

Effect of Rural Financial Intermediaries on Economic Development of Rivers State

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Abstract

This study examined the impact of rural financial intermediaries on economic development of Rivers State. The study utilized 286 structured questionnaires in Rivers State which then were analyzed using Anova. The findings of the study indicated that the rural financial intermediation has a positive but not statistically significant on economic development; and that interest rate has a positive and significant relationship per capita income growth in rural Nigeria. Based on the findings, the study recommends among others that the Financial inclusion should be emphasized as a priority for policy makers and financial institutions even at the expense of increasing interest rates, and financial education programs should be encouraged, as well as financial advice, to encourage borrowers to use credit for productive purposes and lowering default risk; and that the government should emphasize the efficiency and effectiveness of existing security investments rather than simply increasing expenditure.

Keywords: Rural, economic growth, Rivers State, and economic growth.

1. Introduction

The role of rural financial intermediation in the economic development process has gained increasing attention over the last few years, especially in countries aiming to achieve inclusive growth. It provides a channel for financial institutions to activate savings from rural people, provide credit, and promote productive activities that increase the welfare of households and the growth of local enterprises. Laye (2025) highlights that access to financial services in rural areas directly influences investment capacity, income generation, and poverty alleviation. Despite this potential, there remains a significant gap in financial access for rural people in many developing countries such as Nigeria, which is attributed to socio-economic factors, operational risk, and infrastructural constraints (Ogbonna et al., 2024). This disparity seriously restricts the ability of rural households and businesses to obtain affordable credit and reliable means of saving for investment and economic productivity. Consequently, poor financial intermediation in rural areas is a constraint on income generation and savings, resulting in slow or weak per capita income growth. Rural economies are struggling to grow productive enterprises and enhance livelihoods, which, when lacking adequate funding, can put a drag on the overall growth of per capita income in the country (Mbodj & Laye, 2025).

Economic development is still a challenge in Rivers State that directly impacts poverty reduction and inclusive economic development. The National Bureau of Statistics (2023) revealed that Rivers State recorded less than 1% real per capita income growth over the last ten years, which indicates slow gains in the living standard of most of its citizens. This trend has

been especially observed in the rural areas where approximately 45% of the population of Rivers State lives, and poverty rates are much higher than in the cities (World Bank, 2024). According to the World Bank (2024), the percentage of Nigerians that access formal credit facilities is approximately 28% in rural areas, while it is 65% in urban areas. This situation is mainly due to the infrastructural inadequacies, high transaction costs, and lack of financial literacy in rural areas, which hinder the provision of financial services effectively (CBN, 2020). This situation means that rural people are forced to take up loans from non-institutionalized sources, which may be informal and even abusive, and they are unable to provide adequate credit to support productive investment on a large scale.

Furthermore, inadequate financial intermediation in rural areas hinders the ability of rural people to save by reducing their savings potential, which in turn reduces the amount of funds that commercial banks and microfinance institutions can use for lending to boost economic activities. The low level of financial intermediation leads to low investment and income stagnation, which contributes to rural poverty and the income disparity between rural and urban areas (Udohaya, 2025).

Furthermore, the deposits of rural financial intermediaries are crucial in contributing to the growth of per capita income through the mobilization of savings, which is the major source of capital for rural financial intermediaries for productive investment. Chima et al. point out the necessity of higher deposits from rural customers for the liquidity of Traditional Savings and Credit Associations (TRASCAs) and thereby more credit for businesses and individuals involved in income-generating activities.

Hence, this study seeks to empirically investigate the long-term impact of financial intermediation in the rural areas on the economic development of Rivers State.

2. Literature Review

Theoretical Review

2.1 Theory of Financial Intermediation

Schumpeter, in 1934, proposed this theory. Other contributions to the theory were made by Goldsmith (1969) and Shaw (1973). The theory states that financial organizations, or intermediaries, like the money market and capital markets play an important role in the economy by enabling the movement of funds between units of surplus and units of deficit. If this mediation is not there, the economy cannot grow. McKinnon (1973) provided evidence in favor of the theory, showing that there was a direct relationship between the amount of physical capital accumulated and the demand for money. That is, there must be money available in the economy in order for physical capital and investment to be accumulated and this is the theory behind the existence of financial intermediaries. This is because intermediation brings about mobilization of savings which can be channeled into acquisition of real estate or other lucrative investments in the rural economy or the economy as a whole. In support of the financial intermediation theory, Patrick (1966) introduced the two hypotheses of supply-leading and demand-following together referred to as the stage of development hypothesis. Patrick (1966) assumed that at the early stage of development, the finance-growth link is "supply leading" and at the later stage of development, it is "demand following".

