed projects are not given deep consideration by moneylenders. This, in essence, makes loan screening to be done quickly by moneylenders.

Table 5.6 Lending Characteristics of Moneylenders in 1997

S/N	Characteristics	Sample
1	Percentage of Credit that goes to: traders civil/public servants transporters farmers timber-log owner others	 55 17 13 9 3 3
2	Average number of applications received by each moneylender by location: urban rural both urban and rural	 70 87 78
3	Average number of loans granted by moneylenders by State: Oyo State Osun State Ogun State Ondo State Ekiti State	 46 49 70 58 62
4	Percentage of loan applications by sex: Male Female	 60 40
5	Range of interest rates charged by moneylenders	10 - 25%
6	Factors influencing interest rate determination	size of loan, length of time for the loan, the familiarity with the borrower and the collateral submitted.
7	Maximum number of months for loans	6 months

Source: From the survey

III Investment Characteristics

It has been observed that moneylenders are not particularly interested in financing fixed investments and some working capital expenses (Aryeetey, 1995). This situation contrasts sharply with the situation in Asia (Bell, 1990; Ghate, 1990). Bell's study suggests that the dependence on moneylenders by Indian farmers for loans was rather high, where about 17% of household indebtedness was from loans provided by them.

There are a number of reasons why commercial moneylending is not as attractive for investments as anticipated. The reasons have to do with the terms under which the loans are made, as well as the capacity of the lender to provide the quantity and types of loans desired by borrowers. Initial lending capital is usually cash from other economic activities, and growth of this cash is entirely dependent on profits from lending and the other economic activities, if still pursued. Traditionally, moneylenders do not mobilise deposits and therefore cannot expand their lending base rapidly. The limited supply of lending capital has to be allocated among different borrowers within set geographical areas in a manner that permits the lender to appraise early the ability of the borrower to repay. He/she is confronted with a dilemma in view of the imperfect information about the likelihood of repayment. It appears that moneylenders prefer more risky borrowers, invariably consumer, about whom they possess ample information. Hence, low 'bidders' for credit (including small-and medium-scale enterprises (SMEs)), who may be the least risky, are priced out of the market through relatively high interest rates and other unsuitable loan conditions. The moneylender obviously has to confront the problem of adverse selection regularly.

5.3.4iii The Use of Informal Finance by Women

A large percentage of Nigeria's informal sector (both urban and rural) is dominated by women[28]. The dominance of women in the informal sector explains the high participation of women in informal finance. Women constitute the main contributors to informal savings[29]. Women entrepreneurs and farmers have the least access to formal financial sector institutions. Moreover, because the land tenure systems and cultural property rights favour men, few women have access to land or real assets that could be used as collateral. With limited access to formal sector financial institutions, informal finance mechanisms

---

[28] Most Nigerian men are involved in wage labour, skilled craft work and export crop production. However, due to the crisis in the formal sector, more men have been moving into the informal sector. See Magbagbeola (1996).

[29] Women play a very significant in the socio-economic development of Nigeria. From the 1991 population census, women constitute 49.68% of the population. 84.7% of the urban women are employed full time. In the rural areas, 65.5% of the women are employed full time while 58.2% of the men are employed full time. See FOS (1997).

become the main options for women.

The high participation of women in the informal sector is enhanced by the relatively easy entry and exit. It takes very little capital to enter and one can leave anytime to marry, give birth or go on transfer with one's husband, etc. In addition, the qualifications for entry are very low - majority of women have few employable skills for formal sector jobs, due to low formal education. Results from the interviews conducted indicate that most women engage in these economic activities as a way to meet their heavy financial burdens. Family responsibility, within an economy without social safety nets or social security and welfare schemes rests on women.

The main economic activity of Nigerian women after agriculture is trading. Women are found in small scale farming, food processing, distribution and marketing of food, and retail trading. In the survey conducted on women traders in Ibadan City, results show that 34 percent of the women are engaged in petty trading, 21 percent in the sale of fruits and vegetables (See Table 5.6).

89 percent of the women interviewed indicated that they use informal financial services as a last resort because they do not have access to formal banks. Women use variety of structures to finance their businesses, some of which include:

i Self Finance

Self-finance appears to be the main source of funding for women engaged in small scale farming and microenterprises (see Table 5.7). Funding for small scale farmers and microenterprises comes from their own savings, friends and relatives. 47.5 percent of the women interviewed described their source of start-up capital as coming from personal savings followed by 28.0 percent of the respondents whose start-up capital came from their husbands. This is not surprising as such support from the husband is a cultural obligation in Yoruba land. In a society where most women are not educated and there not employable in the higher cadre of the white-collar sector, it is the responsibility of the husband to give seed money to the wife for an income-generating activity. The women are expected to turn the funds around with a profit and thereby pick up some of the family expenses such as food, clothes for kids, etc. The extent of this practice is yet to be estimated.

ii Working Capital

All the women interviewed needed working capital. Trade practices like the purchase of inventory makes the traders' need for working capital urgent. Wholesale supply of goods does not necessarily follow certain patterns. To purchase inventory, traders may have to raise working capital within a few hours. For most traders, raising working capital from banks at such a short notice is impossible. The only recourse to them is informal type financing - ajo collectors or money lenders.

The ajo (or esusu) market is constantly growing because of the promise of loans to the traders. The *alajos* normally give out loans and borrowers pay back in daily installments. Loan collection is done at the same time as the daily savings contribution - this time a borrower may have to increase their contribution to reflect the loan repayments. 96 percent of the women interviewed receive their working capital from the esusu system[30]. Loans are for a short-term, the average length of period being a month. The average loan received by the women respondents was ₦15,000, which is normally repaid within the month. For instance, if a creditable trader deposits ₦50 every day with an alajo and approaches him/her for a loan say on the 5th of the month, the maximum the trader can get is N1,500. The remaining ₦1,250 will be paid on daily basis for the remaining 25 days. The traders prefer daily repayments (as with daily savings) from daily sales. The informal mode of financing is therefore preferred by traders in need of working capital. Moreover, the traders pointed out that they have long-term relationships with the esusu operators and

[30] Some of the women also participate in the semi-formal institutions like the Co-operative Societies

can therefore renegotiate their debts.

iii. Trade Credit

Trade credit transactions are very strong in the informal sector due to strong practices of solidarity and mutuality. 85 percent of the women we interviewed engage in trade credit. Interview results show that traders use trade credit for several reasons: to promote sales, assure markets, competition, when the market is slow, etc. Trade credit takes the form of supplier credits (deferred payment) or customer pre-financing / pre-payment of current or future production and supply. Pre-payments are an important source of working capital. Interview results show that in certain instances as in cloth market, supplier credit acts as a source of initial capital.

Financing arrangements are available in the marketing chain from wholesalers, retailers and cold-store operators. Traders buy inventory on credit and pay within a week after sales. Most of the traders stated that they normally sell for cash but give credit to "good" customers. These good customers are also people well known to the traders and can easily be located in case of default. These good customers are people who have purchased and paid cash for a long time. The reputation/character of the customer is very relevant for trade credit. Traders know the buying habits of customers, their credit history, and any outstanding debts owed to others. Over time traders and buyers who engage in trade credit become known to each other. When this happens people are referred to as "customers". These relationships become long-term and people buy from the same traders whenever they visit the market.

Table 5.7 Characteristics of the Women Depositors

S/N.	Characteristics	Frequency	Percentage (%)
1	Engaged in Daily Contribution:		
	Yes	178	89.0
	No	22	11.0
2	Source of take-off capital:		
	Personal Savings	95	47.5
	Contribution (ajo)	43	21.5
	Loans from friends	4	2.0
	Assistance from husband	56	28.0
	Relatives	2	1.0
3	Engage in trade credit:		
	Yes	170	85.0
	No	30	15.0
3	Family Headship:		
	Self	40	20.1
	Husband	159	79.9
4	Educational Qualification:		
	No Education	63	31.5
	Primary/Adult Education	41	20.5
	Modern School Education	60	30.0
	Secondary Education	25	12.5
	Tertiary Education	11	5.5

S/N.	Characteristics	Frequency	Percentage (%)
5	Type of Business:		
	Stationeries	2	1.0
	Confectioneries	19	9.5
	Beverages	11	5.5
	Fruits and Vegetables	42	21.0
	Petty Trading	68	34.0
	Provisions	19	9.5
	Fried Snacks	13	6.5
	Foodstuffs	12	6.0
	Cooked Food	8	4.0
	Drinks	6	3.0

5.4 Institutional Linkages With Formal Financial Institutions

5.4.1 Introduction

Formal and informal financial sectors in Nigeria do exhibit a degree of linkage. A large section of formal sector employees who have access to formal finance also participate in informal markets. This is because informal market transactions are faster and exhibit higher flexibility and also joins them to community values and practices. Nevertheless, informal financial sector operators like ajo collectors, market women and other microentrepreneurs do save regularly with formal sector banks.

In general, as noted by Soyibo (1997), informal finance providers do not perceive themselves as having sufficient capacity to meet the credit requirements of their clients. They are constrained by limited lending capital and are, thus, forced to reject applications which are perceived to be good. Hence, there is an opportunity for financial integration by means of improved access of the informal sector to greater formal sector credit.

5.4.2 Links With Formal Banks

The most identifiable link between the informal and formal financial sectors is the operation of bank deposit accounts by many informal financial sector operators. Most of the ajo collectors deposit their collection with formal banks.

The mobile collectors visit the banks about twice weekly to make deposits and make two withdrawals in a month.

From the survey conducted, 88% of the ajo collectors indicated that they maintain bank accounts. While 15% of the collectors maintain both demand deposit and savings accounts, 63% and 33% of the ajo collectors maintain savings and demand deposit accounts respectively. In the urban areas, informal financial agents interact more with banks than those in rural areas. Moneylenders, sometimes, deal with borrowers through banks and some of the lenders are known to their banks as informal lenders. Contrary to Soyibo's (1997: 19) observation that ajo collectors enjoy 100% success rate in loan application to banks, the survey results show that direct credit links between formal banks and ajo collectors is weak. Due to the short-term nature of deposits from ajo collectors, the banks are cautious in extending credit facilities to the collectors.

