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   INTRODUCTION

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   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

   ACKNOWLEDGMENTS

   REFERENCES

   APPENDIX/ANNEXURE

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- Bowersox, Donald J., Closs, David J., (1996), "Logistical Management." Tata McGraw, Hill, New Delhi.
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# THE RELATIONSHIP BETWEEN THE INFORMAL AND FORMAL FINANCIAL SECTOR IN NIGERIA: A CASE STUDY OF SELECTED GROUPS IN LAGOS METROPOLIS

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**ABSTRACT**

*This paper investigates the links between the informal and the formal financial sectors in Nigeria. The objectives are two folds. The first is to ascertain the deposit and credit links between the informal and the formal financial sectors of the economy. The second objective is to determine the strength and significance of such links between informal and formal financial institutions with respect to saving mobilization and the process of credit dispersion in the informal sector. To realize these twin objectives, the study focused on moneylenders and savings & credit associations in the informal and semi-formal financial sectors in Nigeria. The study employed primary data, which is obtained through random sampling of the various association and groups in the informal financial sector of the economy such as moneylenders, rotational savings and credit associations, traditional mutual aid groups, credit & thrift societies and semiformal savings organizations within Lagos metropolis. The data was analyzed using descriptive and analytical techniques. We find that there is a strong link between the formal and the informal financial sector on the savings side but there is a weak link between the formal and the informal financial sectors on the credit side in Nigeria. We recommend government should put policy measure in place that will ensure their access to more capital as this will assist to facilitate rapid industrialization of the nation. And banks should remove the stringent conditions and excessive documentation that discourage operators in the informal sector to seek for loans in the bank.*

## KEYWORDS
Informal sector, Moneylenders, microfinance, ROSCA.

## INTRODUCTION
It is an accepted fact that the Nigerian informal financial sector contributes immensely to financial intermediation considering its critical role in provision of funds to the small and micro enterprise in Nigeria. Though the extent of its contribution to the economy has remained largely unquantifiable because of the problem of measuring their performances but there is no doubt that they contribute to the GDP of the Nation. In Nigeria and in many developing countries around the world a lot of economic activities take place outside the purview of government regulations. These activities are in most times not recorded or mis-recorded or even deliberately omitted by the regulatory authorities. The total membership of Informal Financial Institutions in Nigeria is estimated at about 20 million, of an eligible adult population of approximately 50 million. In peasant societies, such as exist in rural Nigeria, between 30-90% of craftsmen and market-women and between 20% and 50% of industrial workers in urban centres still use informal financial markets. (Letvisky, 2000)

The 1973 report of International Labour Organization (ILO) employment mission to Kenya was the first to recognize the significant role of the informal sector in the development of the economy of developing Nations. Prior to this time, little or no account had been taken of the informal sector. The sector accounts for over 50% of operations in most developing countries, they operate in form of micro enterprises, such as artisans, cottage industries, household businesses and self-employed persons.

The informal sector in Nigeria refers to economic activities in all sectors of the economy that are operated outside the purview of government regulation. This sector may be invisible, irregular, parallel, non-structured, backyard, under-ground, subterranean, unobserved or residual. Informal economic activities in Nigeria encompass a wide range of small-scale, largely self-employment activities. Such financial and economic endeavours of subsistence nature include retail trading, local transport, restaurant management, repair services, financial intermediation and household or other personal services (Adamu, 1996). Activities in the informal sector in Nigeria are difficult to measure; they are highly dynamic and contribute substantially to the general growth of the economy and personal or household income (cited in Ekpo and Umoh 2003).

The unwillingness of the formal financial sector to provide financial services to the urban and rural poor, coupled with the unsustainability of government sponsored development financial schemes contributed to the growth of informal financial sector in Nigeria. Informal financial institutions in Nigeria pre-dates modern banking era. They exist in form of traditional groups that work together for the mutual benefits of their members. These groups provide savings and credit services to their members, operating under different names in different part of the country. It is known as 'esusu' among the Yorubas of Western Nigeria, 'etoto' for the Igbos in the East and 'adashi' in the North for the Hausas (CBN, 2000). The key features of these informal schemes are in savings and credit intermediation. Their operations are usually informal and they charge higher interest rates compare to the formal banking sector.

