The Informal Financial Institutions and Poverty Reduction in Nigeria

Okere, Peter Anele PhD
Banking and Finance Department,
Imo State University Owerri.

Adioha, Ndubuisi Francis
Accountancy Department,
Imo State Polytechnic Omuma.

Akpelu, Azunna E
Accountancy Department,
Imo State Polytechnic Omuma
micpetwills@yahoo.com

DOI: 10.56201/ijefm.v9.no1.2024.pg108.119

Abstract

This study investigated the relationship between informal financial institutions and poverty reduction in Nigeria. The study adopted a descriptive survey method comprising a sample of 267 respondents from Owerri North and Owerri West Local Government councils of Imo state. Data were sourced using structured questionnaire and analysed using simple percentage and descriptive statistics. Findings revealed that informal financial institutions have positively influenced poverty reduction in Nigeria. The study therefore recommends that collaboration is more optimal needle-moving strategy between the formal and informal financial institutions and this will ensure sustainable financial inclusion in Nigeria. The informal providers are a lucrative vertical for the formal financial service sector because they have already done a lot of the heavy lifting of financial inclusion. Again, there is urgent need for government to utilize the informal financial institutions in its poverty alleviation programmes most especially in this COVID-19 period

Keywords: *informal financial Institutions, Financial inclusion, Poverty Reduction*

Introduction

Poverty has been defined as a situation where a population or section of the population is unable to meet its subsistence such as basic food, clothing and shelter including basic education in some economies (Oleka and Eyisi,2014). The World Bank Development Statistical Report (1990) explained that a country could be described as being poor if the per capita income is below $275 at any point in time. Adeyemi (2008) in Obadan (2009) rightly summarized the meaning of poverty in both relative and absolute terms as a state where an individual is unable to cater adequately for her basic needs such as food, clothing and shelter, meet social and economic infrastructure with no recognition from any angle. In other words, the poor lacks basic necessities of life, lacks capabilities, lacks exposure, lacks funds, lacks fun, and lacks security and social recognition, hence limited chances of advancement in life.

It follows that poverty remains a major challenge to sustainable development, environmental security and universal stability (Chukwu, 1990). It has been generally noted that economies of developing countries such as Nigeria operate with dual financial institutions[5]. According to Sambo et al there is a group which functions through direct government control and is known as formal financial Institution which included Deposit Money Banks, Insurance Companies, Mortgage banks. There is also another group called the Informal Financial Institutions and they included money lenders, co-operative societies, thrift and loan societies, local bankers etc. The introduction of the Informal Financial Institution (IFI) by individuals and groups is therefore to help cushion the effects of the Formal Financial Institution on the socio-economic wellbeing of the people.

The rapid growth of the informal sector is attributed to the stringent conditions that formal financial institutions attached when granting of loans, as well as the exclusion of the poor from formal financial services. Therefore, as a result of these, majority of the poor rural dwellers especially women resorted to patronizing the informal financial institutions (IFIs). IFIs are age long and ancient institutions whose activities precede those of the formal institutions but are not controlled by government (Iganiga and Asemota 2008). The development of IF is over the years and a number of success stories recorded have lent credence to the idea that they are power instruments for promoting economic development.

Adamu,(2007) defined IFI is as collaboration of group of people united to encourage each other to save regularly with a view of providing themselves with credit facilities at accessible interest rate. IF is include, among others, women self-help groups, family sources, moneylenders and shopkeepers. Saving and loaning is done mainly on trust, with minimal documentation, mostly without any form of security. The amounts loaned or saved are small, frequent and for short durations of time. The default rates are minimal mainly due to group pressure and periodic monitoring meetings.

But this practice is not without its shortfalls as most Esusu groups operate without any written laws, non form of regulation as charge so much interest for the services rendered. It is obvious to note that all governmental actions and plans to reduce the volume of currency outside the banking sector have not achieved the expected result. However, the question that needed an urgent answer is; why have the operations and activities of the informal financial institutions remained significant and still wax stronger despite the sophistication of formal financial institutions in Nigeria?