Of the moneylenders interviewed, 80% agreed that they keep track of going bank lending rates although only 47% allow the bank lending rates to influence their lending rates. More than 80% of the moneylenders and ajo collectors who borrow from the bank use the money borrowed to boost their lending operations while the rest use the loans for other economic activities. 65% of the esusu collectors and 57% of the moneylenders indicated their interest in joining a scheme in which banks would advance credit to them for onward lending to their clients. Similar to Soyibo's (1997:19) discovery, the desire for on-lending of bank credit is stronger in rural areas (63%) than urban areas (52%). The analysis thus confirms the hypothesis of a weak linkage between the informal financial sector and formal banks due to the small proportion of informal financial sector activities passing through the banking system.

CHAPTER SIX

SUMMARY OF MAJOR FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

6.1 Introduction

In Chapter 4, we indicated the research methodology for the study, and discussed the various methods of analysis (including the maximum-likelihood logit estimation technique) after we had described the various types of data to be collected, and the survey areas.

In Chapter 5, we estimated the size of the informal financial sector using four measures of relative sizes. The measures employed include Deposit/M2, Credit/GDP, CC/Deposit and CC/M2 ratios. In the logit model, we estimated the statistical significance of the following independent variables: Gender, Marital Status, Age, Farmer, Transporter, Ethnic Group and Level of Education on the respondents' membership in informal financial groups.

Besides, we attempted to examine the socio-economic and demographic characteristics of the respondents; their perception about financial services as well as the various arrangements and characteristics of savings, borrowing, lending and investment in informal finance. In addition, we strived to find out how much the women respondents were involved in informal finance. To conclude the chapter, we tried to establish the institutional linkages between the informal and formal financial institutions.

This chapter, therefore, tries to give a summary of the major findings of the study as well as proffer policy recommendations emanating from our findings. In addition, in this chapter we attempt to highlight the major limitations of this study, and conclude with suggestions for further research.

6.2 Summary of Major Findings and Conclusions

6.2.1 Size, Role and Nature of Informal Financial Sector

From the survey results, we found that the informal financial sector is about one-third the size of the formal financial sector. This result contrasts the hypothesis in the literature that the informal financial sector is bigger than its formal sector counterpart. The result is not surprising as the volume of cash that passes through the informal financial sector is considerably less than the amount of money that circulates within the formal financial sector. This is because within the broad money supply (M2), deposit, on the average - between 1970 and 1994, accounts for 74% of the broad money supply. Deposit accounts (comprising demand deposit, savings account and time deposits) are within the confines of the formal financial sector. However, if we are interested in the number of participants patronising each of the two sectors, then we may conclude that the informal financial sector is bigger than the formal sector. This is so because of the low literacy rate in the country and the fact that the formal financial institutions require some level of literacy for their transactions.

In addition, it was discovered that the informal financial sector plays a prominent role in financial intermediation in the old Western Nigeria. The ajo (or esusu) collectors make available interest-free loans to credit-worthy customers who are in need of credit. Although slightly different, moneylenders also make available credit to clients but at exorbitant interest rates. Other informal financial groups that enhance financial intermediation include ROSCAs (rotating savings and credit associations). All the identified ROSCAs are mostly localised and work-related, and, in most cases, have between 2 and 10 members. Evidence from our survey shows that about 49% indicate community (or locality) as the factor responsible for the formation of their respective ROSCAs, 29% identify occupation as the factor while the remaining 22% choose the following factors in a descending order: Ethnicity, Gender, Religion and Other.

Besides, it has also been discovered that the informal financial mode allows for low daily savings and withdrawals. Unlike formal banks, savers in the informal mode need very little literacy and numeracy skills. The arrangements which the informal financial institutions offer are clear, easy to understand and very transparent. They require minimal procedures for savings and withdrawals.

6.2.2 Characteristics of Informal Finance Operators

In the estimated maximum-likelihood logit estimation model, we found that women are twice likely to join informal financial groups (IFGs) than men. This finding contrasts the hypothesis that no gender differences exist in membership of IFGs. The reason adduced for this observation is that compared with men, women have a lower rate of literacy. In fact, more than 50 percent of the women respondents did not have more than primary school/adult education (see Table 5.7).

Second, it was discovered that marital status of a respondent is positively related to the respondent's membership of an IFG; and that a married person is twice more likely to join an IFG than a single person. This, however, contrasts the hypothesis in the literature on informal finance that married men tend to participate more in informal financial transactions than married women.

Third, we discovered that younger people are more likely to belong to IFG than older people. Specifically, respondents aged 18-37 years of age are three times more likely to be members of IFGs than respondents who are older than 37 years. Fourth, we observed that a person with no formal education is 3 times more likely to be a member of an IFG than someone with primary education, 7 times more likely than someone with secondary education, and 8 times more likely than someone with tertiary education. This finding lends support to the hypothesis that more educated people make less use of formal financial services than people with little or no formal education.

Fifth, ethnic group was also observed to be positively associated with a respondent's membership of an IFG. From the survey, a Yoruba respondent is 3 times more likely to join an IFG than a non-Yoruba respondent. Sixth, the odds of a farmer, transporter or a trader belonging to an IFG are each twice more likely than respondents who are not farmers, transporters or traders respectively.

Besides, informal finance savers were found across the informal economy and these savers include timber-log owners, traders, transporters, meat sellers, bus and taxi drivers, and newspaper vendors. A higher proportion of the savers are women. Among the 200 women separately interviewed, 89% were involved in ajo contribution on a daily basis. These women include petty traders, fruits and vegetable sellers, confectioneries sellers and drinks sellers (especially water). Depositors engage in ajo to gain access to loans from the collectors and are thus attracted because of the 'promise' of credit facilities. The funds saved with and borrowed from ajo collectors or moneylenders are used to meet consumption and investment needs of the people. Ajo savers collect their bulk savings at month-end to buy stock of goods or assets like radio sets, fans, refrigerators, or to pay for rental advance or loans from friends, relatives or moneylenders.

In the area of lending, it was observed that, in general, rural moneylenders receive loan applications more than their urban counterparts; and that 60% of the applicants were men. The moneylenders charge interest rates between 10% and 25% depending on factors such as location of the lender, size of the loan, time period for the loan and the applicant's closeness to the lender. The interest rate differential in lending to new and old customers could be as high as 10%. In general, these interest rates are higher than those that obtain in the formal financial sector. The relatively high interest rate of moneylenders are often explained by their overestimating the risk element in giving credit, and therefore charging a high risk premium.

6.2.3 <u>Institutional Linkages With Formal Financial Institutions</u>

It was observed that 88% of the ajo collectors deposit their collection with formal banks. Both savings and demand deposit accounts are maintained. For the savings account, the ajo collectors visit the banks two times every week to make deposits and make two withdrawals in a month. On an urban/rural dichotomy, it was observed that informal financial agents in the urban areas interact more with the banks than their rural counterparts. However, evidence shows that direct credit links between formal banks and ajo collectors is weak. It was gathered that as a result of the short-term nature of deposits from ajo collectors, the banks are cautious in extending credit facilities to the collectors.

In addition, although 80% of the moneylenders monitor bank lending rates, only 47% of them use the bank lending rates as bench marks for their own lending rates. More than 50% of both esusu collectors and moneylenders indicated interest in joining a scheme in which banks would advance credit to them for onward lending to their clients. This desire for onward lending of bank credit is stronger in rural areas than urban areas.

6.2.4 <u>Conclusions</u>

The problem of information asymmetry, with the associated problems of adverse selection and moral hazard appear to be less serious for informal finance than formal finance. The highly localised nature of these markets and greater availability of information has a risk-reducing effect. Some of the strengths found in informal finance include flexibility, convenience, low information costs for the lender, high loan recovery rates and ability to resolve the difficult and sometimes costly loan collateral problems.

Most informal finance is client oriented (i.e. they provide services at the residence of the client, at a convenient marketplace or where clients work) while formal intermediaries are often more concerned about their regulators: Central Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC), government officials and their shareholders. Intermediaries with a client orientation substantially reduce the transaction costs for customers and make their service attractive even though explicit or implicit interest charges are relatively high. In contrast, many formal intermediaries focus on keeping their transaction costs low, charge relatively low interest rates, but often impose procedures on lenders and depositors that substantially increase the users' transaction costs to the point where total costs of effecting the financial transaction may be higher than if they were done in informal markets.

Another attractive feature of informal finance is that loans and deposits are often tied. Individuals can increase their access to loans or credit reserves by proving themselves through deposit performance. This includes building bonds of mutual trust that assure future access to loans through reciprocity. In many cases, informal finance allows participants to gradually enhance their credit worthiness, first through savings, then through borrowing and repaying small loans, and only later gaining access to relatively large loans. This process is particularly important for individuals and firms that start small: women, microenterprises and poor people.

The rich variety of types of informal finance and the fact that these activities can be found in virtually every nook and cranny of the Nigerian economy demonstrates the innovative and dynamic nature of at least some parts of the informal financial system. It also demonstrates that informal finance is usually more resilient in the face of adversities that affect the overall economy than is generally true of formal finance, in part, because informal finance is unregulated.

Nevertheless, the informal finance is not without its inherent weaknesses. It is more awkward for informal intermediaries to provide large and long-term loans than it is for formal lenders, and it is also more difficult for informal arrangements to provide the liquidity and security that formal intermediaries ought to be able to furnish to depositors.

However, it is unfortunate to note that in spite of the abundance and vitality of informal financial institutions in Nigeria, their potential for enhancing the development process has not been effectively harnessed. The efforts so far exerted by the Central Bank of Nigeria (CBN) to revamp this anomaly and to bring about closer relationship between the formal and informal financial institutions have been grossly inadequate. Is it then surprising to observe that the CBN has no special unit within its Research Department dealing exclusively with the informal financial sector? In addition, the commercial banks have shied away from financing smallholder agriculture and microenterprises under the guise of high transaction costs. However, given Nigeria's prevailing structural impediments, these transaction costs are bound to remain for years to come. Is it then fair and prudent that the commercial banks should become passive agents of Nigeria's development drive?

The formal financial system, particularly the CBN, is best placed to foster a meaningful partnership between formal and informal financial institutions in Nigeria. Although this change should be propelled by the CBN, it is however equally important to recognise that the effective linkage of formal and informal financial systems should not be viewed as the exclusive domain of the CBN. The resources to be mobilised in the informal financial sector are enormous and could have far-reaching impact on the reduction of Nigeria's staggering debt, alleviating poverty, generating employment and helping the rural and urban poor becoming the most productive segment of Nigeria's population. This is the challenge.