The demand for financial services in Nigeria is high and increasing especially in the informal sector. The continuous lay-off of labour from both the public and private sectors since the introduction of the structural adjustment programme in 1986 and the growing number of school leaver without readily available employment is pushing a large proportion of the population into informal sector activities. Many micro enterprises are, therefore, springing up but without bank financial support. Also the domestic market is large, with over 140 million people in need of various goods and services, including financial services (Anyanwu, 2004).

It is a known fact in Nigeria that the formal financial system provides services to about 35 percent of the economically active population, while the remaining 65 percent are excluded from access to formal financial services (CBN, 2005). The nation is characterized by low banking population density of 1: 30,432 before the bank consolidation in 2005, Soludo (2007). The majority of the active population access financial services through informal arrangement which are usually very exploitative. The objective of this research is to establish the linkages between the formal and the informal financial sector in Nigeria and if there are linkages how strong is the relationship. The remaining part of the paper is divided into four parts. Part II deals with theories on informal financial market and literature review, Parts III – V deals with the research methodology, the analysis of result and the recommendation and conclusion respectively.

## LITERATURE REVIEW
### Theories on informal financial sector
The theoretical analysis of financial markets in developing countries has been transformed through the application of the theory of economic behavior under conditions of incomplete markets and imperfect information. A large number of theoretical papers have explored the implications of imperfect information and incomplete markets for contractual forms in credit markets in low-income rural settings. These theories is directly relevant to informal financial transactions in Africa but the extent to which these theories can provide insight into informal finance in Africa is not yet determined, however, the theories have the potential of illuminating the salient features of many informal financial markets in Africa( Arteerey, 1995).

The pioneering work of Stiglitz and Weiss (1981) marks the beginning of attempts in explaining credit rationing in credit markets. According to them, interest rates charged by a credit institution are seen as playing dual role of sorting potential borrowers (leading to adverse selection), and affecting the actions of borrowers (leading to the incentive effect). Both effects are seen as a result of the imperfect information inherent in credit markets. Adverse selection occurs because lenders would like to identify the borrowers most likely to repay their loans since the banks' expected returns depend on the probability of repayment. In an attempt to identify borrowers with high probability of repayment, banks are likely to use the interest rates that an individual is willing to pay as a screening device. However, borrowers willing to pay high interest rates may on average be worse risks; thus as the interest rate increases, the riskiness of those who borrow also increases, reducing the bank's profitability. The incentive effect occurs because as the interest rate and other terms of the contract change, the behaviour of borrowers is likely to change since it affects the returns on their projects.

Analyzing the rationale for interventions in rural credit markets in the presence of market failure, Besley (1994) commented that since credit markets are characterized by imperfect information and high costs of contract enforcement, an efficiency measure as exists in a perfectly competitive market will not be an accurate measure against which to define market failure. The problem that exists in imperfect market situation leads to credit rationing, adverse selection and moral hazard in the credit markets. Adverse selection arises because in the absence of perfect information about the borrower, an increase in interest rates encourages borrowers with the most risky projects, and hence least likely to repay, to borrow, while those with the least risky projects cease to borrow. Interest rates will thus play the allocative role of equating demand and supply for loanable funds, and will also affect the average quality of lenders' loan portfolios. Lenders will fix the interest rates at a lower level and ration access to credit. Imperfect information is therefore important in explaining the existence of credit rationing in rural credit markets. Moral hazard occurs basically because projects have identical mean returns but different degrees of risk, and lenders are unable to discern the borrowers' actions (Stiglitz and Weiss, 1981; Besley, 1994).

Besley (1994) state further major features of rural credit markets that can be used to explain the existence of formal and informal credit markets in Africa. Among these are the existence of collateral security and covariant risk. Collateral security is often beyond the reach of many borrowers in rural areas. But even where this is not the case, the ability of the lender to foreclose is often limited, making enforcement of loan repayment difficult. Such difficulties help to explain the use of informal financial markets, which use social sanctions to ensure enforcement. In rural areas, shocks in incomes that create borrowers' potential to default will affect the operation of credit markets. In most rural economies, borrowers are faced with risks arising from uncertainties about their incomes. By diversifying their loan portfolios, lenders can avert such risks. However, credit markets in rural areas are segmented, with lenders' loan portfolios being concentrated on borrowers facing common shocks to their incomes.