Therefore, the main objective of this study is to determine the role of informal financial institutions in poverty reduction in Nigeria. The specific objectives are;

1. to determine how informal financial institutions have positively reduced poverty in Nigeria,
2. to investigate the areas the informal financial institutions have addressed poverty,
3. to examine why people prefer informal financial institutions to formal financial institutions

4. to investigate some of the challenges encountered in the services of the informal financial institutions.

Review of Related Literature

Conceptual Review

Informal financial institutions are financing activities that are mostly legal but their activities are often unrecorded, unregistered and unregulated by government. (Todaro, 1997 in Akintaye, 2008). Despite the 2005 launch of the microfinance policy, which ushered in the microfinance banks (MFBs), the informal sector, through which billions of naira circulates, have largely remained unbanked and lack access to formal financial services, which is impacting negatively on the country's economic growth and development. Though a body of evidence shows that access to financial services, and indeed overall financial development is crucial to economic growth and poverty reduction, but a large number of Nigerians have resorted to traditional methods of saving money or taking loans in order to cater for their financial needs. In Nigeria, one of the oldest informal means of collecting and saving money is the group contribution known as esusu, which transcends the shores of Nigeria, to Western African states up to the West Indies and the Caribbean. Adamu,(2007) defined IFIs as collaboration of group of people united to encourage each other to save regularly with a view of providing themselves with credit facilities at accessible interest rate. IFIs include, among others, women self-help groups, family sources, moneylenders and shopkeepers. Saving and loaning is done mainly on trust, with minimal documentation, mostly without any form of security. The amounts loaned or saved are small, frequent and for short durations of time. The default rates are minimal mainly due to group pressure and periodic monitoring meetings.

There is hardly a universal way of defining poverty because it affects many aspects of human conditions. However, the conventional concept of poverty depicts it as a condition in which people live below a specified minimum income level and are unable to provide the basic necessities of life needed for an acceptable standard of living. Poverty is a plaque which affects people all over the world, though generally considered as one of the manifestations of underdevelopment

Theoretical Review

This research is hinged on Residual Paradigm and Dualism Paradigm

The Residual Paradigm

The Residual Paradigm believed that the inefficiencies generated within the formal financial system and the improper way of adaptation of world's formal financial condition led to the existences of informal finance. They argue that informal finance stems from the excessive regulation of the Formal Financial Institution through the use of direct credit policies, interest rate ceilings and preferential allocation of credit which created distortion in the economy. This paradigm originated from the works of MCKinnon 1973 and Shaw 1973. The distortion led to high cost of fund to the poor, rural dwellers, small scale entrepreneurs and other disadvantaged groups thereby accentuating the development of the Informal Financial Institutions.

Thus, the informal sector plays a role as provider of residual finance. The net impact that the two sectors will have on the national economy will depend on the volume of residual financing done by the informal sector in relation to total financing requirements. Residual finance can be seen as additional finance available to investors in excess of what is offered by the formal sector. Therefore, increased demand for informal credit is the result of a growing use of formal credit, due to a growing economy. Nevertheless, formal and informal finance may also compete with one another. In such a case the availability and terms on which financial services of the two types are available will determine the choice of sectoral source. If there is an improvement in one sector, one could expect clients to switch from the other source to this one. Thus, the quantity of credit in a particular informal sub-market is the difference between the total demand for loans of that type, and that part of total demand supplied by the formal sector. As formal loans of this type become more easily available on more favourable terms than those in the informal market, formal loans will displace informal loans (Ghate, 1990). Likewise, financial sector repression, as was the case in Mozambique, causes many market participants to move to the informal sector because the formal sector ceases to provide satisfactory services (Larson, Zaque and Graham, 1994)

The Dualism Paradigm

The dualism paradigm believes that Informal Financial Institutions (IFIs) exist as a result of other motives beyond the purely economic. According to this school of thought, IFI exist due to the subordinate role it plays to the Formal Financial Institutions (FFIs), thus creating market segmentation. In their view the occurrence of market segmentation is not due to regulation but because of the fact that the IFIs serve in redistributing income among community members and provide a form of social security by meeting their fluctuating liquidity. While it is costly informal institution to acquire information about clients, informal utilizes local personal information resulting into a weak legal system which inhibits contract enforcement thereby results in credit rationing of potentials borrower without collateral. The market segmentation can be filled by the informal agent as the collateral is replaced by reputation, group responsibility and interlinked transaction