6.3 Policy Recommendations

The following strategies are recommended for enhancing the economic development of Nigeria through the informal financial sector:

- Government should cultivate a complementary relationship with the informal sector, generally, through an institutional framework that will promote the principles of partnership, collaboration and consultation. The national planning process should recognise the roles, capacities and resource needs of the sector.
- Commercial banks should set up micro-credit desks. Credit can be given to ajo collectors or moneylenders at mutually agreed terms for onward lending to their customers.
- The Central Bank of Nigeria should create a unit in its Research Department whose mandate will be to study the informal sector and generate data from the sector.
- Informal moneylenders should utilise to a great extent the interlinking processes in markets which can provide a way for lenders to get more information on their clients and to better enforce payments. Interlinking permits the involvement in high-return activities such as trading, and reduces a lender's default rate thus improving the return on lending.

- Under selected circumstances, group-lending (also known as peer monitoring) is a recommended mode of credit operations. In many instances, formal credit systems cannot ensure that high rates of loan collection will occur, and foreclosure actions are often difficult and costly to enforce. Since it is difficult to guarantee the full value of a loan with borrower and guarantor's savings alone when lending to poor clients, group-lending is a preferable and potentially low-cost alternative for achieving high rates of loan repayment. Group-lending schemes should be carefully designed and implemented if they are to be effective in improving loan performances.
- Finally, the monetary authorities, especially the Central Bank of Nigeria, should learn from informal finance but not attempt to alter its activities through outside intervention. This would largely involve doing research on informal finance to clarify the types of services it provides and the techniques and practices used to provide financial services to the poor. This should include analysis of informal financial activities as part of financial sector assessments as well as more specific analysis of particular forms of informal finance. Useful ideas from these studies might then be grafted onto formal finance programmes so that their design more closely emulates informal finance.

6.4 Limitations of the Study

Because of the heterogeneity, small transactions and dispersion of informal finance, it is extremely costly to do the large surveys necessary to answer statistically significant and theoretically plausible questions about the relative importance of informal finance for an entire economy. Hence, the reduction of this study to a regional survey.

This study faced some problems, characteristic of studies that conduct fieldwork in sub-Saharan African countries. The main limitations that this study had to deal with included sampling error, measurement error and the inherent weakness of single surveys. We made a serious effort to tackle these limitations right from the sampling stage to the end of the field work. Fortunately, the research team was able to effectively deal with many of the problems through a number of measures discussed below.

Sampling error was minimised in this study. Although the sample design used was not perfectly randomised, the sampling error was minimised by applying a multistage stratified random procedure in selecting all units of interest. The use of a fairly large sample size of 608 respondents also helped in reducing sampling error. Thus, we can confidently use the results derived from this sample to draw inferences about the survey areas.

Measurement error was more difficult to surmount, because it involves assessing validity and reliability which are cumbersome to handle. To combat this problem, a number of measures were taken. We conducted a pilot survey and used the results to fine tune the questions. In addition, the enumerators were adequately briefed to prepare them effectively for the interviews. As a matter of fact, respondents had no serious difficulties in comprehending and answering the questions. This greatly helped to minimise measurement error.

Another seemingly intractable problem was **recall** problem. The issue of recall presents a potential challenge in collecting data that required respondents to remember facts and figures over a substantial lapse of time. This, in particular, concerns questions about activities and transactions that took place over the past several years. In this study, respondents experienced some difficulties remembering information about past income and expenditure items. However, the problem of recall was of minor concern, as the respondents were asked to provide income and expenditure estimates only for the past two years. As such, these estimates are considered close approximations to the real income and expenditure figures.

Finally, a more general question related to the reliability of the data derives from the nature of **single visit** surveys. The data used in this study were typically collected in a cross-sectional survey over a limited time period (6 months) during which respondents were interviewed in single visits. This 'one shot' nature of cross-sectional surveys is an inherent weakness.

6.5 Suggestions for Further Research

Only the informal financial sector was analysed in this study by the logit estimation technique. We did not consider the semi-formal and formal financial sectors. An area for further research is the use of a multinomial logit model to estimate the linkages among the informal, semi-formal and formal sectors. The multinomial logit model is used to estimate the relationship between a multilevel dependent variable with binary response categories and a set of ordinal independent variables with categorical variables. The dependent variable could be a dichotomous multilevel dependent variable with the following categories of use:

1. Does not use any external source of finance
2. Uses informal sources only
3. Uses semi-formal sources only
3. Uses formal sources only
4. Uses both informal and semi-formal sources only
5. Uses both informal and formal sources only
6. Uses both semi-formal and formal sources only
7. Uses informal, semi-formal and formal sources of finance.

It is also suggested that the survey exercise be extended to other parts of the country. Two types of questionnaires should be administered to the formal financial sector: (1) formal bank staff and (2) bank customers. The formal financial sector will seek the following data:

- **deposit characteristics:** these data will provide insight into types of depositors, size of deposits, maturities, seasonality of deposits, savings by gender within and between households;
- **criteria and procedures:** these data reveal transaction costs for savers in informal, semi-formal and formal (rural/urban) financial markets - the number of hours to process deposits/withdrawals, minimum deposit levels, interest rates;
- **determination of the degree of mistrust:** these data will show the extent to which 'non-mobilised savings' (tangible savings - money, real assets, jewelry, precious metals, cattle, stored produce, and durable goods) are a result of low confidence in formal financial institutions.

The focus of this investigation should be to:

- determine the scope of financial intermediation - quality and range of financial services in the informal, semi-formal and formal financial markets;

- determine the monetization and variations in saving behaviour (daily, monthly, and seasonal) of rural/urban microentrepreneurs; and
- ascertain customers' perspective of financial services (the degree of trust, safety of deposits, accessibility and convenience).

The primary data should be used to confirm "official position" on the structures and processes derived from the secondary data. The secondary data can be obtained by reviewing the various banking regulations (including the BOFI (Banks and Other Financial Institutions) Decree), procedures, balance sheets, annual reports, publications of Money Market Association, Central Bank of Nigeria Annual Report and Statement of Accounts and Central Bank of Nigeria Statistical Bulletin. The publications will provide information on macroeconomic indicators such as monetary aggregates, depth of the financial system and currency holdings. At individual bank's head-office, data pertaining to deposit structure, loans and investment characteristics, sectoral lending patterns, number of borrowers, interest rates, income analysis, balance sheets, financial reporting, organisational structure, credit risk management and institutional development should be obtained.

Other new research topics emerging from this thesis include:

- studying the role of imperfect information in financial markets to establish the relative importance of adverse selection and moral hazard;

- broadening the analysis of borrowing costs from just interest charges to include expenses associated with providing collateral, transaction costs, and quality of financial services; and
- studying the practices and techniques used in informal finance to reduce transaction costs.

REFERENCES

Adams, D.W. (1992) "Taking a Fresh Look at Informal Finance" In Adams, D.W. and D.A. Fitchett (eds) *Informal Finance in Low-Income Countries*. San Francisco, CA: Westview Press.

Adams, D.W. and D.A. Fitchett, eds. (1992) *Informal Finance in Low-Income Countries*. San Francisco, CA: Westview Press.

Adams, D.W. and V. Sandoval (1989) "Informal Finance in the Phillipines", *Economics and Sociology Occasional Paper, No. 1570*. Department of Agricultural Economics and Rural Sociology. Columbus, Ohio: Ohio State University.

Adams, D.W., Graham,D., and J.D. Von Pischke, eds. (1984) *Undermining Rural Development with Cheap Credit* (Boulder: Westview Press).

Adegboye, R.O. (1969) "Procuring Loans by Pledging Cocoa Trees", *Journal of the Geographical Association of Nigeria*, 12.

Adera, A. (1995) "Instituting Effective Linkages Between the Formal and the Informal Financial Sectors in Africa: A Proposal" *Savings and Development*, Vol. XIX, No. 1

African Development Bank (ADB) (1995) "Domestic Resource Mobilisation" in *African Development Report 1995*, Abidjan: Côte d'Ivoire, Chapter 11.

Ahmed, A.H. (1975) *Private money-lenders in the Sudan Gezira Scheme*, Department of Rural Economy, University of Khartoum, Sudan.

Ajakaiye, D.O. and W.O. Akerele (1995) "Overview of Conceptual and Methodological Issues In Informal Sector Research", a paper presented at the CBN/NISER Workshop on Conceptual and Methodological Issues in the Informal Financial Sector Research, 30th - 31st August.

Amani, H.K.R., L.A. Msambichaka, M. Lundahl and S. Hedlund (1987) "Agricultural Credit in Tanzania - a Peasant's Perspective" *Savings and Development* 11 (4), pp. 379-400

Ardener, S. (1964) "The Comparative Study of Rotating Credit Associations", *The Journal of the Royal Anthropoligical Institute of Great Britain and Ireland* 94: 201-229.

Aredo, D. (1993) *The Informal and Semi-Formal Financial Sectors in Ethiopia: A Study of the Iqqub, Iddir and Savings and Credit Cooperatives*. AERC Research Paper 21, Nairobi.

Aryeetey, E. and M. Hyuha (1991) "The Informal Financial Sector and Markets in Africa: An Empirical Study". In: *Economic Reform in Sub-Saharan Africa*. Ajay Chibber and Stanley Fischer,eds. The World Bank, pp. 125-136.

Aryeetey, E. and M. Hyuha (1991) "The Informal Financial Sector and Markets in Africa: An Empirical Study", in Chibber, A. And S. Fischer (eds.), *Economic Reform in Sub-Saharan Africa*, A World Bank Symposium, World Bank, Washington, D.C.

Aryeetey, E. (1995) *Filling the Niche: Informal Finance in Africa*. Nairobi: AERC/East African Educational Publishers.

Aryeetey, E. (1997) "Savings, Investment and Financial Development With Informal and Semi-Formal Financial Markets" *African Development Review*, Vol. 9, No. 1: 210-233.

Aryeetey E. and C. Udry (1994) "The Characteristics of Informal Financial Markets in Sub-Saharan Africa", Paper Presented at the Plenary Session of the Research Workshop of the African Economic Research Consortium, Nairobi, December.

Aryeetey, E. and F. Gockel (1991) *Mobilising Domestic Resources for Capital Formation in Ghana: The Role of the Informal Financial Sector*. AERC Research Paper 3, Nairobi.

Aryeetey, Ernest (1994) *Financial Integration and Development in Sub-Saharan Africa: A Study of Informal Finance in Ghana*, Working Paper 78, Overseas Development Institute, London.

Awasu, C. (1996) *Savings Mobilisation and Financial Market Development in Ghana*. Unpublished Ph.D. Dissertation, Graduate School of Syracuse University.