Another important factor of both formal and informal markets relates to penalties. In the absence of formal contract enforcement mechanisms, both formal and informal institutions rely on lending practices that emphasize loan screening rather than monitoring, which appears to suggest more concern with adverse selection than moral hazard. Differences emerge in the methods used by formal and informal institutions. Where formal lenders rely more on project screening, informal lenders rely more on the character and history of the borrower, particularly on personal knowledge of the borrower. Loan monitoring is rarely done by informal lenders due to the lenders' knowledge of borrowers, while in the formal market it is mainly due to lack of facilities. Transaction costs are generally lower in informal markets than in formal ones. One of the issues that emerge from this market structure is which financial institutions are accessible to the rural poor, and which factors determine their demand for credit from the different sources as determined by their participation decisions (Atieno, 2001).

Credit markets in Africa have mainly been characterized by the inability to satisfy the existing demand for credit in rural areas. Arteerey (1995) propose two theories to explain Africa informal financial market. The first is a credit transaction when information is incomplete. This is a situation where lenders do not have complete information with respect to the characteristics of potential borrowers. The second is a credit transaction when contracts are not perfectly enforced, that is, when there is no external contract enforcement agency (such as the legal system) which forces borrowers to repay their loans. He opined that credit markets in Africa are characterized by information asymmetry, agency problems and poor contract enforcement mechanisms. Africa financial markets are fragmented because different segments of the credit market serve clients with distinct characteristics. This is because lending units are unable to meet the needs of borrowers interested in certain types of credit. This result in credit gap that captures those borrowers who cannot get what they want from the informal market yet they cannot gain access to the formal sources. African economy is filled with enterprises that want to expand beyond the limits of self-finance but lack access to bank credit, yet the informal sector is unable to satisfy them.

Investigating factors that motivate the private sector to conduct financial transactions in the informal financial sectors Aryeetey and Gockel (1991), argued that the informal sector derives its dynamism from developments in the formal sector as well as from its own internal characteristics. The informal and formal sectors offer similar products that are not entirely homogeneous, implying that both sectors cater to the needs of easily identifiable groups of individuals and businesses, but at the same time serve sections of the total demand for financial services. However, participants from either sector may cross to the other depending on factors like institutional barriers, availability of credit facilities and the ease of physical access.

The foregoing literature review shows that financial markets in African countries are characterized by imperfect and costly information, risks, and market segmentation, resulting in credit rationing. This is one of the underlying factors in the coexistence of both formal and informal credit markets serving the needs of the different segments of the market. On the other hand, policy-based and structural-institutional explanations attempt to explain the coexistence of both segments of the market as a result of policy and structural-institutional rigidities. This review provides a theoretical and conceptual background for the existence of formal and informal financial markets coexistence in Africa financial market.

Also, imperfect information emerges as an important explanation for credit rationing. This is because, due to information asymmetry, loan terms and conditions are used affect the behaviour of borrowers. The literature shows that formal interest rate is not the reason why borrowers do not use formal credit market. Rather, the unique characteristics of credit services explain segmentation in the credit market. Lack of effective contract enforcement and the consequent default risk are important in loan rationing. With the literature review, there is no doubt that the African financial market is fragmented but the major question is if there are linkages between the segments of the market. An empirical investigation will help to explain the strength and the significance of the relationship that exists between the formal and informal financial market in Africa.

## LINKAGES BETWEEN THE FORMAL AND INFORMAL FINANCIAL SECTOR

The linkages between the formal and the informal financial sector could be described as being complimentary and not competitive where they exist (Ojo 1996). Most writers believe that positive relationship exit between the formal and the informal financial sectors. Knowledge of the level of interaction between the two sectors will provide useful guide to understanding the efficacy of development policies for improving the performances of both sectors. Without such information, it is quite possible that a policy targeted at improving the performance of the formal financial sector may lead to surprising and disappointing development. The omission of the activities of the informal financial sector in the official statistics calls for serious concern because the level of economic development in most developing nation depends on the size of its informal sector. In many developing countries especially in Africa the informal sector is larger than the formal sector that generates the data that formed the basis of macroeconomic policies. Economic policy relies on data compiled from the activities of the formal sector may not be appropriate and may, in fact, be unfavourable to the larger informal sector. (see Ajakaye and Akerele, 1996 and Oresotu, 1996)

Oresotu (1996) concluded that there is a strong link between macroeconomic policy environment and the informal sector. The link is provided by the activities of the informal financial agents that rely on loans taken from the formal financial intermediaries to relend to borrowers in the informal financial market. The informal financial agents render valuable financial services by financing production activities through the extension of loans to micro enterprise and peasant farmers who ordinarily are not considered in the scheme by formal sector because of their inability to provide suitable collateral.

