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Pattern of Informal Financial Institutions' Patronage by Rural Farmers in Kwara State, Nigeria

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Abstract

The rural farmers who constitute a large percentage of food producers in Nigeria have problem of access to financial resources from the formal financial institutions because of the institutions' stringent conditions and location. In effect, most of the rural farmers have to rely mainly on the informal financial institutions for funding. The objective of this study was to indentify the nature and extent of patronage of informal agricultural financing institutions in the rural economy of Kwara State, Nigeria. The source of data for this study was mainly primary that was collected using structured questionnaire from sampled farmers who were participating in three informal financing schemes namely: (i) periodic savings; (ii) money lending; and (iii) rotating savings in the sampled nine Local Government Areas spread through the three senatorial districts of Kwara State, Nigeria. Employing a multi-stage random sampling method, a total of 1,350 farmers were selected for the study. The returned 1,249 copies of questionnaire were then processed using descriptive statistics. The findings indicated that the farmers patronized and used the three sources of finance with periodic savings (595) and rotating savings (421) being the widely patronized. The least patronized was money lender by 60 respondents. Based on the results, the study recommended that the rotating loans should serve as an impetus to agricultural financing among the farmers in the rural areas with the improvement on the other informal financing sources, the periodic savings with a view to increasing the membership drive of all the informal institutions.

Key Words: Informal Financing, Financial Institutions, Rural Famers

1. Introduction: Overview of the Informal Financial Market

Discussing the theory of the origin of the informal financial market, Adeusi and Familoni (2004) and Iganiga and Asemota (2005) stated that the origin of the market is based on two schools of thought, namely, the Financial Repression and the Structural Schools. According to Adeusi and Familoni (2004) and Iganiga and Asemota (2005),

- (i) The Financial Repression School originated from the work of Mc Kinnon and Shaw (1973) who put forward the theory that the informal financial market originated as a result of the excessive regulation of the formal financial sector which led to credit rationing by banks and other financial institutions and their administrative sluggishness, payment delays and high management costs, thus preventing the small businesses from enjoying bank facilities "as cited in Adeusi Familoni, (2004)". All these, according to them promote the development of the informal finance.
- (ii) On the other hand, Adeusi and Familoni (2004) and Iganiga and Asemota (2005) stated that the Structural School views the existence of informal finance as products of other forces other than economic forces. They explained further that, "the view of this School of Thought is that the unorganised financial systems are subordinated to the formal financial system". Also that financial segmentation occurs not because of regulation but that informal financial systems develop to serve social goals than simply to make huge profits. "The informal systems redistribute income among community members and provide a form of social security by meeting members' liquidity needs" (Iganiga and Asemota; 2005).

In the developing countries where the financial market is very much divided into two sectors, the formal and informal sectors, vast majority of financial transactions occur outside the boundaries of the regulated banking sector, (Aryeetey and Udry, 1995, Mehrteab, 2005). In Nigeria, for example, it is estimated that as at 2004, there were more than N400 billion outside of the banking system due to large informal economy among other reasons (Soludo, 2004).

Sanmugam (1989) stated that, the informal financial institutions play an indispensable role in rural economies of less developed countries (LDCs) because it is the only source of financial services for the poor, the landless and those living in isolated regions (Meyer and Nagarajan, 1991). Koning (1997) however stated that the extent to which informal financial sector affects the general operation of an economy as well as the strength of the various aspects of its operation varies across countries. According to Ojo (2005), the modes of operations of certain informal financial sector activities differ from place to place depending on the prevailing market situation and customer's demands and accessibility. Christensen (1993) reported that the informal financial sector increased in importance in proportion to the level of underdevelopment. Koning (1997) went further to report that for example in Malawi, the informal financial sector was estimated at three times as big as the formal sector. In Ghana, the informal credit seemed to be four to five times more important than the formal credit. In Cameroon, approximately 75% of rural financial assets and obligations stood on the account of the informal sector's "tontines". In Malawi and Zimbabwe respectively, 43% and 87% of farmers' credit needs were met by informal arrangement" (Adera, 1995).