Bagachwa, M.S.D. and A. Naho (1994) A Review of Recent Developments in the Second Economy in Tanzania, *AERC Special Research Paper 16*. Nairobi: AERC

Bagachwa, M.S.D. (1994) *Financial Integration and Development in Sub-Saharan Africa: A Study of Informal Finance in Tanzania*, Working Paper 79, ODI, London.

Basu, K. (1984) *The Less Developed Economy*. Oxford: Blackwell.

Bell, Clive (1990) "Interactions Between Institutional and Informal Credit Agencies in Rural India". *The World Bank Economic Review* Vol. 4, no.3, pp. 297 - 327.

Besley, T., S. Coate, and G. Loury (1993) "The Economics of Rotating Savings and Credit Associations" *American Economic Review*, 87/4.

Besley, T. (1994) "How Do Market Failures Justify Intervention in Rural Credit Markets?" *World Bank Research Observer* 9/1, pp. 27-74.

Bester, Helmut (1985) "Screening versus rationing in credit markets with imperfect information", *American Economic Review*, vol. 75, no.4:850-855.

Bhaduri, A. (1977) "On The Formation of Usurious Interest Rates in Backward Agriculture", *Cambridge Journal of Economics* 1: 341-352.

Binswanger, H. and M. Rosenzweig (1986) "Behavioural and Material Determinants of Production Relations in Agriculture", *Journal of Development Studies*, Vol. 22, No.3, pp. 503-589

Binswanger, H. and J. McIntyre (1987) "Behavioural and material determinants of production relations in land-abundant tropical agriculture", *Economic Development and Cultural Change* vol. 36, no. 1: 73-99.

Bouman, F.J.A. (1995) "ROSCA: On the Origin of the Species" *Savings and Development*, No. 2, Vol. 19, pp. 117-148.

Bouman, F.J. and R. Houtman (1988) "Pawnbroking as an instrument of rural banking in the Third World", *Economic Development and Cultural Change*, vol. 37, no. 1: 68-89.

Bouman, F.J.A. (1984) "Informal Savings and Credit Arrangements in Developing Countries: Observations from Sri Lanka" in D.W. Adams, Douglas H. Graham and J.D. Von Pischke (eds.) *Undermining Rural Development with Cheap Credit*, Westview Press: Boulder, Colorado, pp. 232-247.

Bouman, F.J.A. (1977) "Indigenous Savings and Credit Societies in The Third World - Any Message?" *Savings and Development*, 1: 181-218.

Burton, C. (1973) "Credit and the Small Farmer: A Case Study of the Mekong Delta, South Vietnam", in *AID Spring Review of Small Farmer Credit*, AID: Washington, D.C.

Callier, Philippe (1990) "Informal Finance: The Rotating Saving and Credit Association - An Interpretation", *Kyklos*, vol. 43, no. 2: 273-6.

Central Bank of Nigeria (1995b) *Annual Report and Statement of Accounts*

Central Bank of Nigeria (1995a) *Statistical Bulletin*

Chandavarkar, A.G. (1985) "The non-institutional financial sector in developing countries: Macroeconomic implications for savings policies", *Savings and Development*, 9(2).

Chinnapa, A. (1977) "Adaptation of new agricultural technology in North Arco Division" in B.H. Farmer (ed.) *Green Revolution: Technology and Change in Rice Growing Areas of South Asia*. Macmillan: London, Chapter 7.

Chipeta, C. and M.L.C. Mkandawire (1991) "The Informal Financial Sector and Macroeconomic Adjustment in Malawi", *Research Paper* 4, AERC, Nairobi.

Christensen, G. (1993) "The Limits to Informal Financial Intermediation", *World Development*, Vol. 21, No. 5, pp. 721-731.

Deaton, A. (1989) "Saving in Developing Countries: Theory and Review", *Proceedings of the*

World Bank Annual Conference on Development Economics. Washington, DC: World Bank.

Deaton, A. (1990) '*Saving in Developing Countries: Theory and Review*', Proceedings of the World Bank Annual Conference on Development Economics, Washington D.C.

Delancey, Mark (1977) "Credit for the common man in Cameroon", *Journal of Modern African Studies*, vol. 15, no. 2: 316-322.

Delancey, Mark (1978) "Institutions for the accumulation and redistribution of savings among migrants" *Journal of Developing Areas*, vol. 12, no. 2: 209-224.

Economic Commission for Africa (1994) *Economic Report on Africa* (E/ECA/CN.17/2)

FAO (1974) "Agricultural Credit in Three Villages in Northern Tanzania" unpublished *FAO Working Paper*, No. 2.

Federal Office of Statistics (FOS) (1997) *Annual Abstract of Statistics 1996 Edition*. Lagos: Nigeria.

Fendru, I. (1995) *A Socio-Economic Study of Access To Rural Finance in Uganda*. Unpublished Ph.D. Dissertation, Department of Agricultural Economics and Rural Sociology, Columbus, Ohio: Ohio State University.

Fruin, T.A. (1937) "Popular and Rural Credit in the Netherlands Indies" *Bulletin of The Colonial Institute of Amsterdam* 1: 106 - 115.

Fry, M.J. (1988) *Money, Interest and Banking in Economic Development*, The John Hopkins University Press, Baltimore and London.

Fry, M.J. (1995) *Money, Interest and Banking in Economic Development*, 2nd Edition. The John Hopkins University Press, Baltimore and London.

Ghate, P.B. (1992) "Interaction between the Formal and Informal Financial Sectors: The Asian Experience" *World Development* Vol. 20, No. 6(June)

Ghate, P.B. (1988) "Informal Credit Markets in Asian Developing Countries" *Asian Development Review*, vol. 6, no. 1, pp. 64-85.

Ghosh, Dipak (1986) "Savings Behaviour in the Non-Monetized Sector and Its Implications". *Savings and Development*, no. 2.

Gonzalez-Vega, C. (1984) "Cheap Agricultural Credit: Redistribution in Reverse", in Adams, D.W. and others (eds) *Undermining Rural Development with Cheap Credit*, pp. 120 - 132. Boulder, Colorado: Westview Press.

Graham, D.H. and others (1988) "Informal Finance in Rural Niger: Scope, Magnitude and Organisation", *Economics and Sociology Occassional Paper* No. 1472. Department of Agricultural Economics and Rural Sociology. Columbus, Ohio: The Ohio State University.

Haggblade, Steve (1978) "Africanization from below: The evolution of Cameroonian savings societies into Western-style banks," *Rural Africana*, no. 2: 35-55.

Harris, B. (1989) "Money and Commodities Monopoly and Competition" , in *Borrowers and Lenders: Rural Financial Markets and Institutions in Developing Countries*, Overseas Development Administration: London, pp. 107-29.

Hemmer, H-R. and C. Mannel (1989) 'On the Economic Analysis of the Urban Informal Sector', *World Development*, Vol. 17, No. 10, pp. 1543-1552.

Herath, G. (1996) "Rural Credit Markets and Imperfect Information: A New Perspective", *Savings and Development*, no. 2: 241-252.

Hoff, K. and J. Stiglitz (1990) "Introduction: Imperfect Information and Rural Credit Markets - Puzzles and Policy Perspectives" *The World Bank Economic Review*, vol. 4, no.3.

Hyuha, M, M.O. Ndanshau and J.P. Kipokola (1993) *Scope, Structure and Policy Implications of Informal Financial Markets in Tanzania*, AERC Research Paper 18, Nairobi

Iqbal, F. (1988) "The determinants of moneylender interest rates: Evidence from rural India", *Journal of Development Studies*, vol. 24, no. 3: 364-378.

Johnson, S.O. (1897) *The History of the Yorubas*, Nigeria: CMS Bookshops, Lagos.

Larson, D.W. and R. Urquidi (1987) "Competitiveness of Informal Financial Markets in Bolivia", *Economics and Sociology Occassional Paper*, No. 1426. Department of Agricultural Economics and Rural Sociology. Columbus, Ohio: Ohio State University.

Lele, U. (1975) *Rural Credit and Socialism - the Designing of Rural Development: Lessons from Africa*, John Hopkins University Press: Baltimore.

Magbagbeola, N.O (1996) "The Role of the Informal Sector in Nigeria's Post-adjustment Economy" in *Beyond Adjustment: Management of the Nigerian Economy* Proceedings of the 1996 Annual Conference of the Nigerian Economic Society. Ibadan: Multi-media Publications, Ltd.

Maloney, C. and A.B. Ahmed (1988) *Rural Savings and Credit in Bangladesh*. Dhaka: The University Press Ltd.

McKinnon, R.I. (1973) *Money and Capital Markets in Economic Development*. Washington, D.C.: The Brookings Institution.

Miracle, M.P., D.S. Miracle and L. Cohen (1980) "Informal savings mobilization in Africa", *Economic Development and Cultural Change*, vol. 28.

Morgan, J.N. and J.B. Lansing (1971). *Economic Survey Methods*, Michigan: Institute for Social Research.

Mrak, M. (1989) "Role of the Informal Financial Sector in the Mobilization and Allocation of Household Savings: The Case of Zambia", *Savings and Development*, 13(1):65-83.

Mwega, F.M. and D. Seck (1991) "Comments on Financial Sector Policy". In: *Economic Reform in Sub-Saharan Africa*. Ajay Chibber and Stanley Fischer,eds. The World Bank, pp. 161-169.

Nisbet, C. (1969) 'Interest Rates and Imperfect Competition in the Informal Credit Market of Rural Chile', *Economic Development and Cultural Change*, Vol. 16, No. 1 (October).

Nissanke, Machiko (1991) "Mobilizing Domestic Resources for African Development and Diversification: Structural Impediments to Financial Intermediation". In: *Economic Reform in Sub-Saharan Africa*. Ajay Chibber and Stanley Fischer,eds. The World Bank, pp. 137-147.

Nissanke, M., E. Aryeetey, Y. Asante, A. Kyei, F. Mwenga, C. Chipeta, M. Mkandawira and M. Mturkwa (1991) *Domestic Resource Mobilization for African Development and Diversification*. Queen Elizabeth House (mimeo).

Nwoko, S.G. and O.A. Ajayi (1990) "The Structure and the Savings Potentials of Esusu Savings System Among the Yorubas of Oyo State", Paper Presented at the Workshop on *Mobilisation of Savings Among Non-Traditional Users of the Nigerian Banking System.*

Nzemen, M. (1988) *Théorie de la Pratique des Tontines Au Cameroun*. Yaoundé, Cameroun: Société de presse et d'Editions du Cameroun

Okorie, F.A. and L.F. Miller (1976) "Esusu Clubs and their Performance in Mobilising Rural Savings and Extending Credit" *Technical Report AFTR/76.1*, Department of Agricultural Economics, Univesity of Ibadan.