Empirical review

According to Oluwoyo and Audu (2019) whose study centred on the role of the informal financial institution on the sustainable goal of poverty reduction in Nigeria with particular reference to Kogi State using the Moneylender theory as its theoretical Framework. The study sampled 600 respondents using stratified sampling technique carried out by dividing the population into 3 subsets based on the senatorial districts (East, West, Central) 4 local government areas are randomly selected from each of the senatorial districts and response was analyzed using descriptive statistics and Ordinary Least square hence the result showed that Non financial institution is a potential voyage toward the actualization of the Sustainable goal of poverty reduction in Kogi state, Nigeria.

Oleka and Eyisi (2014) investigated the effect of informal financial institutions on poverty alleviation in Nigeria. The study adopted a descriptive survey design comprising of a population of 800 respondents. Data collected were analyzed using simple percentage and descriptive statistics. Findings revealed that informal financial institutions have no significant effect in alleviating poverty in Nigeria.

Anyanwu, Okere and Adioha (2020) examined the effects of financial dualism and inclusion on the economic development in Nigeria. Data were obtained principally from primary sources, interviews and questionnaires. The qualitative data were transformed into quantitative form with the use of likert scale. The ordinary least square (OLS) estimation technique was employed to test for relationship in the model. The study revealed a significant relationship between financial inclusion and economic development in Nigeria.

Mohammed, Awe and Obansa (2017) investigated the Relationship between informal financial sector activities and poverty alleviation in Nigeria. A multivariate panel data approach was used with data from 150 informal sector operators in Gwagwalada Area Council-FCT. Data was collected using structured questionnaire and analyzed with appropriate technique in order to identify the perception of socio-economic impact of Informal sectors on poverty alleviation in Nigeria. The findings revealed that informal financial sector operators have a positive and significant impact on poverty alleviation in Nigeria.

Ademola, Adegoke and Adegboyegun (2019) studied the Nexus between Informal Financial Institutions (IFIs) and Performance of Women Entrepreneurs in Nigeria and a sample of 348 entrepreneurs was selected using multi-stage sampling technique and data were analysed using frequency and percentages, spearman rank correlation and factor analysis. Findings revealed that IFIs contribute significantly to job creation, accumulation of assets, savings mobilization, poverty alleviation and women entrepreneurship development.

Sambe, Korna and Abanyam (2013) examined the effects of Informal financial Institutions on socio-economic development of Adikpo town and randomly sampled 200 respondents as questionnaires were used to collect data. Chi-square was employed in the test of hypotheses using SPSS. Dependency theory was used in analysing the study. Findings showed that Informal Financial Institutions were more effective in reducing poverty among members than non-members. Furthermore, the institutions guaranteed more access to credit than non-members and lastly, Informal Financial Institutions were effective in promoting investment among members as compared to non-members. It was therefore concluded that Informal Financial Institutions have been effective in promoting socio-economic development of the town.

Methods and Materials

This section deals with the procedure for carrying out the research. The descriptive design is used for this study. Descriptive Survey Design is a formal method of obtaining data from population or items that are considered to be representative of the entire group mainly through questionnaire and interviews. The area of the study is Owerri West and Owerri North Local Council Areas. These two local government councils are strategic in Imo State as have the highest number of markets, artisans, and farmers. Again, the local governments surround the Capital city of Imo State. The study used random sampling techniques by means of Ballot system to select 300 customers of 15 informal financial institutions in Owerri North and Owerri West Local Government Areas. The informal financial institutions considered here are the Esusu and Cooperatives.

This study adopted a primary source of data and developed a well structured questionnaire to be used for this study. It is divided into two sections- A and B sections. Section A, sought information on personal data (Biodata) while Section B comprises of four items that is, questions based on the research objectives to ascertain the views and opinion of the customers on the effect of informal financial institutions on their welfare. This study is expected to be completed in six months years (from August 2021 to February 2022) all things being equal.