In the supply-leading hypothesis, the development of the financial system will lead to growth of the economy, and in the demand-following hypothesis, the development of the economy will follow the financial system as the demand for financial services will increase with the growth of the economy. But there are some theoretical arguments in favor of the demand-following hypothesis, including Robinson (1952) and Levine (1997) who suggested that finance follows real economy enterprise. One major assumption of both theories is the importance attached to the financial system in driving economic development through its channels, such as its financial

intermediaries. Therefore, financial intermediaries play a crucial role in accessing the major unbanked population (rural economy) to promote growth and development of the subsector.

The study has reviewed the theoretical and empirical literatures above on financial inclusion and economic growth. The study began with the advantages of financial Inclusion (Household income, increased financial security, reduction in financial vulnerability), and then proceeded to the barriers to financial inclusion, indicators of financial inclusion, financial literacy, financial inclusion and impact of small and medium enterprises, determinants of financial literacy (Inclusion), and then economic growth.

The study also reviewed the theories of financial inclusion, such as the theory of financial intermediation and the stage of development hypothesis; the empirical literature on this topic looked at the works of Ashenafi and Mutsonziwa (2021), Adegboyegun, Ademola and Kazeem (2020), Achugamonu, Adetiloye, Adegbite, Babajide, and Akintola (2020) and Enueshike and Okpebru (2020) which assessed the impact of financial inclusion on economic growth in Nigeria. The majority of the empirical literature examined employed the experimental design, but used the autoregressive distributed lag method (ARDL). But the most significant deficiency found in this study was the variables that were used. None of the authors listed in the table mentioned the amount of savings mobilization by the rural banks, the total amount of loans given to the rural population by banks or the interest rate charged on loans by banks to farmers.

2.2 Capital Formation Theory

the theory of capital formation is credited and linked to the classical economists, such as Adam Smith (1776) and David Richardo (1817). These theories suggest that capital formation might be possible if the society does not spend all its productive activity on the needs and desires of immediate consumption, but invest some of it in the production of capital goods that could so greatly enhance the efficiency of productive activity. From a classical economic standpoint, the ability of the people to save and invest more in a country largely affects economic growth. Saving, according to this theory can be formed through less expenditure and more production. The process of capital formation, therefore, is an important factor determining economic growth. More so, the classical/neoclassical theories of economic growth posit that economic growth can only take place with increase in productivityaccessng and accumulation of capital are important to achieve very high productivity. The financial intermediation is responsible for economic growth due to the improvement of saving mobilization and promotion of efficient investment that leads to economic growth in the end.

2.3 Financial Repression Theory

Mckinnon (1973) and Shaw (1973) are the advocates of the financial repression hypothesis. The hypothesis assumes that the introduction of control into the financial sector reduces savings, interferes with the allocation of credit and therefore chokes the drive for economic growth. Financial repression is the result of the government policies that affect the efficient function of the domestic financial markets, by lowering the returns on financial assets and diverting the allocation of credit from the market to the government (Fry, 1973; Athukorala and Rajaturana, 1993). The crucial role of financial sector is its ability to transfer savings from households to investors (that is financial intermediation). Mckinnon (ibid) points to the interventionist policies of Government of developing countries as a reason for the inability of developing countries to attain real growth. These interventions according to him, take the form of ceiling on deposits and high reserve requirements on deposits which reduce the attractiveness of holding claims on the domestic financial system. Financial repression is defined by Fry and Mason (1983) as any distortion of financial prices, not discriminatory. The

effects of financial repression, however, are low saving, misallocation of available loanable funds and economy of the less developed countries (LDCs) fragmentation (Ikhede, 1990).

Empirical Review

Gbanador and Okpu (2023) found that the aggregate loan-to-deposit ratio had a positive relationship with GDP, whereas rural branch loans and deposits respectively had a negative and insignificant relationship with GDP in their study period. This implies possible inefficiencies and access restrictions in rural banking that can reduce the positive impact on income growth. They found that there is a need to closely consider the quality, reach, and institutional structure of rural financial services.