Oladeji, S.I. and I.O. Ogunriola (1992) "The Demand for Credit in the Informal Financial Sector of South-Western Nigeria". *Nigerian Journal of Economic and Social Studies*, vol. 34, no. 2. pp.95-109.

Olomola, A. (1992) *Interlinked Credit Transaction in Nigerian Rural Credit System*. Report of Individual Research Project, Agriculture and Rural Development Department, Nigerian Institute of Social and Economic Research, Ibadan.

Owen, P.D. and O. Solis-Fallan (1989) "Unorganized money markets and unproductive assets in the new structuralist critique of financial liberalisations" *Journal of Development*

Economics, 31.

Pindyck, R.S. and D.L. Rubinfeld (1991) *Econometric Models and Economic Forecasts*. McGraw-Hill, Inc. Third Edition.

Pollard, S.K. and P.J. Heffernan (1983) "Agricultural Productivity and Credit Use of Small Farmers in Jamaica" *Social and Economic Studies*, 32, pp. 42-62.

Ragazzi, Giorgio (1981) "Savings Mobilization in Africa", *Savings and Development*, no. 1

Roberts, R.A.J. (1973) "Zambia: Private Borrowing and Lending Arrangements Involving Cultivators' Cash Savings", in *The Role of Money in Development Farming in the Mumbwa and Katete Areas of Zambia*, Chapter 8; reprinted in *AID Spring Review of Small Farmers Credit*, AID: Washington, D.C.

Roe, Allan (1990) "The Role of Informal Financial Markets" in "Financial Systems and Development in Africa", *EDI Working Papers*, EDI: World Bank.

Roemer, M. and C. Jones, eds.(1991) *Markets in Developing Countries*, San Francisco, CA: ICS Press.

Sacay, O.J., M.H. Agabin and C.I. Tonchoco (1985) *Small Farmer Credit Dillema.* Manilla: Technical Board on Agricultural Credit.

Samson, R.(1970) *The Economics of Insurgency in the Mekong Delta of Vietnam*, MIT Press: Cambridge, MA.

Schreider, G. (1989) *Informal Financial Groups in Cameroon: Motivation, Organisation and Linkages*. Unpublished Masters thesis, Department of Agricultural Economics and Rural Sociology. Columbus, Ohio: Ohio State University.

Schreider, G.R. and C.E. Cuevas (1992) "Informal Financial Groups in Cameroon" in Adams, D.W. and D.A. Fitchett (eds) (1992). *Informal Finance in Low-Income Countries*. San Francisco, CA: Westview Press.

Seibel, H.D. and M.T. Marx (1987) *Dual Financial Markets in Africa*, Verlag Breitenbach Saarbrucken.

Sharpe, K.E. (1977) *Peasant Politics: The Struggle in a Dominican Village*, John Hopkins University Press: Baltimore, London

Shaw, E.M. (1973) *Financial Deepening in Economic Development*. Oxford: Oxford University Press.

Siamwalla, A., C. Pinthong, N. Poapongsakorn, P. Satsanguan, P. Nettayarak, W. Mingmaneenakin and Y. Tubpun (1990) "The Tai Rural Credit System: Public Subsidies, Private Information and Segmented Markets", *The World Bank Economic Review*, vol. 4, no.3 pp. 271 - 295.

Siamwalla, A., C. Pinthong, N. Poapongsakom, P. Satsanguan, P. Nettayarak, W. Mingmaneenakin, and Y. Tubpun (1996) "The Thai Rural Credit System and Elements of a Theory: Public Subsidies, Private Information, and Segmented Markets" in Hoff, K. A. Braverman and J. Stiglitz (eds.) *The Economics of Rural Organisation: Theory, Practice, and Policy*. Oxford University Press. Published for the World Bank.

Siebel, H.D. (1986) "Rural Finance in Africa: the Role of informal and formal financial institutions", *Development and Change*, 6, pp. 12-14.

Soyibo, A. (1994) *Financial Linkage and Development in Sub-Saharan Africa: A Study of the Informal Finance Sector in Nigeria*. Mimeo., Overseas Development Institute, London.

Soyibo, A. (1995) *Conceptual and Theoretical Issues in the Study of Informal Finance*, Paper presented at the CBN/NISER Workshop on Conceptual and Methodological Issues in the Informal Financial Sector Research, 30th - 31st August.

Soyibo, A. (1997) "The Informal Financial Sector in Nigeria", *Development Policy Review*, vol. 15, no. 1, March.

Soyibo, A. (1996) *Financial Linkage and Development in Sub-Saharan Africa: A Study of the Informal Finance Sector in Nigeria*. Working Paper 90, Overseas Development Institute, London.

Stiglitz, J.E. (1990) "Peer Monitoring and Credit Markets". *The World Bank Economic Review*, vol. 4, no. 3, pp. 351-366.

Stiglitz, J. and A. Weiss (1981) "Credit Rationing in Markets With Incomplete Information". *American Economic Review*, 17.

Stringer, R.S. (1984) "An Analysis of Credit Use in the Honduran Agrarian Reform Sector", unpublished PhD dissertation, University of Wisconsing, Madison.

Tapsoba, E.K. (1981) "An Economic and Institutional Analysis of Formal and Informal Credit in Eastern Upper Volta: Empirical Evidence and Policy Implications", unpublished PhD dissertation, Michigan State University.

The Guardian (1997) "Informal Credit Market Waxes Stronger", (newspaper) Wednesday, March 12, pp.23-26, Lagos: Guardian Press .

Timberg, T.A. and C.V. Aiyar (1984) "Informal Credit Markets in India", *Economic Development and Cultural Change*, 33: 43-59.

Udry, C. (1994) "Risk and Insurance in a Rural Credit Market: An Empirical Investigation in Northern Nigeria", *Review of Economic Studies*, 61(3), No. 208, pp. 495 - 526.

Udry, Christopher (1990) "Credit Markets in Northern Nigeria: Credit as Insurance in a Rural Economy". *The World Bank Economic Review*, Vol. 4, no. 2, pp. 251-269.

UNCTAD (1994) *World Investment Report, Transnational Corporations, Employment and the Workplace*, United Nations, Geneva.

USAID (1989) *Informal Financial Markets: Senegal and Zaire*. Final Report published by Arthur Young for the Bureau for Private Enterprise of USAID, Washington.

Venieris, Y.P. and D.K. Gupta (1986) "Income Distribution and Sociopolitical instability as determinants of saving: A cross-sectional model, *Journal of Political Economy*, 94(4), August.

Virmani, Arvind (1982) "The Nature of Credit Markets in Developing Countries: A Framework for Policy Analysis", *World Bank Staff Working Papers*, No. 524.

Von Pischke, J.D. (1992) "ROSCAs: State-of-the- Art Financial Intermediation" in *Adams, D.W. and D.A. Fitchett (eds) (1992). Informal Finance in Low-Income Countries*. San Francisco, CA: Westview Press.

Von Pischke, J.D., D.W. Adams, and Gordon Donalds, eds. (1983) *Rural Financial Markets in Developing Countries: Their Use and Abuse* (Baltimore: John Hopkins University Press)

Von Pischke, J.D. (1991) "Finance at the Frontier" *EDI Development Studies*, The World Bank, Washington, DC.

Wai, U. Tun (1957) "Interest rates outside the organized money markets of underdeveloped countries", *IMF Staff Papers*, Vol. V, No. 2 (August).

Wai, U Tun (1980) *Economic Essays on Developing Countries*. The Netherlands: Sijthoff and Noordhoff.

World Bank (1989) *World Development Report* (New York: Oxford University Press).

World Bank (1995) *The Nigerian Rural Financial System: Assessment and Recommendations*. Washington, D.C.: World Bank, Africa Technical Department.

World Bank (1993) "Adjustment in sub-Saharan Africa: Progress, Payoffs, and Challenges", *Policy Research Report* No. 2, working draft (June).

Yaron, J. (1994) "What Makes Rural Finance Institutions Successful?" *The World Bank Research Observer*, 9 (1):49-70.

Yaron, J. (1992) "Succesful Rural Financial Institutions" *World Bank Discussion Papers* 150, Africa Technical Department Series, Washington, D.C.

APPENDIX

SURVEY INSTRUMENT

Informal Financial Markets

Questionnaire 1 (Market Participants)

Questionnaire No.__________ ____(1-3)
State______________ ____(4)
Village/Town ____________________ ____(5-6)
Tribe of the Respondent____________ ____(7)
Interviewer's Name ______________________
Date of Interview _____________________

A. Personal Details of Respondent

1. Age in Years
   1 = (less than 18)
   2 = (18-27)
   3 = (28-37)
   4 = (38-47)
   5 = (48-57)
   6 = (58-67)
   7 = (68 and above) ____(8)

2. Gender
   1_ Male 2_ Female ____(9)

3. Religion
   1_ Christianity 2_ Islam 3_ Other ____(10)

4. Marital Status
   1_ Married
   2_ Single
   3_ Divorced/Separated
   4_ Widowed ____(11)

5. How many dependants do you have ? State Number
   1_ Wives ____(12-13)
   2_ Children ____(14-15)
   3_ Other dependant ____(16-17)

6. Did you go to School ?
   1_ Yes 2_ No ____(18)

7. If 6 is Yes, Up to what level ?
1_ Primary 2_ Secondary 3_ Tertiary ____(19)

8. Are you employed ?
1_ Yes 2_ No ___(20)

9. If 8 is Yes, what are you ?
1_ Trader
2_ Timber-log owner
3_ Farmer
4_ Salaried worker
5_ Professional Money lender
6_ Vendor
7_ Transporter
8_ Bricklayer
9_ Other ____(21)

B. Saving Behaviour

10. Do you save any portion of the returns you make from your business for future use ?
1_ Yes 2_ No ______(23)

11. Do you have an idea of how much you approximately earn in a week ?
1_ Yes 2_ No ______(24)

12. If 11 is yes, could you please give me the approximate figure? ₦________________(25-29)

13. What percentage of your savings do you put at
__Home ______(30-31)
__Bank ____(32-33)
__Cooperative Society ____(34-35)
__ROSCAS ______(36-37)
__Esusu/Ajo/Isusu/Adashi ____(38-39)
__Other ____(40-41)