Soyibo (1996) opine that the informal sector indicates the failure of the modern market economy to provide jobs and livelihoods for large sections of the population. It consist of the individuals and groups left out of the development of the modern economy, in an effort to survive, develop entrepreneurial initiatives in traditional forms but on a small scale and it keeps expanding on a daily basis as people loss their job in the formal sector. Growth of the formal sector had been sluggish in many developing economy while the government have to cope with a dual economy in order to foster economy development. The formal financial system in most developing countries is inadequate to meet the total needs of all and sundry in their pursuit of economic activities. As a result economic development is hampered, the bulk of the rural population and the urban poor, in particular, and sometimes the lower middle class have no access to banks or other official credit institutions so they resort to getting their financial needs met in the informal sector.

In a study carried out by the World Bank on four African countries in 1997, it was discovered that

*A financial gap remains for small businesses, which generally need larger loans at lower rates than informal agents can provide but lack the track record and collateral necessary to access bank loans. However, some new financial institutions are beginning to emerge with the potential to respond to excess demand for credit that is being satisfied by neither formal nor informal sectors. In Ghana and Nigeria, in particular, there has been a steady emergence of formal non-bank financial intermediaries-discount houses, leasing companies, finance companies. It is important both to include informal institutions in financial development strategies and to link them more closely with the formal financial system in order to both increase savings mobilization and make more funds available to high-return investments in informal activities.*

Many of the informal financial intermediaries that operate as self-help organizations tried to establish linkages with the formal institutions in their local settings so as to help small entrepreneur to have access to bank loan. The banks may not be big commercial banks but a non-banking formal savings and credit cooperative that metamorphose from self help organizations. It is the formal savings and credit institutions that in turn set up linkages with development banks because they are registered and recognized than individual rotational savings and loan groups. Banks often find it difficult to deal directly with groups that do not have legal status. This is because banks rely heavily on legal contracts to function. Informal groups without legal status are generally not allowed to open saving accounts and cannot obtain group loans. That is why attempt are made to transmute self-help organizations to formal groups to give them legal status so that they can link directly with the banks.

Chipeta and Mkandawire (1992) confirmed the existence of links between the Informal Financial Sector and the Formal Financial Sector.

*Moneylenders, indigenous bankers and cooperative savings society are known to be depositing surplus funds with Formal Financial Institutions. Similarly, customers of formal financial institutions have lines of credit with informal financial institutions. These links establish the channel through which credit control and monetary policies targeted at the formal financial sector affect the volume of resources and credit in the informal financial sector and hence the overall effectiveness of financial policies. Both indirect and direct credit and deposit links exist. The indirect credit and deposit linkages are significant. The direct credit links are insignificant, but the direct deposit links with moneylenders are significant.*

(Ojo, 1996) believes that linkages between the formal and the informal financial sector exist in both side of the market, in savings mobilisation as well as in credit administration. There are occasions the informal groups save with the banks as a group and at time they share the same client. Informal groups are even encouraged to have a legal status that will give them stronger front to obtain loan from the formal sector. It is no doubt that informal credit markets are generally complementary to the formal market but there is still a large and unsatisfied demand for credit by informal and small borrowers mainly because over zealousness of the formal financial sector and poor integration between the formal and informal financial system. But the formal sector could make fund available to the informal sector for onward lending to the small entrepreneur.

Thillairajah (1995), suggested three types of institutions in a properly functioning financial market, which would ideally play the roles of, wholesaler, intermediary, *and* retailer, of financial services to the ultimate customers at the grassroots, according to him,

1. The *retailers* would cope with the rurality of the small scattered customers and minimize the cost of collecting information on credit-worthiness, as well as loan recovery and savings mobilization.
2. The *intermediary role* of the semi-formal sector would enable the informal and semi-formal customers to earn interest by depositing their savings in the formal sector. This would assist the mobilization of savings and help the formal sector to create more money. The intermediaries would also save the formal sector the extra cost of dealing with small deposit and loan accounts. The same intermediaries would pass on loanable funds to the retailers, relieving the excess demand for credit at the grassroots. And lastly,
3. The *wholesaler* formal sector intermediaries would be able to meet cash shortages and utilize idle funds. These operations would be crucial in meeting the problems of seasonality and mitigating co-variant risk.