Validation of the Instrument

Instrument used for the study was subjected to the scrutiny by the researchers' supervisor and experts in measurement and evaluation. Each of these experts in the area ticked the items that were suitable and suggested other items to be included. The corrections were effected before the final copy is produced.

Reliability of the Instrument

The study conducted test-retest using the same instrument which was administered to 100 customers in Okigwe Local government area of Imo state. The instrument was administered on them twice in a space of three weeks. The two scores were correlated using Pearson product moment and a correlation coefficient of 0.69 was obtained. This indicates that the test instrument is reliable. A total of 300 copies of the questionnaire were distributed to the customers of the sample IFIs personally by the researchers. These copies were collected back within two days to ensure high percentage returns.

Data Analysis and Interpretations

The design of the study was descriptive survey method and it is ideal because the study involved collecting raw data from customers of these Esusu and Cooperatives in the two chosen local government areas in Imo state. The study adopted the use of personal observation, interview and questionnaire. A total of 300 questionnaires were administered to the customers.

Table 1: Questionnaire Distribution and Collection

Questionnaires	Number	Percentage
Returned	267	89
Not returned	33	11
Total no. administered	300	100

Source: Field Survey, 2022.

Out of the total number of 300 questionnaires administered to the customers of the 15 Esusu and cooperatives in Owerri North Local Government and Owerri West Local Government, 267 questionnaires were properly filled and returned. This represented 87% return while only a little fraction of 11% was not returned.

Table 2: Socio- Demographic Characteristics of the Respondents.

Demographics	Frequency	Percentage (%)
Age		
18 -29	26	9.73
30-39	75	28.09
40-49	111	41.58
50-59	43	16.10
60 and above.	12	4.50
Sex		
Male	91	34.08
Female	176	65.92
Marital Status		
Single	56	20.98
Married	164	61.43
Widow	34	12.74
widower	13	4.87
Divorced	-	-
Level of Education		
Primary	91	34.08
Secondary	98	37.70
Tertiary	35	13.11
No Education	43	16.10

Occupation Distribution		
Farmers	44	16.48
Artisans	118	44.19
Petty traders	60	22.47
Transporters	34	12.74
Civil servants	11	4.12

Source: Field Survey, 2022

Table 2 above represents socio-demographic characteristics of the respondents in relation to age, sex, marital status, and level of education and occupation. The Table shows that the majorities of the respondents fall within the age range of 40-49 with 41.58 percent while those of 60 and above were the least with 4.50 percent. Further, respondents in the age range from 18-29 had 9.73 percent; 30-39 had 28.09 percent while 50-59 had 16.10 percent. With regard to sex distribution, females were majority with 65.92 percent while males were minority with the percent of 34.08

On marital status, married respondents constituted the bulk of the study with 61.43 percent while widow and widower constituted 12.74 and 4.87 percent respectively. There was no divorced respondent and respondents who were single had 20.98 percent. With respect of educational level, respondents with secondary level had most percentage with 37.70 percent while those with no schooling had the least with 16.10 percent. Further, respondents with primary education had 34.00 percent while those with tertiary education had 13.11 percent. Finally, the occupation distribution revealed that the majority of the respondents are artisans representing about 44.19 percent of the total respondents. Following the artisans are the petty traders which represents 22.47 percent. Farmers represent 16.48 percent of the respondents while transporters and civil servants had 12.74 percent and 4.12 percent respectively. This occupational distribution shows that the majority of the customers of the informal financial institutions are artisans, petty traders, famers and transporters, hence indicating the high level of poverty.

Table 3: Objective one: Informal Financial Institutions have positively Reduced Poverty.