14. If you have any non_financial savings, in what form are they ?
1 ___ Jewellery
2 ___ Undeveloped Land
3 ___ Real Estate
4 ___ Livestock
5 ___ Other durable goods
6 ___ Not applicable _________(42)

C. Financing of Trading Activity

15 From which sources did you obtain capital to start your trading activity ?
A _ Own Savings at home 1_ Yes 2_ No ____________(43)
B _ Own Savings in the Bank 1_ Yes 2_ No ____________(44)
C _ Loan from parents/close relatives 1_ Yes 2_ No ____________(45)
D _ Money lender 1_ Yes 2_ No ____________(46)
E _ Ajo/Otutu/Adashi Contribution 1_ Yes 2_ No ____________(47)
F _ Cooperative society 1_ Yes 2_ No ________(48)
G _ Suppliers' Credit 1_ Yes 2_ No ________(49)
H _ Bank Credit 1_ Yes 2_ No ____________(50)
J _ Other (specify) 1_ Yes 2_ No ________(51)

16. How do you finance occasional lump sum expenditures (e.g. for expansion purposes)?
A _ Own savings at home 1_ Yes 2_ No ____________(53)
B _ Own savings in the bank 1_ Yes 2_ No ________(54)
C _ Loan from parents/close relatives 1_ Yes 2_ No ____________(55)
D _ Money Lender 1_ Yes 2_ No ____________(56)
E _ Esusu (either ROSCAS) or Single Collector) ____________(57)
F _ Cooperative Society 1_ Yes 2_ No ____________(58)
G _ Supplier's Credit 1_ Yes 2_ No ____________(59)
H _ Bank Credit 1_ Yes 2_ No ____________(60)

17. How do you finance day_to_day expenditures for your enterprise ?
A _ operational expense account 1_ Yes 2_ No ____________(61)
B _ Supplier's credit 1_ Yes 2_ No ____________62)
C _ Money Lender 1_ Yes 2_ No ____________(63)
D _ Bank Credit 1_ Yes 2_ No ____________(64)
E _ Esusu (either ROSCAS) or Single Collector) ____________(65)
F _ Cooperative society 1_ Yes 2_ No ____________(66)
G _ Savings from profits 1_ Yes 2_ No ________(67)
H _ Any cash at hand 1_ Yes 2_ No ____________(68)
I _ Other 1_ Yes 2_ No ________(69)

D <u>**Access to Banks**</u>

18. Did you operate a bank account before 1994 ?
1_ Yes 2_ No ____________(1)

19. What type of account did you operate ?
1 _ Current account only
2 _ Savings account only
3 _ Both current and savings account
4 _ time deposit
5 _ Other
6 _ Not applicable ____________(2)

20. If you stopped operating a bank savings account after 1994, why?
1 _ Transactions take too long 1_ Yes 2_ No ____________(3)
2 _ Lack of confidence in banks 1_ Yes 2_ No ________(4)
3 _ Interest rate no longer attractive 1_ Yes 2_ No __________(5)
4 _ Official requirements are too many 1_ Yes 2_ No __________(6)
5 _ Banks are too far away 1_ Yes 2_ No __________(7)
6 _ Found more profitable way to save 1_ Yes 2_ No __________(8)
7 _ Other 1_ Yes 2_ No __________(9)
8 _ Not applicable 1_ Yes 2_ No __________(10)

21. ___ Is there any bank close to you ? 1_ Yes 2_ No ____________(11)

22. ___ Do you save at this bank ? 1_ Yes 2_ No ____________(12)

23. ___ Have you ever borrowed from a bank ? 1_ Yes 2_ No ____________(13)

24. If (23) is Yes, to what use was this credit put ?
1 _ General household consumption 1_ Yes 2_ No ____________(14)
2 _ To start business 1_ Yes 2_ No ____________(15)
3 _ To expand business 1_ Yes 2_ No __________(16)
4 _ For construction 1_ Yes 2_ No __________(17)
5 _ School fees 1_ Yes 2_ No ________(18)
6 _ social activity (funerals, marriage, etc) 1_ Yes 2_ No __________(19)
7 _ Other 1_ Yes 2_ No ________(20)
8 _ Not applicable 1_ Yes 2_ No __________(21)

25. If (23) is no, why not ?
1 _ Never had the need for a loan
2 _ Application was rejected
3 _ Did not apply because did not have collateral
4 _ Did not apply for other reason
5 _ Not applicable __________(22)

26. If in (25) application was rejected, why ?
1 _ Did not have adequate collateral
2 _ Other
3 _ Not applicable ___________(23)

27 What type of collateral did bank ask for in (26), if applicable ?
1 _ Landed Property
2 _ Other Physical asset
3 _ Guarantor
4 _ Insurance
5 _ Other
6 _ Not applicable _______(24)

E. Participation in Esusu Club

28. If you are in an Esusu Club, how many other people are registered with your club ?
1 _ less than 5
2 _ 5_20
3 _ 21_40
4 _ 41_100
5 _ More than 100
6 _ Don't know
7 _ Not applicable ________(26)

29. Which type of Esusu system are you involved in ?
1 _ Single Collector (type 1)
2 _ Rotating Savings (type 2)
3 _ Both Single Collector and Rotating Savings
4 _ Other
5 _ Not applicable ________(27)

30 Are you involved in more than one esusu club ?
1 _ Yes
2 _ No
3 _ Not applicable ________(28)

31 Who introduced you to the esusu club(s) ?
1 _ Friend
2 _ Collector approached me
3 _ Relations
4 _ Fellow workers
5 _ Other
6 _ Not application ________(29)

32. What conditions did you have to fulfil to become a member ?
1 _ Sign an undertaking to contribute regularly
2 _ Sign additional undertakings
3 _ No undertakings or obligations whatsoever
4 _ Other
5 _ Not applicable ________(30)

33. If you are involved in 'Type 1 esusu', how much do you pay to each collector ?
Club 1_____ Club 2 ________
(31-35) (36-40)

34. If you are involved in 'Type 1 esusu' how regularly do you pay the above sum(s) to the collector(s) ?

Club 1	Club 2
1 _ Daily	1 _ Daily
2 _ Weekly	2 _ Weekly
3 _ Monthly	3 _ Monthly
4 _ Other	4 _ Other
5 _ Not applicable	5 _ Not applicable
____(41)	______(42)

35. How regularly do you get back your savings from the collector involved in type 1 ?

Club 1	Club 2
1 _ Weekly	1 _ Weekly
2 _ Bi_weekly	2 _ Bi_weekly
3 _ Monthly	3 _ Monthly
4 _ Annually	4 _ Annually
5 _ Not applicable	5 _ Not applicable
______(43)	_________(44)

36. Are you paid any interest on any of your esusu savings ?
1 _ Yes
2 _ No
3 _ Not applicable _________(45)

37. If (36) is yes, what is the highest rate of interest ?
1 _ less than 5% per month
2 _ 5_10% per month
3 _ 11_20% per month
4 _ 21_30% per month
5 _ More than 30% per month
6 _ Not applicable _______(46)

38. If (36) is no, why do you save with the collector ?
1 _ Interest is not important 1_ Yes 2_ No ___________(47)
2 _ Easy access to collector 1_ Yes 2_ No ______________(48)
3 _ Social reasons for joining 1_ Yes 2_ No _________(49)
4 _ Interested in lump sum after saving period 1_ Yes 2_ No ___________(50)
5 _ Other 1_ Yes 2_ No _________(51)
6 _ Not applicable 1_ Yes 2_ No _________(52)

39. Do you pay any service charges for saving with the collector(s) ? (Does the collector keep any part of your savings ?)
1 _ Yes
2 _ No
3 _ Not applicable _________(53)

40. How much do you pay for the services of the collector for a month ? (Convert if necessary)

Club 1	Club 2
1 _ Less than 1 day's saving	1 _
2 _ Whole day's saving	2 _
3 _ More than 1 day's saving	3 _
4 _ Not applicable	4 _
_________(54)	___________(55)

41. Is the service charge a deterrent to saving ?
1 _ Yes
2 _ No
3 _ Not applicable _________(56)

42. Can you borrow from the collector(s) ?

Club 1	Club 2
1_ Yes	1 _ Yes
2 _ No	2 _ No
3 _ Not applicable	3 _ Not applicable
_______(57)	______(58)

43. If (42) is yes, what is the usual length of time allowed for repayment ?

Club 1	Club 2
1 _ 1 month	1 _
2 _ 2 months	2 _
3 _ 3_6 months	3 _
4 _ 7_12 months	4 _
5 _ More than 12 months	5 _
6 _ Not applicable	6 _
_________(59)	_________(60)

44. If (42) is yes, at what interest rate per month can you borrow from the collector ?

Club 1	Club 2
1 _ 0%	1 _
2 _ 1_5%	2 _
3 _ 6_10%	3 _
4 _ 11_20%	4 _
5 _ 21_30%	5 _
6 _ 31_50%	6 _
7 _ More than 50%	7 _
8 _ Not applicable	8 _
_________(61)	_______(62)

45. Have you ever lost money through a collector defaulting in payments to you ?
1 _ Yes
2 _ No
3 _ Not applicable _________(63)

46. How did he/she default ?
1 _ Disappeared one day
2 _ Could not pay me back on schedule
3 _ Lost book on my account
4 _ Other (please specify)
5 _ Not applicable ________(64)

47. Do you ever worry that the collector might default in payments to you ?
1 _ Yes
2 _ No
3 _ Not applicable ______(65)

48. Do you know anybody who has lost money through a collector defaulting in payments ?
1 _ Yes
2 _ No _________(66)

49. How long have you been saving with your ajo collector ?

Club 1	Club 2
1 _ Under 1 year	1 _
2 _ 1_2 years	2 _
3 _ 3_5 year	3 _
4 _ More than 5 years	4 _
5 _ Not applicable	5 _
_______(67)	_______(68)

50. If you are involved in 'Type 2 esusu', how many are you ? ________(69-71)

51. When was your ROSCAS (or Group fund/contribution) formed ? 19 .... ______(72-73)

52. How is the money for the Group fund raised ?
1 _ Financial contribution of members
2 _ Group work
3 _ Other (please specify)
4 _ Not applicable _________(74)

53. If the money is raised through financial contribution, how much does each member contribute?
₦________(75-79)

54. How often is the contribution ?
1 _ yearly
2 _ monthly
3 _ weekly
4 _ other (please specify)
5 _ Not applicable ________(1)

55. If the money is raised through work, what type of work is it ?
1 _ agricultural
2 _ construction
3 _ processing produce
4 _ harvesting
5 _ other (please specify)
6 _ not applicable ______(2)