The above statements underscore the relevance of the informal financial institutions in the economy of developing countries of the world. The main objective of this study therefore is to discuss the various institutions, schemes and practices of informal savings and credit associations in the rural economy of Kwara State, Nigeria.

2. Literature Review

Meyer and Nagarajan (1991) stated that there is no standard definition for informal finance. According to Von Pischke (1996), informal finance can be described as borrowing among individuals and firms that are not registered with the government as financial intermediaries and are not subject to government supervision.

Informal finance has been described as those financial transactions that take place beyond the functional scope of various countries' banking and other financial sector regulations (Aryeetey and Udry 1995). This definition of informal finance embraces such schemes as the operations of the savings and credit associations, professional moneylenders, part-time moneylenders such as estate owners, traders, employers, relations and friends. Others include the mobile bankers known as "susu" or "esusu" collectors. These schemes exist in both urban and rural settings. Other schemes include Rotating Savings and Credit Associations (ROSCAs) which normally operate among salaried employees such as civil/public servants as well as market women.

Mehrteab (2005) also defined the informal financial sector as individuals such as moneylenders, relatives, friends, neighbours, landlords, traders, pawnbrokers, and group of individuals (ROSCAs, mutual aid associations, savings clubs) and deals with the traditional rural subsistence-oriented branch of the economy. Fadiga and Fadiga-Stewart (2004) in their own view defined the informal financial market as consisting of all sources of credit that are not regulated and they operate independently of governmental controls. Okurut and Thuto (2007) saw an informal financial sector as that which encompasses all financial transactions that take place outside the supervisory regulation of Central Bank and are subject to self regulation. Molnar and Tanaka (2007) viewed informal finance as a sector of the economy which is not regulated by the financial regulatory agency. The fact that it is not regulated, it is not necessarily illegal. In the view of Chandavarkar (1985), the informal financial market is that non-institutional financial market that covers all financial activities outside the ambit of the institutional finance, (see also Oloyede 2005).

From the various definitions of the informal financial market as given by the various authors cited above, one common feature of the market is the non-regulation of the market by the Regulatory Authorities of the financial markets of the countries. This unique feature has thus brought the Savings, Credit and Cooperative Societies outside the purview of this study as they are classified as semi-formal financial markets because of their legal registration under the commercial laws of countries.

Aryeetey and Udry (1995) discussed the type, nature and characteristics of informal financial units in Africa. Accordingly, there are generally three types of informal units. These according to them include: (i) savings mobilization units that do little or no lending; (ii) lending units that seldom engage in savings mobilization; and (iii) units that combine deposit mobilization with some amount of lending, albeit to members of distinct associations or groups mainly. They went on to describe the first units which are available in virtually all countries of West Africa as savings collectors which are known as "susu" or "esusu" collectors in Nigeria. They do not engage in lending and the "susu" or "esusu" member merely collects what he or she has saved at the end of an agreed period. The second category of informal financial units include moneylenders which include relations and friends who seldom engage in savings mobilization but engage purely in lending money while the third units of the informal market include savings and credit associations, credit unions/credit cooperatives that take deposits and also lend in various forms.

Citing informal financial units that are found in Ghana as an example, Aryeetey and Udry (1995) stated that the units include moneylenders, Savings and Credit Associations (SCA) or "susu" groups, Savings and Credit Cooperatives (SCC), "susu" collectors, mutual association groups, landlords, neighbours, friends, family members, etc. They are collectively important lenders but units like landlords, neighbours, friends and relations; seldom lend large amounts on an individual basis. It is however interesting to know that most surveys of enterprise's finance in Africa obtained their start-up funds through these sources. Moneylenders on the other hand are known to be significant commercial lenders; such lendings often come from surplus proceeds earned from farming or trading. Other informal forms are groups or associations that take deposits from members and lend the funds to other members of the group. These funds often assist members to smoothen their consumption over a period of time while others use such funds to purchase household items like refrigerators, gas cookers, which ordinarily they could not afford within the short-run from their own sources (Aryeetey and Udry 1995).