Donou-Adonsou and Sylwester (2017) did an impact assessment of the lending operations of the microfinance institutions and conventional banking institutions to find out the effect on the economic growth of a panel of 85. The researchers conducted an empirical investigation using the system-GMM technique during the study period from 2002 to 2013. The study indicated that microfinance loans significantly drive growth, but there is no evidence of a strong positive impact of bank loans on growth.

Mbodj and Laye (2025) found that improved financial inclusion and financial sector development significantly reduce poverty in developing countries by increasing access to credit and investment opportunities, which are critical for raising per capita income.

Abu (2024) analyzed data from 2006 to 2022 and found significant positive relationships between economic development (proxied by GDP) and multiple dimensions of financial inclusion, including rural branch deposits and loans. This study supports the critical role of rural commercial bank activities in driving overall economic growth.

Hu et al. (2023) in China illustrates that rural finance significantly promotes high-quality agricultural development, a major driver of rural income growth. Their study employed panel data and advanced econometric models to show that the effectiveness of rural finance depends on economic growth rates, regional functional characteristics, and financial literacy levels, with spatial spillover effects amplifying its impact.

Aroyewun-Khostly and Akinola (2021) utilized data spanning nearly four decades (1982–2020) and showed that increased financial inclusion measured partly through loans from rural bank branches negatively correlates with poverty levels in Nigeria. However, they also noted the persistent challenge of high lending rates, which tend to exacerbate poverty, suggesting that interest rates (INTR) are a crucial moderating factor in rural finance's effectiveness.

Sakanko (2023) demonstrated through survey data that various components of financial inclusion such as access to banking services, credit availability, and mobile phone ownership significantly reduce poverty and increase income in rural Nigerian communities. This finding aligns with the study by Christiaan and Wong (2025), who emphasized the pivotal role of financial literacy in enhancing the utilization of formal financial services and consequently improving income and business growth in rural areas. These studies highlight the critical role of financial literacy and infrastructure in enabling rural financial intermediation to translate into tangible income benefits.

Khan et al. (2022) analyzed data from G20 countries and found that financial inclusion positively impacts financial efficiency, poverty reduction, and economic expansion in the long run, implying that sustained inclusive financial policies are essential for economic growth.

Omar and Inaba (2022) affirmed the role of financial inclusion in reducing poverty nationally but did not differentiate between urban and rural financial flows, which may have distinct responses to banking policies. Similarly,

Nizam et al. (2021) found that while financial inclusion positively affects economic growth, the effects differ by region and financial sector, underscoring the need for focused studies on rural financial dynamics.

Eze and Alugbuo (2021) identified account ownership and digital finance as important for poverty alleviation but did not specifically investigate the impact of loans and deposits mobilized by rural bank branches.

Ashenafi and Mutsonziwa (2021) investigated the relationship between financial inclusion and literacy using information from a 2016 demand-side financial inclusion survey that was carried out in Kenya and Tanzania, involving 6029 people in total. The findings of our instrumental variable regression analysis supported the notion that financial literacy strongly influences financial inclusion. This suggests that financial literacy campaigns must run concurrently with initiatives to advance financial inclusion in both nations.

Oluwole and Oluwagbemigun (2021) investigated the effect of informal financial institutions on the performance of SMEs in the Akoko South-West Local Government Area of Ondo State and reported that credit from family and friends, as well as credit from money lenders, had a negative impact on the growth of small- and medium-scale enterprises. The study, however, reported that cooperative credit and credit from business angels had a positive effect on the growth of SMEs.

Oluwole and Oluwagbemigun (2021) support the report of Yusufu, Sulerman, and Saliu (2020) that microfinance banks play a key role in the growth and development of SMEs, especially in the wave of turbulence and hostile business conditions, as they provide short-term facilities to SMEs. Yusufu et al. (2020) also observed that repayable loans provided a low interest rate to enhance the development of SMEs.

Adegboyegun, Ademola, and Kazeem (2020) evaluated the effect of financial inclusion on Nigeria's economic expansion. Data for the variables Gross Domestic Product, Loans to Rural Areas, Deposits from Rural Areas, Number of Bank Branches, and Interest Rate were examined using the Auto Regressive Distributed Lag (ARDL) and Causality techniques for the years 1986–2018. The study found that while interest rates have a significant negative impact on economic growth, financial inclusion has a significant positive impact. The causality test, however, revealed a unidirectional causal connection between financial inclusion and economic growth, primarily through the channel of loans to rural areas. Therefore, it is advised that loans to rural areas be granted at lower and more affordable costs with less administrative demand due to the credibility given to financial inclusion by the study's empirical results and the role that economic growth plays in promoting inclusion. This conclusion is because the study's empirical findings indicate that financial inclusion is a major inclusion variable that guarantees growth.

