

## **Leveraging the Private Capital Growth in Nigeria for Entrepreneurial Development through the Informal Sector**

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**Abstract:** *The Small and Medium Scale entrepreneurs in rural and semi-urban areas lack the necessary financial services especially credit from the Commercial Banks; this is because they are considered not credit worthy. Considering the role credit facilities plays as an important factors of production that helps to transform idea to wealth. The aim of the study is to understudy the mechanics of informal financial sector in promoting Entrepreneurial development activity in urban and rural areas in Nigeria. The study is postulating that informal financial institutions bridges the gap created by formal financial institution. Specific objectives achieved are: to identify the participants in the informal sector, to identify sources of fund from the informal sector, types of informal financial institutions and compare formal financial institutions and informal financial institution. The study adopted a descriptive approach in analyzing the differences in accessing credit from formal financial institutions and informal financial institutions by Small and Medium Scale entrepreneurs in rural and semi-urban areas.The study recommended the integration of the informal sector into the Nigeria micro finance system.*

**Key words:** *Leveraging, Private fund, Informal Sector, and Entrepreneurial Development.*

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### **I. Introduction**

In Nigeria, credit has been recognized as an essential factor of production to promote small and medium small enterprises. According to Muktar(2009)he pointed out that for any business to grow credit is essential, lack of credit is a barrier to investment and growth of income of poor households. He went further to explain capital arise as a result of access to credit which also enhances the level of households productive and physical assets and also raise expenditure that lead to improvement in the consumption of rural poor. The exclusion of small and medium scale entrepreneurs from the formal financial system as a result of not being credit worthy.Consequently,most small and medium scale entrepreneurs look for succor from families, friends and other informal sources of fund to finance their businesses.Nevertheless,successive government have intervene to bridge the gap of underserved by making conscious effort.Unfortunately,most of the programmes failed to achieve the desired result .This led to emergence of the informal sector which extend credits to micro enterprises and encourage entrepreneurship development in semi-urban and rural areas.

### **II. Literature review**

#### **2.1 Conceptual framework**

As was captured in Masha (2004) there two basic schools of thought that explains the origin of the informal financial market, the financial repression school and structuralist school. As was explained by Masha (2004) in Mckinnon(1973)and Shaw(1973) that informal finance agents emerged as a result of excessive regulation of the formal sector with the instrument of monetary policies of direct credit controls such as interest rate ceiling and prescribed credit allocation to preferred sectors. The activities of the regulatory body led to distortions in the economy resulting in crowding out of financial needs of the informal sector by the formal financial institutions. In addition, the effective cost of funds to small and medium scale enterprise became excessively high.

While structuralist school views the existence of informal finance market as product of other non-economic forces. As was stressed in Masha(2004) according to the work of Hugon(1997)informal financial system are subordinate to the formal financial system. He went further to explain that market segmentation occurs not because of regulation but because informal financial system exist to serve social goals and because of some other non-economic attributes which they employ to deliver tailor-made services to their clients. They redistribute income among community members and provide a form of social security meeting by members fluctuating liquidity needs based on kinship, ethnicity or religion. According to Aryeetey and Hyuha(1991)informal financial market have been identify as a highly heterogeneous grouping, incorporating all financial transactions consummated outside the functional scope of formal financial regulation.

## **2.2 Historical Background of Informal Financial Market**

As was documented in the work of Otu et al (2003) that the history of the evolution of informal financial markets in Nigeria is lost in antiquity but recent studies have traced the evolution to the transformation forces of barter system, in which accumulated surpluses were exchanged in kind for labour and later advanced to higher technology. The pre-banking informal financial markets served the Nigeria communities relatively well and performed some of the functions of modern banking though in limited and traditional manner. As a result of unregulated environment, informal financial markets have poor record keeping and no established process of auditing, as was stated in Otu et al (2004). In terms of outreach, the informal financial markets extend their financial services to large number of people compared to the formal financial institutions but not necessarily in the volume of transaction.

Onoh (2002) highlighted that as many as five or more informal financial market grouping can be found in a village or less than 500 people and as 20 in a Nigeria rural town. However, with the geographical spread of banks and other formal financial intermediaries, informal financial markets continue to show strong presence in the urban centers.

## **2.3 Features of informal market**

As outlined in Otu et al (2004) the following are common features of informal institutions operating in urban and rural areas.