Another type of informal financial markets that are normally found in Senegal are the Rotating Savings and Credit Associations (ROSCAs) or "Tontines" (Aryeetey and Udry 1995). These types of units are commonly operated among salary employees, that is, people with regular incomes such as teachers, doctors and other public employees as well as market women. As a result of the type of people patronising these types of informal markets, they are common in towns than in villages. The funds saved through these means are usually used for investment purposes as well as for consumption and sometimes funds are used to purchase other assets like jewellery and commodity inventories.

Mauri (1987) and Aredo (1993) opined that the most important types of informal markets that are observed in Ethiopia are the Mutual Assistance Associations called "Iddir" and the ROSCA-types called "Iqqub". These associations come together primarily to encourage wide range of mutual assistance to members which at the end result into provision of financial assistance to members. The members come together to support each other in times of personal or household crises. On the reasons for the variation in the types of informal financial units that are found in various parts of Africa, they discovered that each unit of the informal market is purpose-oriented and the formation is dependent on the socio-economic goals of communities with the institutions developed to meet the demand for specific financial services. The financial markets thus respond to the demand of the type of clients defined by the members using geographical or socio-economic criteria to determine the financial services. As long as there exists significant variation in the goals of social groups and communities within countries, so also will different units emerge.

The characteristic of these various informal financial units as observed is that although each unit may differ in name or size, each unit operates within the common principle of its type of market and the fundamental practices in the administration of credit tend to be quite similar. As goals change overtime, the units are forced to change their mode of operation and this leads to formation of a "new institution" (Aryeetey 1994).

Another unique characteristic of the informal financial markets in Africa as confirmed by various studies is that the markets thrive under both harsh and liberal financial sector policies so long as the level of economic activity within the economy calls for increasing financial services from groups that cannot be reached by the existing formal financial institutions (Aryeetey, 1994; Bagachwa, 1995; Chipeta and Mkandawire, 1994; and Soyibo, 1994). It was observed that whenever there is a demand for a short-term credit particularly among traders, farmers, and consumers, an informal unit is likely to emerge to meet the demand (Aryeetey and Udry 1995). For example, studies by Soyibo (1994) and Aryeetey (1994) have shown that "susu/esusu" collectors in

both Ghana and Nigeria have grown steadily over many years both in terms of the number of depositors involved and also in sizes of deposits. In Accra, it was discovered that the mean number of deposits in a month per collector rose from 155 in 1990 to 221 in 1991 and 290 in 1992, a total increase of 48% over the period (Aryeetey 1994). Soyibo (1994) also reported that in Nigeria, the average number of clients per "esusu" collector rose from an average of 250 in 1991 to 438 in 1993, an increase of 75%. Also, various studies have shown that at the period when various countries have tried to liberalise their financial sectors, credit flow from informal sector continues to grow (Aryeetey and Udry 1995). In Malawi, for example, it was observed by Chipeta and Mkandawire (1994) that the mean number of people receiving loans from a moneylender rose from 44 in 1990 to 70 in 1992. Similarly in both Ghana and Nigeria, steady growth in the flow of loan applications to informal lenders was observed, (Aryeetey 1994; Soyibo 1994).

A characteristic of the informal financial market which was reported by Falegan (1987) is the failure of the informal market to effectively invest its idle funds as being done in the formal market. This is considered not good for the economy.

Having discussed the types of informal financial units and their major characteristics, Aryeetey and Udry (1995) went further to highlight the lending culture in the informal financial sector in Africa. This includes the following.

A major characteristic of informal lending as observed is that while individual lender in the informal market may grant different credit packages to different borrowers, the differences in loan characteristics were found to represent different lender types and the placement of different borrowers into distinct categories, that is, while there are different types of lenders, so also are the borrowers categorised.