It is obvious from the literature search that Nigeria has to put a system in place that would enhance integration of the informal sector into the formal financial sector and improve access to finance.

## RESEARCH METHODOLOGY

### RESEARCH DESIGN

In an attempt to obtain the sample upon which this study is based, the population for this study is defined as the total collection of various informal financial groups such as rotational savings and credit association (RSCA), mutual aid group (MAG), credit and thrift society (CTS) and semiformal savings organizations (SSO) within Lagos metropolis. The informal groups in various market places in Lagos metropolis, the credit and thrift societies in small business organization as well as semi-formal organizations were targeted. However, since focusing on the whole population will take time as well as huge cost, a sample of the entire population was selected. In deriving a representative sample from the population of various informal groups, all the informal groups were given equal chances of being selected in the survey. The main research instruments used to elicit data in this study was a well structured questionnaires designed by the researcher. A random sampling technique was employed. Using this procedure a sample of 350 questionnaires was sent out for the study but only 200 was usable out of the questionnaires returned. The questionnaire was filled by executive member of the groups. The questionnaire is made up of twenty items and centres on three point criteria. These criteria include the saving and lending behaviors as well as the relationship of various informal groups with formal financial sector. To ensure the reliability of the instrument used, the split-halves method was used. To use the split-halves method, the sample was randomly divided into two halves and alternate form of reliability measure were estimated for half of the group. Results from the two halves are then compared. The alpha ($\alpha$) reliability coefficients for the first and second halves of questionnaire are 0.7905 and 0.7890 respectively. This indicates that the research instruments are quite reliable.

## ANALYSIS OF RESULTS AND DISCUSSION

### PROFILE OF RESPONDENTS

The sample selected for this study, as seen in Figure 1(a) is made up of 93 males executives, representing 46.5% of the total respondents and 107(53.5%) female executives. Figure 1(b) and 1(c) show the age distribution and educational qualifications of respondents. With respect to age, Fig. 1(b) indicates that 122 (61%) of respondents are within the ages of 20 and 40, while 72(36%) are within the age of 40 and 50. The remaining 6 (3%) of the respondent are within the age bracket of 50 years and above. Fig. 1(c) also shows that out of two hundred respondents, 5 (representing 2.5% of total respondents) had no formal education (NFE), 9(4.5% possessed) primary school leaving certificate (PLS), 29(14.5) were West African School Certificate holder and 89(44.5%) holds either national diploma (OND) or National Certificate in Education (NCE). Out of the remaining 68 respondents, 64(32%) and 4(2%) of the respondents had first degree (B.Sc/B.A/B.Sc & HND) and postgraduate degrees respectively. The implication of this sample is that our respondents are of mature age and majority of them also have adequate educational background to be able to provide logical answers to questions in the questionnaire drawn.