Options	**Number of respondents**	**Percentage (%)**
Agreed	63	23.60
Strongly Agreed	182	68.16
Disagreed	13	4.87
Strongly Disagreed	7	2.62

Neutral	2	0.75

Source: Field Survey, 2022

From the table three above, 30 representing 23.60% of the respondents agreed that informal financial institutions have positively reduced poverty, 182 representing 68.16% of the respondents strongly agreed that informal financial institutions have positively helped in poverty reduction. Again, a total of 13 representing 4.87% disagreed with this assertion and 7 respondents representing 2.62% strongly agreed that informal financial institutions have positively reduced poverty in Nigeria. Only 2 representing 0.75% were neutral if informal financial institutions have actually reduced poverty in Nigeria.

Table 4: Research Objective two: Utilization of Loans from Informal Financial Institutions

Options	**Respondents**	**Percentage (%)**
Start a business	69	25.84
Stock up business	78	29.21
Build a house/ house rent	33	12.60
Educational fees	55	20.37
Farming	32	11.98

Source: Field Survey, 2022

The table 3 above is meant to investigate how loans granted by these informal institutions to the customers is been utilized in addressing their pressing needs. From the table it can be observed that 69 customers representing 25.84 % used their facility to start a new business, 78 of the respondents representing 29.21% of the total respondents utilized their used to purchase or stock-up their existing business, 12.60% of the respondents used theirs either to buy houses or pay for their rents. It is observable that 20.37% of the total respondents used the facility granted to them to pay for their wards school fees while 11.98% of the respondents used the loans granted to them for farming purposes.

Table 5: Research Objective Three: Reasons for more Patronage of Informal Financial Institutions.

Options	**Respondents**	**Percentage (%)**
Quick and easy access to credit facility.	73	27.33
Less loan documentation	51	19.10
Little or no collateral	57	21.54
Friendly repayment plan	68	25.47
Friendly interest rate	18	6.74

Source: Field Survey, 2022

Table 4 above aimed at examining why people patronize informal financial services instead of the formal financial services. It was revealed from the table 5 above, that 73 respondents representing about 27.33% preferred informal financial services because they easily and quickly get financial assistance from them than the formal financial institutions. Again, 19.10% of the respondents preferred informal financial institutions because of less documentation involved while accessing loan facility, 21.54% also preferred informal financial institutions because according them, little or no collateral is required when given a loan. Furthermore, 25.47% of the total respondents liked the friendly repayment plan which does not much stress in repaying the loans from informal financial institutions. However, only 6.74% complained that their interest rate is high.

Table 6: Research Objective Four: Problems Encountered by Customers of Informal Financial Institutions.

Options	Respondents	Percentages (%)
High interest rate	154	57.68
Abscond with customers money	66	24.71
Hidden charges	47	17.61

Source: Field Survey, 2022

From the table 6 above which looked at some of the problems encountered by the customers of the informal financial institutions, it can be observed that 154 representing 57.68% of the total respondents confirmed that the interest rate is much high compared to the formal financial institutions, 24% of the respondents said that sometimes the Esusu or cooperatives operators fraudulently collected their money and abscond with it. There are also hidden charges noticeable in their services as 17.61% of the respondents confirmed this.

Summary of findings

In line with the objectives of the study, the following findings were made;

i. The study revealed that informal financial institutions have positively reduced poverty in Nigeria
ii. The informal financial institutions have tremendously assisted rural people financially in areas like; starting a new business, to build or pay their house rent, pay school fees of their wards and also stock up their business.
iii. The study also revealed that the high patronage of the informal financial institutions is as a result of quick and ease at loan facilities are accessed, little or no collateral is required when granting a loan, friendly repayment plan that allow people to repay without so much stress.
iv. However, the study investigated the challenges people encountered with the informal financial institutions which included; high interest rate charges, fraudulent practices and sometimes absconding with customers' money.

Conclusion and recommendations

The study examined the effect of informal financial institutions on poverty reduction in Nigeria. Based on the results, it was revealed that informal financial institutions have positively reduced poverty in Owerri North and Owerri West Local council Areas of Imo State. The finding is line with the residual paradigm theory and most economic scholars who have through several empirical studies discovered that the Informal Financial Institutions are mechanism for poverty reduction and thereby improve the welfare of people more especially those in the rural areas.