On the interest rates structure in the informal markets, it was observed that informal lenders generally charge outrageously high rates in contrasts with the formal lenders, (Aryeetey and Udry 1995). It was also generally observed that informal lenders grant loans of short maturities ranging between 1-12 months but loans of 3-6 months maturity dominate the market. Furthermore, rural interest rates were usually not much different from urban rates. Aryeetey and Udry (1995) stated further that there was no evidence to support the fact the informal lenders attached different risks to different borrower categories as they would have applied differential interest rates.

On the issue of collateral against lending in the informal market, they observed that moneylenders and credit unions would need security against loans among the community or group based institutions and similarly for savings collectors, security is needed only when they lend to the non-deposit clients. Adeusi and Familoni (2004) reported that the informal lenders do not generally require collateral security but rely mainly on guarantee as security.

They further reported that loans from moneylenders are generally found to be more expensive than other sources of loan in the informal financial market but the moneylenders are found to be the only credit source open to the general public. This finding, according to them, is because other sources such as savings collectors, savings and credit cooperatives (SCC), and savings and credit associations (SCA) require borrowers to satisfy the obligation of being members of a group. Also, the reason for the high interest on loans from moneylenders according to them compared with other sources is due to the fact that they do not have sanctioning authority that is inherent in other informal arrangements that involve membership of a group and as such the higher interest rate represents a risk premium for the lender. It was also reported that another unique characteristic of moneylenders apart from ROSCAs is that it is the only source from which borrowers are assured of high probability of having their loan requests met and this makes it more acceptable to borrowers than other sources especially from those requiring loans to meet social and economic needs. They are more often not attractive for those seeking working capital and fixed investment loans (Aryeetey 1994).

The savings collectors on the other hand, according to Aryeetey and Udry (1995), serve that segment of the informal financial market dominated by low income earners who are interested in very short-term and regular working capital with low interest rate, which is a characteristic of this market segment.

As a unit of the market, it was reported that the savings and credit cooperatives (SCC) and savings and credit associations (SCA) offer larger loans/amounts at comparative rates than savings collectors but only limited number of borrowers have access to these loans at any time because of the condition of membership. They went further to state that membership is crucial for screening loan applications and for ensuring that contracts

can be enforced. They stated further that there are also restrictions on group size to ensure effective management which constrains the number of people that may have access to loans from the group and also loan sizes. The loans in this segment of the market according to them are not regular and they are commonly used to purchase a relatively expensive consumption item.

Discussing loan screening practices in the informal financial market, Aryeetey and Udry (1995) stated that a distinguishing feature of informal finance in Africa is that informal lenders attach more importance to loan screening- the selection of applicants – than to monitoring the loan as it is used. They stated further that in community or group-based arrangement, the screening practices are based on groups' observation of individuals' habits and groups' obligations towards applicants and whether a person can be trusted to regularly meet his obligations to the group. Informal financial markets lenders do not therefore screen loans but they actually screen membership. The major criterion in the selection of loan beneficiary is the individual's character and how reliable he/she is.

As regards individual lenders, it was reported that they generally rely on recommendation from old clients. Thus studies have shown that there is little evidence of any attempt by the informal lenders to monitor the use of loans by their lenders as it is the practice in the formal market.

On loan repayment rate in the informal financial market, Aryeetey and Udry (1995) reported that informal lenders achieve high repayment rates in contrast with banks. They stated further that for example, 77% of the sample of different informal lenders studied by Aryeetey (1994) in Ghana had no delinquent borrowers in 1990 and 70% had none in 1991. The same observation according to them was made in Malawi and Tanzania. The figures obtained suggest low default rates.

This study was an attempt to document the nature and the extent of patronage of informal financial institutions in the rural economy of Kwara State, Nigeria.