**2.3.1 Rotating Savings and Credit Association (ROSCAS)** Most informal financial institution in Africa adopts the principle of rotating savings and credit association (ROSCAS) which have a long history in developing countries. Most small group is formed from village or family where enforcement cost is minimal because of powerful social sanctions. Each member of the group agrees to contribute periodically into a common pool, which is rotated among member. It is built on trust and understanding. The membership is often drawn from homogeneous groups, e.g. some ethnic background, same work place or same neighbourhood. If any member defaults in repaying a loan, the community banishes him.

**2.3.2 Sanctions and Loan Recovery Methods** The spread and multiplicity of membership among different forms of institution have not compromised the sanctions and loan recovery methods which is similar between urban and rural dwellers, across peoples, societies, communication and countries.

**2.3.3 Periodic and Regularity of Contribution** Informal financial institutions are also characterized by periodic and regular contribution. The frequency of contributions is determined by nature of informal institution operated which ranges from itinerant bankers type which contributes on daily basis, while the semi-formal type which looks more organized contributes on monthly basis and the co-operative type is the Adashi and Bam groups.

**2.3.4 High Interest Rate** Informal financial institutions normally charge high interest rate which is often higher than the formal market rates. But the irony is that instead of serving as a discouragement to clients in the informal credit market rather the market is flexible enough to accommodate the credit needs of every group. This is normally seen from the unusually high patronage observed in the market.

**2.3.5 Localization of the market** Memberships of informal financial associations are normally restricted to people in a particular place. The admission is unconditional; the member must have a good financial stand in addition to impressive moral record in order to qualify him to be a member. There are no entry/exit barriers and trading usually takes place among kinsmen and people in the same locality.

Small scale and little or no record keeping According to Aryeetey (1997) and Soyabo (1994) operations are done on small scale, while there is little or no record-keeping, the security of information on the size and nature of the informal market hampered further innovation of such markets

## **2.4 Participants involved in informal financial institutions**

As was outlined by Otu et al (2004) the informal network of financial markets participants include money lenders, rotating saving and credit associations, mobile saving collectors, mutual assistance groups, landlords, neighbours, friends and who are active in financial intermediation through saving mobilization and credit creation among low income earners.

## **2.5 Types of Informal Financial Institution**

As was documented by Otu et al (2004) the most common forms of informal credit market involved in transfer of funds in Nigeria are the Esusu, Bam and Adashi. In the southern part of Nigeria most informal financial institutions are designed to suit the peculiarities of their communities, e.g. it is regarded as Isusu in the

southeast, while the Yoruba call it Ayo, the Ibibio call it efe, while the kalabari ijaws call it Oku. In the north central they are regarded as Adashi, Adashe, Dashe and Bam

2.5.1 Esusu/Isusu/Adashi As explained by Otu et al (2004) is a saving scheme whereby members make contribution that attracts zero interest. Esusu is a saving scheme among most rural communities in Nigeria. The determinant factor for the emergence of this saving scheme is shared or common interest while Adashi is a rotating saving scheme whereby members make periodic contribution which can be weekly, fortnightly or monthly depending on collective agreement. Every member is entitled to all contribution in turns.

2.5.2 Bam According to Otu et al (2004) it is a saving scheme mostly found in the north central part of Nigeria. All members contribute to a common pool of fund, which is loaned to interested members of the public at an attractive interest rate. The accrued interest is paid up-front. The loanable funds are given out and secured by a security. 2.5.3 Default attracts a penalty. The benefits of multi-membership are that the accrued interest from loans granted by the bam is shared at the close of every season to members according to contribution.

2.5.4 Daily/periodic contribution This is a saving scheme common among traders and artisans in which an agreed amount of money is paid daily to itinerant bakers. All contribution or saving are recorded against any member, which are paid back to the contributors at the end of an agreed period, usually a month.

2.5.5 Money lenders Money lenders are direct offshoot of post-barter and pre-colonial money economy. The practice is therefore as old as the origin of money. It is a typical economic model that illustrates how surplus spending-units led their surplus to deficit-spending units for investment. Since a money lender operates a monopolist market, he is at liberty to charge frivolous interest rates that are most often very high and not related to the economy-wide interest rates. Though, replenish his money stock from formal financial market, he charges interest plus profit margin to offset the cost of the fund.