Fig. 1(a) Sex distribution of respondents

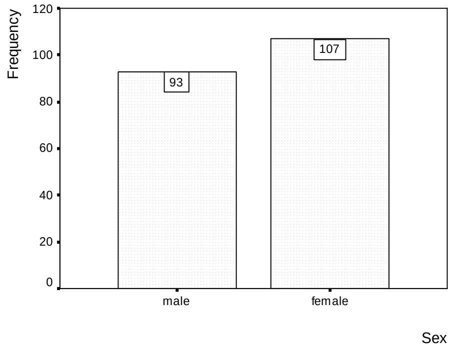



Fig. 1(b) Age distribution of Respondents

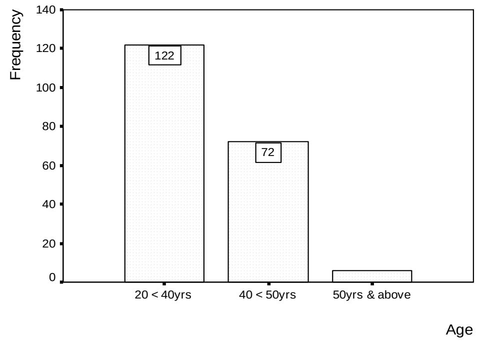



Fig. 1(c) Educational Qualif. of Respondents

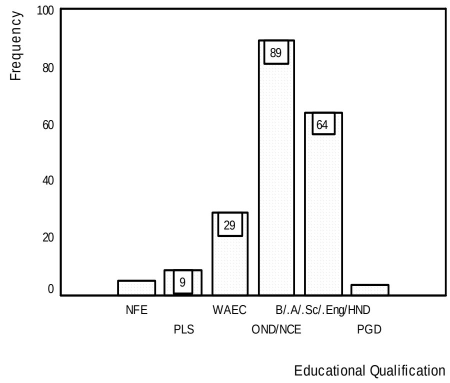



Fig.(1d) Profession of members

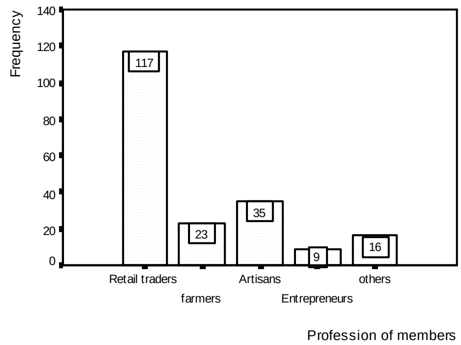



Fig. 1(e) Informal group

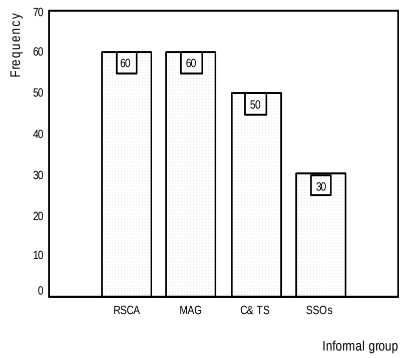



Fig. 1(f) Range of membership of IG

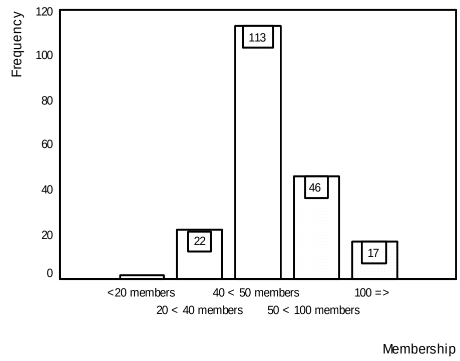



Figure 1(d) and 1(e) reveals the distribution of respondents according to their various professions and the informal groups they belonged. As regards the profession of members, it is apparent in Figure 1 panel (d) that 117 and 23 respondents representing 58.5% and 11.5 % of the total sample are retail traders and farmers respectively. In the same vein, 35 (17.5%) and 9(4.5%) of members are artisans and entrepreneurs respectively. Other sixteen (16) respondents representing 8% of respondents belong to other professions. Fig. 1(e) indicates that 60(30%) of respondents belong to Rotational Saving and Credit Institutions (RSCA), the same number belong to mutual aid group (MAG), 50(25%) belong to credit and thrift society(C&T), while the remaining 50 members belong to semi formal savings organization. The implication of all these is that the sample of respondents used for the study is very ideal and they could be relied upon for making valuable inference about the link between formal and informal financial sectors in Nigeria.

**LINKS BETWEEN FORMAL AND INFORMAL FINANCIAL SECTORS IN NIGERIA**

For the purpose of investigating the links between formal and informal financial sectors in Nigeria, the study examines the saving and credit link of sampled respondents. In this respect, the numbers of respondents that saved with and obtain credit from the formal financial institutions are investigated.

Fig. 2(a) and 2(b) investigates whether respondents save their taking in the bank and if not where they maintain their saving. In Fig. 2(a), 155 respondents representing 77.5% of the sample affirmed that they save their surplus funds with bank. Forty-five (45), representing 22.5% of all the respondents sampled however maintained that they do not keep their takings in the bank. A proper investigation revealed in Figure 2(b) shows that out of these 45 respondents, 9(4.5%) keep their money at home, 4(2%) save with other groups, while the remaining 32(16%) respondents save with cooperatives. The main implication of Fig. 2(a) and 2(b), therefore is that majority of respondents indicated that they save with banks. This means that these informal groups have a strong savings link with formal sector of the economy.

Fig. 2(a) Saving with banks?