3. Methodology

3.1 Data Source

A survey aimed at gathering primary data on the Socio-economic and Demographic / Characteristics of the respondents, the nature and the extent patronage of Informal Financial Institutions in the rural areas of Kwara State, Nigeria was conducted through the distribution of copies of structured questionnaire on sampled farmers who were participating in the three identified informal financial schemes in nine Local Government Areas covering the three Senatorial Districts of the State. Multi-stage random sampling method was used for selecting the respondents, by selecting 50% of the Local Government Areas in each of the senatorial districts, three (3) rural areas from each Local Government and fifty (50) farmers from each of the rural areas. A total of 1,350 farmers were selected for the study but only 1,249 farmers or 92% of the farmers satisfactorily completed the copies of the questionnaire which formed the basis for the analysis.

The questionnaire was backed with oral interviews to elicit more information from the rural farmers

3.2 Data Analysis

The analysis was based on descriptive statistics. The descriptive statistics were employed to summarise the nature and the extent of patronage of informal financial institutions in the study area. This involved the use of cross tabulations and percentages. The nature in this case is the type of informal financial institution while their extent of patronage is the number of participant in each type of informal financial institution. Informal financial institution's nature could be categorized into (i) savings mobilization units, that is, periodic savings- "ajo", (ii) lending units (moneylenders) and (iii) deposit mobilization units with some amount of lending to members only that is, rotating savings, "esusu group" (Aryeetey and Udry 1995)

4. Results and Discussions

Table 4.1: Socio-Demographic Characteristics of the Respondents in the Rural Areas of Kwara State, Nigeria

S/No.	Variables	Frequency	Percentage (%)
1	Age of the Respondents		
	< 20	68	5.44
	21 – 30	331	26.50
	31 – 40	430	34.43
	41 – 50	336	26.90
	51 – 60	79	6.33
	> 60	05	0.40
2	Educational Status of Respondents		
	Informal	487	39
	Primary	400	32
	Secondary	300	24
	Tertiary	62	5
3	Marital Status of Respondents		
	Single	328	26.26
	Married	871	69.74
	Widow/Widower	44	3.52
	Others	6	0.48
4	House Hold Size of the Respondents		
	1 – 3	346	27.70
	4 – 6	680	54.45
	7 – 10	186	14.89
	> 10	37	2.96
5	Gender of Respondents		
	Male	573	45.88
	Female	676	54.12

Source: Author's Computation, 2010

4.1 Socio-Demographic Characteristics of the Respondents

The age, educational status, marital status, household size and the gender of farmers are given in the table 4.1 above. Majority of the farmers (34.43%) fell within 31 to 40 years of age cohort. Quite negligible proportion of the respondents was younger than 21 years (5.41%). Those above 60 years were equally negligible (0.4%). The result implies that the farmers were in their active productive years. This is expected to impact positively on their productivity. Given sufficient financial mobilization for the farmers, it is expected that their age would not have negative influence on productivity.

The educational status of the respondents as shown in table 4.1 indicates that majority of the farmers had primary (32%) and secondary (24%) education while only 5% had tertiary education. 39% had no formal education. This pattern of distribution is expected because the study area is a rural setting.

The distribution of the respondents by marital status shows that most of the farmers (69.74%) were married. This is typical of Nigeria rural setting because family members often serve as a source of additional labour on the one hand, and the cultural value attached to marriage on the other. Next to this category of those married were those that were single (26.26%).

The distribution of the respondents by household size shows that more than half of the respondents (54.45%) had between four to six household members. Household in the context of this study refers to total number of people eating from the same pot.

The gender distribution of the respondents shows that female farmers (54.12%) were greater in number than male farmers (45.88%) in the study area. It has been discovered that 60% of labour force in agriculture in Nigeria are women (Ajetomobi, Olamide and Ayanwale 2003).