56. What is the money used for ?
1 _ Private emergencies
2 _ Community Projects
3 _ Both 1 and 2
4 _ Other
5 _ Not applicable ________(3)

57. Is the money lent out to individual members
1 _ Yes
2 _ No
3 _ Not Applicable ________(4)

58. If (57) is yes, is it lent out on interest ?
1 _ Yes
2 _ No ________(5)

59. If it is lent out on interest, what is the rate of interest ? ____ % ________(6-7)

60. What is the required time period ?
1 _ 1 week
2 _ 1 month
3 _ 1 year
4 _ Indefinite
5 _ Other (Please specify) __________(8)

61. Did you borrow from the Group fund last year (1995) ?
1 _ Yes
2 _ No ________(9)

62. If (61) is yes, how much was it ? ₦ ________(10-14)

63. Did you return the whole sum ?
1 _ Yes
2 _ No ________(15)

64. If not, how much was not repaid ? ₦ ______(16-20)

65. Are you generally satisfied with the savings facility afforded you by the esusu club(s) ?
1 _ Yes
2 _ No
3 _ Not applicable __________(21)

66. Are you generally satisfied with the borrowing facility granted you by the esusu club(s) ?
1 _ Yes
2 _ No
3 _ Not applicable __________(22)

F GENERAL ATTITUDE

67. Under the present economic conditions, how long do you think you can afford to let a large sum of money lie idle ?
1 _ Under 6 months
2 _ 6_12 months
3 _ 13_24 months
4 _ More than 24 months __________(24)

68. If the current interest paid on savings deposit with formal banks were doubled, would you save with banks?
1 _ Yes
2 _ No __________(25)

69. What do you understand to be the main functions of banks?
1 _ Mainly to lend for economic purposes
2 _ Mainly to lend for social purposes
3 _ Savings institution
4 _ Provide other financial services
5 _ Other __________(26)

70. Do you borrow from the informal financial market?
1 _ Yes
2 _ No __________(27)

71. If (70) is yes, from which source ?
i _ Single_Collector (alajo)
1 _ Yes 2_No 3_Not Applicable __________(28)

ii _ Rotating Savings (Group found)
1_Yes 2_No 3_Not Applicable __________(29)

iii _ Money lender
1_Yes 2_No 3_Not Applicable __________(30)

72. What do you think of owing in general ?
    1 _ Good
    2 _ Bad
    3 _ indifferent ________(31)

73. In your Group, (ROSCAS), what is the cost (in naira)values of screening an applicant for a loan (transactions cost) ? ₦ ______ __________(32-35)

Questionnaire 2 (Esusu Collectors)

Questionnaire No. ______________ ____(1-3)
State__________________________ ____(4)
Village/Town______________________________ ______(5-6)
Tribe of the Respondent_______________ ____(7)
Interviewer's Name__________________________________
Date of Interview_____________________________________

1. How old are you? ________Years old ______(8-9)

2. Sex 1_Male 2_Female _______(10)

3. Did you go to school?
   1_Yes 2_No _______(11)

4. If Q.4 is yes, up to what level?
   1_Primary 2_Secondary 3_Tertiary __________(12)

5. How long have you been an *esusu* collector?
   __________Years _______(13-14)

6. Do you have any job beside *esusu* collection?
   1_ Yes 2_ No _______(15)

7. If Q.6 is yes, which type of business?
   1_ Civil Servant
   2_ Transport owner
   3_ Hotel/Restaurant/bar
   4_ Real Estate
   5_ Farming
   6_ Trading
   7_ Log-timber work
   8_ Small-scale Manufacturing/repair
   9_ Other
   10_ Not applicable _____(16)

8. Why did you choose to collect *esusu*?
   1_ To raise capital for running other business
   2_ To generally raise income level
   3_ Only employment opportunity available
   4_ Other (please specify) ______(17)

9. What was your previous occupation, if no longer engaged in it?
   1_ Self-employed artisan
   2_ Self-employed small-scale businessmen
   3_ Self-employed large-scale businessmen
   4_ Junior Civil Servant (Below Grade Level 07)
   5_ Senior Civil Servant (Grade Level 07 and above)
   6_ Farmer
   7_ Timber-log owner
   8_ Transport owner
   9_ Other ________(18)

10. Did you start the esusu collection with any capital?
   1_ Yes 2_ No ________(19)

11. If Q.10 is yes, how much was the start-up capital?
   ₦__________ _______(20-24)

12. Who were your initial customers?
   1_ Relations
   2_ Friends
   3_ Fellow Traders
   4_ Colleagues at work place
   5_ Other (please specify) _______(25)

13. How many people were involved in the first month of operation?
   ____________ _______(26-28)

14. Did any of the initial customers ask for some security for their savings?
   1_ Yes 2_ No _______(29)

15. If Q.14 is yes, what type of security were they looking for?
   1_ Good standing in the eyes of the public
   2_ Landed property
   3_ Guarantor
   4_ Other (please specify) _______(30)

16. If Q.14 is no, why do you think depositors decided to save their money with you?
   1_ Because of a mutual trust in the esusu system
   2_ Other (please specify) _____(31)

17. Do you live in the same community as your clients?
   1_ Yes 2_ No 3_ Not applicable _______(32)

18. If Q.17 is no, do depositors know where you live?
   1_ Yes 2_ No 3_ Not applicable _______(33)

19. Do you have a permanent office known to your clients?
   1_ Yes 2_ No _______(34)

20. Do you possess any valuable immovable property?
    1_ Yes 2_ No ____(35)

21. How many clients did you have in 1995?
    ________ ____(36-38)

22. What is your average monthly collection?
    ₦____________ ____(39-43)

23. What is the usual period you can keep collected savings?
    _______months ____(44-45)

24. What single saving period do clients prefer?
    1_ Short (1 month)
    2_ Medium (up to 3 months)
    3_ Long (More than 3 months) ____(46)

25. Why do many of your clients prefer the period stated in Q.24?
    1_ Ensures liquidity
    2_ Provides investible funds
    3_ Fear of loss of real money value
    4_ Other (please specify) ________(47)

26. What is the present lowest daily payment?
    ₦______________ _______(48-50)

27. What is the present lowest daily payment?
    ₦______________ _______(51-54)

28. Do some of your clients also keep accounts with the banks?
    1_ Yes 2_ No 3_ Don't Know ______(55)

29. If Q.28 is yes, why do they continue to save informally?
    1_ Large deposits go to bank and small ones to esusu
    2_ They like to have the best of both systems
    3_ Assets in esusu savings are more liquid
    4_ Other (please specify)

    _____(56)

30. Do you place collected savings in banks?
    1_ Yes 2_ No ______(57)

31. If Q.30 is yes, in whose name is the account?
    1_ Collector's name
    2_ Separate accounts for all clients
    3_ Company name
    4_ Other (please specify)
    5_ Not applicable _______(58)

32. If you place collected savings in bank accounts, which type?
    1_ Demand deposit
    2_ Savings deposit
    3_ Time deposit
    4_ Treasury bills
    5_ Other (please specify)
    6_ Not applicable _______(59)

33. Do you save part of personal income with the banking system?
    1_ Yes 2_ No _______(60)

34. If Q.33 is yes, do you keep separate bank accounts for personal income and the esusu collections?
    1_ Yes 2_ No 3_ Not applicable _______(61)

35. Have you ever applied for a loan from the bank?
    1_ Yes 2_ No _______(62)

36. If Q.35 is yes, was the loan granted?
    1_ Yes 2_ No 3_ Not applicable _______(63)

37. Do you engage in lending?
    1_ Yes 2_ No _______(64)

38. If Q.37 is yes, do you lend out of esusu collection?
    1_ Yes 2_ No _______(65)

39. If Q.37 is yes, who are the debtors?
    1_ Esusu contributors only
    2_ Relations and friends
    3_ Any credit-worthy person
    4_ Other (please specify) _______(66)

40. If you lend from esusu collection, how long do you usually lend?
    _______Months (enter 99 if not applicable) _______(68-69)

41. Does lending sometimes affect your repayment obligations to depositors?
    1_ Yes 2_ No 3_ Not applicable _______(70)

42. Do you borrow money from the bank to supplement esusu collection for lending?
    1_ Yes 2_ No 3_ Not applicable _______(71)

43. What percentage do you charge on loans?
 ________% (enter 999 if not applicable) ________(72-74)

44. Do you charge different interest rates to different categories of borrowers?
 1_ Yes 2_ No 3_ Not applicable ________(75)

45. If Q.44 is yes, why?
 1_ esusu contributors deserve preferential treatment
 2_ other (please specify)
 3_ not applicable ______(76)

46. Do you have any defaulters on loan repayment?
 1_ Yes 2_ No 3_ Not applicable ______(77)

47. If Q.46 is yes, what is the nature of the default?
 1_ Delay in principal repayment
 2_ Delay in interest repayment
 3_ Delay in repayment of interest and principal
 4_ Refusal to repay any part of loan
 5_ Not applicable ______(78)

48. What are your earnings from esusu collection?
 1_ A day's payment per saver in a month
 2_ Other (please specify) ______(79)

49. How do you mainly utilise earnings from esusu?
 1_ To finance another economic activity
 2_ To expand lending base
 3_ For consumption purposes
 4_ Other (please specify) ____(80)

50. Do you pay any dividend to esusu depositors out of profit from lending operations?
 1_ Yes 2_ No 3_ Not applicable ____(1)

51. What is the usual limit to a regular esusu depositor's borrowing capacity?
 1_ Up to a month's payment
 2_ Two months' payment
 3_ More than two months' payment
 4_ Other (please specify) ____(2)

52. What measures do you take to retrieve debts from defaulters?

1_ Recourse to Police / other law enforcement agency
1_ Yes 2_ No ____(3)

2_ Seek assistance from juju people/*babalawo*
1_ Yes 2_ No ____(4)

3_ Moral persuasion
1_ Yes 2_ No ____(5)

4_ Forfeiture of collateral or other asset
1_ Yes 2_ No ____(6)

5_ Other (please specify)
1_ Yes 2_ No ____(7)

6_ Not applicable
1_ Yes 2_ No ____(8)

53. Do you keep any records?
1_ Yes 2_ No _____(9)

54. What type of records?

1_ Ledger
2_ Large notebook with details of each account
3_ Receipt book
4_ Simple cards with columns for entry of different payments and kept by depositor
5_ Other ______(10)