Recommendations

Based on the findings and conclusions above, the following recommendations have been made;

i. Collaboration is more optimal needle-moving strategy between the formal and informal financial institutions and this will ensure sustainable financial inclusion in Nigeria. The informal providers is a lucrative vertical for the formal financial service sector because they have already done a lot of the heavy lifting of financial inclusion

ii. There is urgent need for government to utilize the informal financial institutions in its poverty alleviation programmes most especially in this COVID-19 period

iii. There should be an effective use of Microfinance banks as second-tier regulatory body charged with the registration and supervision of viable informal financial institutions as this may result to organizational efficiency and stability in their operations.

References

Adamu, G. (2007), Role of Microfinance Institutions in Actualization of MDGs. Paper delivered at the induction ceremony of Institute of Chartered Economists of Nigeria (ICEN) in Port Harcourt.

Ademola A.O, Adegoke K.A and Adegboyegun A.E.(2019) Nexus between Informal Financial Institutions (IFIs) and Performance of Women Entrepreneurs in Nigeria. *Saudi Journal of Economics and Finance, Journal homepage: http://saudijournals.com/sjef/*.

Akintoye, I.R. (2008) Reducing Unemployment through the Informal Sector: A Case Study of Nigeria. European Journal of Economic and Administrative Sciences, 11, 97-106.

Anyanwu G.I., Okere P.A and Adioha N.F(2020)Effects of Financial Dualism and Inclusion on Economic Development in Nigeria. *Asian Journal of Economics, Business and Accounting*, Page 1-13

Chukwu, S.C. (1990) Economics of Cooperative Business Enterprise, Germany: Mulberry Consult Publication.

Economics and Sociology Occasional Paper No. 2102. Selected paper prepared for presentation at XXII Conference of the International Association of Agricultural Economists (IAAE) Harare, Zimbabwe.

Ghate, P.B (1990). Interaction between formal and informal financial sectors. United Nations' International Conference on Savings and Credit for development, Denmark.

Iganiga, B. O., & Asemota, A. (2008). The Nigerian unorganized rural financial institutions and operations: A framework for improved rural credit schemes in a fragile environment. *Journal of Social Sciences, 17(1), 63-71*.

Larson D.W, Zaque F, Graham D.H.(1994) Why users prefer informal financial market services: The case of Mozambique.

Mckinnon, R.I. (1973): Money and Capital in Economic Development". Washington D.C. Institution.

Mohammed Y, Awe E.O. and Obansa S.A.J. (2017) Analysis of the Relationship between Informal Financial Institutions and Poverty. Alleviation in Nigeria: A Multivariate Panel Data Approach. *The International Journal of Social Sciences and Humanities Invention 4(7):3657-3665, 2017 DOI: 10.18535/ijsshi/v4i7.13.*

Obadan, M. I. (1996). "Analytical Framework for Poverty Reduction: Issue of Economic growth versus other strategies" Proceedings of the 1996 Annual Conference of the Nigeria Economic Society.

Obadan, M. I. (2009). Poverty Reduction in Nigeria: The Way Forward. *CBN Economic & Financial Review, 39, 15-45.*

Oleka, C and Eyisi, N (2014). The Effect of Informal Financial Institutions on PovertyAlleviation in Nigeria, *Journal of Economics and Sustainable Development www.iiste.org ISSN 2222-1700 (Paper) ISSN 2222-2855 (Online).*

Oluwoyo J.T and Audu P. (2019) Informal Financial Institution and Sustainable Development Goal of Poverty Reduction in Kogi State, Nigeria. *South Asian Journal of Social Studies and Economics.*

Sambe N, Korna J.M and Abanyam N.L (2013) The Effects of Informal Financial Institutions on the Socio-Economic Development of Adikpo Town, *International Journal of Business and Social Science. Vol. 4 No. 15.*

Sambo, Ngutor, Korma, Johnmark M and Abanyam, Noah Luuman (2013). "The Effects of Informal Financial Institution on the Socio-economic development of Afikpo Town, *International Journal of Business and Social Science. Vol 4,* No.15