2.5.6 Co-operative and Thrift Societies They are associations of persons, employees usually of limited means, who voluntarily come together on basis of equality and equity for the enhancement of member's corporate and individual welfare. Members normally borrow from the association and repay at convenient period of time at reduced interest rate. Members are entitled to borrow above 100 percent of their deposits and repay the loan in more than one year. Default risk is minimized through deduction at source i.e. salary of all repayment due to co-operative. The society derives substantial income through the investment of surplus contribution in formal financial institutions.

2.5.7 Saving and credits associations it is a more formalized saving scheme that benefits its members, they are mainly organized by traders or persons in the same trade or even by people whose profession cut across. Their saving is periodic but depends on the ability of its members. While benefits may be in kind or financial. e.g. sometimes members are given bonus share or loans to expand their trade or business. On default of the loan, the properties of the beneficiary are foreclosed to offset the outstanding balance.

### **III. Methodology of the Study**

The study adopted a descriptive approach to analyze the difference between accessing credit from formal financial institutions and informal financial institutions.

### **IV. Results**

According to Enhancing Financial Innovation and Access (2010) the survey carried showed that those Nigeria banking populations that have access to formal financial institution is 36.3 percent. It then follows that 63.7 percent patronize the informal sector

### **V. Discussion of finding**

Table I This indicates the strength, weakness, and prospects of the informal financial institutions. The informal financial institutions have a flexible structural credit lending method while formal financial institutions have a rigid structural credit lending method. The informal financial institutions are not integrated into the macroeconomic system thereby causing distortions in the system. While the formal financial institutions are not free from global economic shocks. The informal financial institutions have wider outreach to low income earners in Nigeria compared to formal financial institution that focuses on high net worth clients. Informal financial institutions adopt micro financing while formal financial institutions adopt wholesale lending. The

formal financial institution adopts collateral based lending while informal financial institution adopts deposit based lending.

**VI. Table I**

Summary of Analysis of Formal Financial institutions and Informal Financial Institutions.

CRITERIA OF ANALYSIS	INFORMAL FINANCIAL INSTITUTION	FORMAL FINANCIAL INSTITUTION
Structure of credit lending	The informal financial institution have a flexible structure of credit lending	The informal financial institution have a rigid structure of credit lending
Cost of fund	There are issue of high interest rates which is fixed and unconventional charges.	There are issue of high interest rates which is floating and profession charges.
Default risk	There is minimal default risk.	There is high default risk.
Financial system	They are outside the purview of the CBN legal system	They are part of the Nigeria financial system.
Loan processing	The loan processing is very fast.	The loan processing is very slow.
Collateral	They use guarantors who are member and deposit of member as security for the loan.	They use personal property as a security for the loan.
Methodology of lending	They adopt relationship based lending method.	They adopt collateral or credit analyst based lending method.
Record keeping	There is no proper record keeping.	There is proper documentation of transaction.
Fractional or reserve banking system	They keep part of their contribution to meet up future demand for money.	They keep part of their deposit to meet up future demand for money.
Entrance into the market	There is free entry/exit barriers	There are entry/exit barriers.
Global financial shock	They are not exposed to global financial shock because they are integrated into the macroeconomic system.	They are exposed to global financial shock because they are integrated into macroeconomic system.
Outreach	Therefore, they serve the underserved which constitute 63.7percent of Nigeria banking population.	According to Enhancing financial innovation and access (2010) the banking population that has access to formal financial institution is 36.3 percent of Nigeria.
Volume of transaction	They deal with micro level of transaction.	They deal with large volume of transaction.
Liquidity risk	Informal financial institutions operate a flexible credit lending which does not create room for liquidity risk.	Informal financial institutions operate a rigid credit lending which give rise to liquidity risk.
Inflationary risk	Informal financial institutions interest rate are not subject to inflation risk	While formal financial institutions interest rate are subjected to inflationary risk.
Management team and Staff	Their management and staff are properly trained.	Their management team and staff are properly trained.

Source: Authors modification; Otu et al (2004),Masha et al(2004)and Otu et al(2003)

**VII. Conclusion**

The informal financial institution helps the entrepreneurs to cultivate some element of financial discipline in business by imbibing saving culture. The flexible credit lending helps entrepreneurs to avert any liquidity risk which minimizes default in payment of the loan collected. They entrepreneurs are favorable disposed in accessing credit from the informal sector

### **VIII. Recommendation**

1. The informal financial institutions should be integrated into Nigeria financial system.
2. There should be a linkage programme with informal financial institution and formal financial institutions to extend their outreach and depth.
3. The government should promulgate a law to guide the activities of the informal financial institutions.

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