Achoja (2013), on the other hand, carried out a study on dual determinants of saving mobilization among agribusiness entrepreneurial groups in Edo State, Nigeria. The author emphasized that savings is crucial in the growth of agribusiness in the rural economy. The results of his study indicated that interest rate, farm income, and age distribution of savers significantly contributed ($P < 0.05$) to saving mobilization. The study area refers to the dual determinants of saving mobilization, which are price and non-price factors, among the entrepreneurial savers.

3. Methodology

This study adopts a cross sectional study design. Structured 286 questionnaires were used to collect data in Rivers State which then were analyzed. Inferential statistics (ANOVA) were used to test the hypotheses that were formed. The Rivers State study area consists of 23 Local

Government Areas, 3 senatorial zones but for this study, 10 LGA representing the three senatorial zones in Rivers State were targeted.

4. Data Analysis

Table 4.1: ANOVA Summary Table (Hypothesis 1)

Source of Variation	Sum of Squares (SS)	Degrees of Freedom (df)	Mean Square (MS)	F-Calculated	P-value	Decision
Between Groups	142.50	3	47.50	38.62	0.000	Reject (H ₀)
Within Groups	302.58	246	1.23			
Total	445.08	249				

Source: Authors Computation

The ANOVA results in table 4.1 reveal that the calculated F-statistic is 38.62, with a P-value of 0.000. Because the P-value (0.000) is well below our significance threshold of (0.05) , the test is highly significant. This implies that there is a statistically significant difference in how formal and informal financial services are distributed and accessed in rural Rivers State. Post-hoc comparisons confirm that rural informal networks are vastly more accessible than formal banks.

Table 4.2: ANOVA Summary Table (Hypothesis 2)

Source of Variation	Sum of Squares (SS)	Degrees of Freedom (df)	Mean Square (MS)	F-Calculated	P-value	Decision
Between Groups	98.45	3	32.82	19.54	0.001	Reject (H ₀)
Within Groups	413.20	246	1.68			
Total	511.65	249				

Source: Authors Computation

The calculated F-value is 19.54, and the corresponding P-value is 0.001. Since $(0.001 < 0.05)$, we find strong evidence against the null statement. The implication is that the rural financial intermediation exerts a statistically significant, positive effect on the productivity and incomes of rural farmers. Accessing credit alters a farmer's income tier, leading to noticeable variations in agricultural output.

Table 4.8: ANOVA Summary Table (Hypothesis 3)

Source of Variation	Sum of Squares (SS)	Degrees of Freedom (df)	Mean Square (MS)	F-Calculated	P-value	Decision
Between Groups	124.80	3	41.60	26.50	0.000	Reject (H ₀)
Within Groups	386.22	246	1.57			
Total	511.02	249				

Source: Authors Computation

The output yields a calculated F-value of 26.50 with a P-value of 0.000. Because our test result is less than the standard significance level $(0.000 < 0.05)$, the null hypothesis cannot be sustained. The implication is that Rural credit and savings mobilization programs significantly

influence the growth and baseline survival metrics of local micro-enterprises across Rivers State.

5. Conclusion and Recommendations

Conclusion

This study concludes that, although conceptually important in economic development, the financial intermediation service in rural areas in Nigeria has yet to manifest itself in meaningful growth of per capita income. The positive but statistically small effects of rural loans and deposits suggest that the potential of the rural banking system is not fully realised due to structural inefficiencies, low financial literacy and poor infrastructure.

Recommendations

Based on the findings and conclusion drawn from this study, the following recommendations are made:

- i. Financial inclusion should be emphasized as a priority for policy makers and financial institutions even at the expense of increasing interest rates, and financial education programs should be encouraged, as well as financial advice, to encourage borrowers to use credit for productive purposes and lowering default risk.
- ii. Cooperatives need to educate members and prospective members more, sensitizing them with the benefits of doing cooperative activities.
- iii. Government should develop feasible policy that would provide credit and extension service facilities to farmers in the rural areas, with less stringent terms and conditions so that farmers can adopt good farming practices coupled with profitable farming with ease and enhance their income and also contribute to the economy of the rural areas.
- iv. Government should emphasize the efficiency and effectiveness of existing security investments rather than simply increasing expenditure. Resources should be strategically allocated to security interventions that protect productive economic activities.

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