Table 4.2: Membership by Type of Informal Financial Institutions in the Rural Areas of Kwara State

Type	Kwara Central		Kwara North		Kwara South		Kwara State	
	Freq.	%	Freq.	%	Freq.	%	Freq.	%
Ajo	74 ASA 37 Il South	12.44 6.22	65 Baru 86 Edu 49Kai	10.92 14.45 8.24	67 Ek 59 Ire 78 Isin 80 Offa	11.26 9.92 13.10 13.45	595	47.64
Money Lender	1 Asa 6 Il South	1.7 1	5 Baru 7 Edu 11 Kai	8.3 11.7 18.3	11 Ek 8 Ire 10 Isin 1 Offa	18.3 13.3 16.7 1.7	60	4.80
Esusu	49Asa 57 Il South	11.64 13.54	46Baru 33 Edu 61 Kai	10.93 7.84 14.49	45 Ekiti 47 Ire 53 Isin 30 Offa	10.69 11.16 12.59 7.12	421	33.71
Ajo & Money lender	1 Asa 6 Il South	3.1 18.8	6 Baru 4 Edu 6 Kai	18.8 12.5 18.8	3 Ekiti 3 Ire 1 Isin 2 Offa	9.4 9.4 3.1 6.3	32	2.56
Money Lender & Esusu	1 Asa 1 Il South	4.35 4.35	5 Baru 3 Edu 7 Kai	21.74 13.04 30.43	2 Ekiti 3 Ire 1 Isin 0 Offa	8.70 13.04 4.35 0%	23	1.84
Ajo & Esusu	9 Asa 33 Il South	8.1 3	10 Baru 13 Edu 15 Kai	9 11.7 13.5	7 Ekiti 16 Ire 1 Isin 7 Offa	6.3 14.4 0.9 6.3	111	8.89
Ajo, Esusu & Money lender	1 Asa 2 Il south	14.3 8.6	2Baru 1 Edu 1 Kai	8.6 4.3 4.3	0 Ekiti 0 Ire 0 Isin 0 Offa	0 0 0 0	7	0.56

Source: Author's Computation, 2010

Key: Asa=Asa LG, Baru=Baruten LG, Edu=Edu LG, Ekiti=Ekiti LG, Il South=Ilorin South LG, Ire=Ireponun LG, Isin=Isin LG, Kai=Kaiaama LG, Offa=Offa LG.

4.2 Nature and Extent of Informal Financial Institutions in the Rural Areas of Kwara State

Table 4.2 above indicates membership structure and types of informal agricultural financing institutions across the three zones in Kwara State. 595 (47.64%) of the respondents used periodic savings "ajo". Of the 595 who indicated that they used only "ajo" source, 18.86%, 33.61% and 47.73% were from Kwara Central, Kwara North and Kwara South senatorial districts respectively. Apart from "ajo", two other informal sources of agricultural finance being patronized in the study area were rotating savings "esusu" by 421 (33.71 %) and moneylending by 60 (4.80%). The least patronised out of the three financing schemes being money lending. The respondents also patronised a combinations of the financing schemes. These are "ajo" and moneylender by 32 (2.56%), moneylender and "esusu" by 23 (1.84%), "ajo" and "esusu" by 111 (8.89%) and "ajo", "esusu" and moneylender by just 7(0.56%) respondents.

5. Conclusion and Recommendations

This study examined the nature and types of informal agricultural financing in the rural economy of Kwara State, Nigeria. Three units of the informal financial institution, namely, periodic contribution, moneylender, and rotating savings were the focus of the study. The study covered the rural areas of the three Senatorial Districts in nine Local Governments Area of the State. A total of 1,350 copies of questionnaire were

administered on randomly selected farmers who were participating in the three informal financial schemes. Only 1,249 of the copies of the questionnaire were returned which formed the basis for the analysis. The analysis was based on descriptive statistics.

The findings indicated that the rural farmers patronized and used the three sources of finance with the periodic savings "ajo" by 595 respondents and rotating savings "esusu" by 421 respondents being the most widely patronized in the study area. The least patronized was money lender by 60 respondents. Oral interview revealed that poor infrastructure in the rural area contributed to the low patronage of the institutions.

Based on the findings of this study, it was recommended that membership drive be further intensified. This will lead to higher participation and increased mobilization of funds. Government at all levels should improve infrastructure in the rural areas to boost economic activities as more money in the hands of the rural farmers will improve their propensity to save and enhance the informal financial institutions' performance in further financing of agriculture in the study area. In this way, the activities of informal agricultural financing will be further enhanced.

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