55. Approximately how much did you give out as loan in 1995?
₦________________ _____(11-16)

56. Approximately how many people borrowed from you in 1995?
₦________________ _____(17-19)

57. What is the average cost of screening an applicant for a loan (administration cost)?
₦________________ _____(20-23)

Questionnaire 3 (Moneylenders)

Questionnaire No. ____________ ____(1-3)
State____________________________ ____(4)
Village/Town____________________________ ______(5-6)
Tribe of the Respondent__________ ___(7)
Interviewer's Name______________________________
Date of Interview________________________________

1. How old are you? _______Years old ______(8-9)

2. Sex 1_Male 2_Female ______(10)

3. Area of Operation_______________ ______(11)

4. Did you go to school?
1_Yes 2_No ______(12)

5. If Q.4 is yes, up to what level?
1_Primary 2_Secondary 3_Tertiary ________(13)

6. How long have you been in the moneylending business?
_______Years ______(14-15)

7. Are you a full-time moneylender?
1_Yes 2_No ______(16)

8. What was your previous occupation?
1_ Self-employed artisan
2_ Self-employed small-scale businessmen
3_ Self-employed large-scale businessmen
4_ Junior Civil Servant (Below Grade Level 07)
5_ Senior Civil Servant (Grade Level 07 and above)
6_ Farmer
7_ Timber-log owner
8_ Transport owner
9_ Other ______(17)

9. Are you currently engaged in any other economic activity?
1_ Yes 2_ No ______(18)

10. If Q.9 is yes, indicate type of economic activity
    1_ Civil Servant
    2_ Transporter
    3_ Landlord (housing)
    4_ Farmer
    5_ Trader
    6_ Manufacturer
    7_ Hotel/bar/restaurant owner
    8_ Other (please specify)________________________________ ______(19)

11. if Q.9 is yes, which of the businesses takes more of your time?
    1_ Moneylending 2_Other economic activity 3_Not applicable __________(20)

12. Why did you choose to engage yourself in moneylending?
    1_ Out of sympathy for others (social consideration)
    2_ Profit motive (economic consideration)
    3_ Other (please specify)_________________________ __________(21)

13. Who are your main clients?
    1_ Market Women
    2_ Civil Servants
    3_ Farmers
    4_ Businessmen
    5_ Other (please specify)______________________________
    __________(22)

14. Are you acquainted with all your clients?
    1_ Yes 2_ No __________(23)

15. How did your clients get to know you?
    i. Advertising
       1_ Yes 2_ No __________(24)
    ii. Through recommendation by contact persons
       1_ Yes 2_ No __________(25)
    iii. Through recommendation by old clients
       1_ Yes 2_ No __________(26)
    iv. Through relations/friends of clients
       1_ Yes 2_ No __________(27)
    v. Through relations/friends of moneylender
       1_ Yes 2_ No __________(28)
    vi. Other (please specify)__________________
       1_ Yes 2_ No __________(29)

16. How does loan negotiation take place?
    1_ Verbal discussion between client and lender
    2_ Written exchanges between two parties only
    3_ Verbal discussion with witness present
    4_ Other (please specify)
    __________(30)

17. Do you keep any records?
    1_ Yes 2_ No ________(31)

18. If Q.17 is yes, what type of records do you keep?
    1_ General ledger
    2_ Individual ledger
    3_ Simple list of debtors
    4_ Other (please specify) ________(32)

19. Do you operate any *esusu* club?
    1_ Yes 2_ No ________(33)

20. If Q.19 is yes, which type?
    1_ Single collector (alajo)
    2_ Rotating savings (Group fund)
    3_ Not applicable ________(34)

21. If you are involved in single-collector (alajo) esusu, how often are savings returned to saver?
    1_ Month 2_ 2 Months 3_ 3 Months 4_ 6 Months 5_ Other (please specify)
    6_ Not applicable ________(35)

22. If you are also an alajo, do you lend out some of the mobilised savings from ajo contributions?
    1_ Yes 2_ No 3_ Not applicable ________(36)

23. If you are also an alajo, to whom do you lend?
    1_ Ajo contributors only
    2_ Any member of the public
    3_ Small businesses
    4_ Large businesses
    5_ Others
    6_ Not applicable ________(37)

24. How did you obtain starting capital?
    1_ Susu contributions
    2_ Gratuities/Pension fund
    3_ Accumulated savings
    4_ Other (please specify) ________(38)

25. How much was the starting capital?
    ₦______________ ________(39-43)

26. What is the highest amount of loan you can grant?
    ₦______________ ________(44-49)

27. What is the average duration of loans you can grant?
    ___________Months ________(50-51)

28. Do you prefer loan for particular purposes?
 1_ Yes 2_ No ________(52)

29. If Q.28 is yes, please specify
 i. Social emergency
 1_ Yes 2_ No ________(53)
 ii. Business (trading)
 1_ Yes 2_ No ________(54)
 iii. Farming
 1_ Yes 2_ No ________(55)
 iv. Other (please specify)
 1_ Yes 2_ No ________(56)

30. Approximately how many people borrowed from you in 1995? _____ ________(57-59)

31. Approximately how much did you give out as loan in 1995?
 ₦______________ ________(60-65)

32. Do you ask for security against loans granted?
 1_ Yes 2_ No ________(66)

33. If Q. 32 is yes, what type of securities do you prefer?
 i. Landed property
 1_ Yes 2_ No ________(67)
 ii. A written undertaking
 1_ Yes 2_ No ________(68)
 iii. Jewellery
 1_ Yes 2_ No ________(69)
 iv. Other physical asset
 1_ Yes 2_ No ________(70)
 v. Other (please specify)
 1_ Yes 2_ No ________(71)
 vi. Not applicable ________(72)

34. Do you take any other measures to forestall defaults?
 1_ Yes 2_ No ________(73)

35. If Q.34 is yes, what are these other measures?
 1_ Use of Police to threaten client
 2_ Threats of reprisal from fetish (juju)
 3_ Ridicule in the Community
 4_ Legal suits
 5_ Other (please specify)
 6_ Not applicable ________(74)

36. Do you deal with banks?
 1_ Yes 2_ No ________(75)

37. If Q.36 is yes, what type of dealings?
 1_ Saving only
 2_ Saving and borrowing
 3_ Other (please specify)
 4_ Not applicable ________(76)

38. Does your bank always grant your loan requests?
    1_ Yes 2_ No 3_ Not applicable ______(77)

39. For what purposes do you borrow money from the banks?
    1_ Promote lending business
    2_ Promote other economic activity
    3_ Other (please specify)
    4_ Not applicable ______(78)

40. Why do people come to you for loans instead of going to banks?
    i. Customers lack suitable collateral
       1_ Yes 2_ No ______(1)
    ii. Bank transactions are too cumbersome
       1_ Yes 2_ No ______(2)
    iii. Potential clients do not have bank accounts
       1_ Yes 2_ No ______(3)
    iv. Bank loans are inadequate for intended purposes
       1_ Yes 2_ No ______(4)
    v. Other (please specify)
       1_ Yes 2_ No ______(5)

41. What is the usual duration (maturity period) of loans you grant?
    ________Months ______(6-7)

42. Do you have debtors defaulting?
    1_ Yes 2_ No ______(8)

43. What type of default?
    i. Principal
       1_ Yes 2_ No 3_ Not applicable ______(9)
    ii. Interest
       1_ Yes 2_ No 3_ Not applicable ______(10)
    iii. Principal plus Interest
       1_ Yes 2_ No 3_ Not applicable ______(11)

44. Do you have different interest rates for loans of varying time periods?
    1_ Yes 2_ No ______(12)

45. What is the average interest rate per month?
    ________% ______(13-14)

46. Do you charge different people different interest rates for similar loan sizes and term?
    1_ Yes 2_ No ______(15)

47. If Q.46 is yes, why?
    1_ Some borrowers are less trustworthy
    2_ Administration costs vary among different borrowers
    3_ Other (please specify)
    4_ Not applicable ______(16)

48. What is the average cost of screening an applicant for a loan (administration cost)?
    ₦__________ ______(17)

WOMEN DEPOSITORS

QUESTIONNAIRE

A. Personal Data

1. Geographical Location: ---------------------------------------

2. Age: Below 20------; 21 - 30 ----; 31-40 ----; Above 40 --

3. Marital Status: Single ----; Married -----; Widowed ------

B. Socio-Economic Profile

4. Educational Qualification: None ---; Pry/Adult Education---

   Secondary ----; Tertiary: ----

5. How many children have you?:

   1-2 ---; 3-4 ---; 5-6---; 7-8---; Above 8 ---

6. How many non-nuclear family members have you?:

   2 - 5----; 6 - 10 ---; Above 10 ----

7. Are you the bread winner of the family?: Yes---; No----

8. How many children are in school?:

   1-2 ---; 3-4 ---; 5-6---; 7-8---; Above 8 ---

9. Do you pay for their school fees? Yes ---; No----

10. If yes, How much do you pay? Below ₦350-----; ₦351 - 550 --;

    ₦551 - 750---; ₦751 - 1000---; Above ₦10,000-----

11. Are you the head of the family?: Yes ---; No----

12. What are your favourite foods?:

    Eba, Amala, Fufu, Rice, Gari----; Beans, Meat, Fish

13. What other responsibility do you take care of the home?

    None ----; Taking care of parents---; Others (specify)---

31. Expenditure on labour monthly (if any).
₦500----; ₦501 - 1000---; Above ₦1000----

32. Tick the appropriate problem as per labour in your business.
(a) Securing labour
(b) Maintaining the labour
(c) Paying the labour
(d) Low productivity
(e) Fraudulent practices
(f) Seasonal variation in labour

F. Income and Expenditure

33. Please indicate below the income and expenditure of your business since its commencement.

Daily	(Income (₦)	Expenditure	Profit/Loss (₦)

G. Institutional Support

34. What type of support do you receive from your local/state government?
(a) None---------------
(b) Financial Support-----------------
(c) Moral Support------------------
(d) Others (specify)------------------------------

35. What types of assistance do you expect from government?.
Financial------; Training------; Provision of market----
Others (specify)------------------------------

36. Which financial institution provides credit to micro enterprises?.
None-----; Government-----; Non-governmental institution----
Others (specify)------------------------------

H. Conclusion

37. What do you think should be done to assist micro-enterprises like yours? Tick as applicable.
(a) Recognition by both governmental and non-goernmental institutions.
(b) Fund for Bank loan.
(c) Access to bank loan.
(d) Others (specify)------------------------