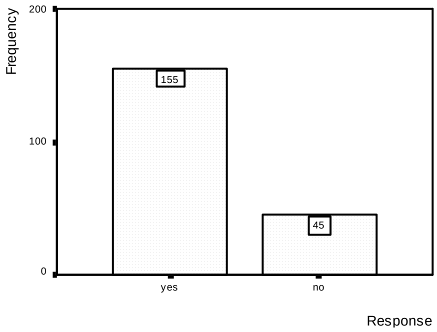



Fig. 2(b) Safekeeping of Money

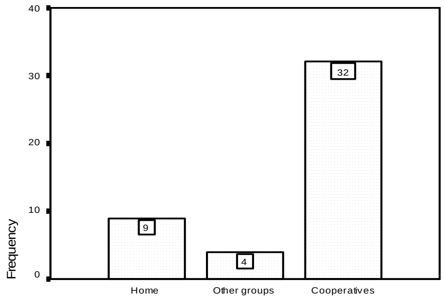



Fig. 2(c) Do you borrow from banks?

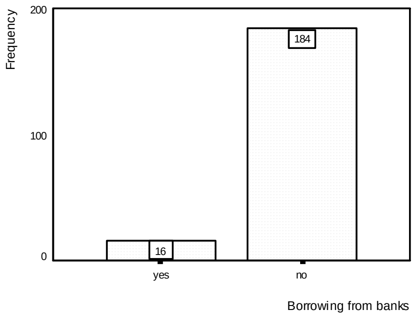
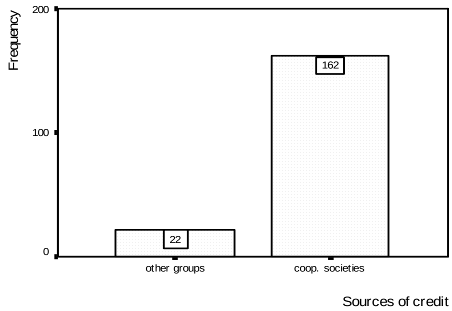



Fig. 2(d) Preference for sources of credit




Having examined the savings link between formal and informal sector, we further investigate their credit link. Fig. 2(c) shows that 16 (8.0%) of respondents do obtain credit from the bank. However, 184(92%) of the sampled respondent maintained that they do not obtain credit from the bank at all. The reason for this may not be unconnected with some stringent requirement for obtaining credit from banks in Nigeria. In sampling the preference of respondent concerning various sources of credit, Fig. 2(d) revealed that majority of respondents (162 respondents) preferred cooperative societies as a source of credit to banks and other groups. It becomes glaring at this juncture that though the informal sector appreciate the importance of saving may be as a result of fear of loosing the money if they keep it with them (see Figure 2e) and their link with formal sectors is a strong one, the empirical evidence emerging from this study indicate that the credit link between these sectors is still somehow very weak.

Fig. 2(e). Importance of Savings

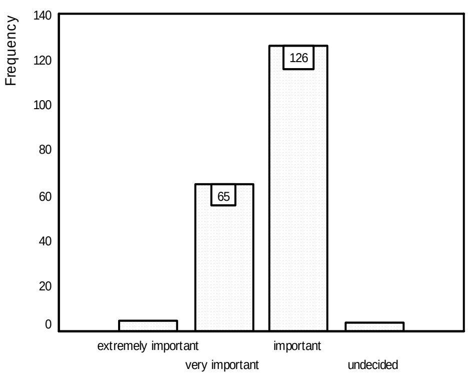
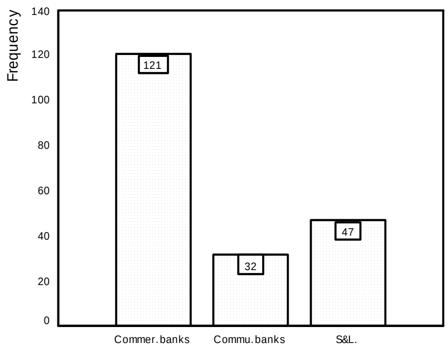



Fig. 2(f) Relationship with formal sector




To further examine which financial institution(s) the informal groups relate mostly with, Figure 2(f) revealed that majority of responds prefer to deal with commercial banks than with community or savings and loans institutions.

**TEST OF HYPOTHESIS**

The null hypothesis earlier specified in this study is that there is no relationship between formal and informal financial sectors in Nigeria. To test this hypothesis, the cross tabs procedure, which provides a variety of tests and measures of association for two-way tables, is adopted. Having carried out a cross tabulation of essential variables necessary for the test of our hypothesis, Table 1(a) shows the proportion of the sampled population that saved with formal financial sector. It could be observed that more than 70% of each informal group agreed that they save with banks, while less than 30 % save elsewhere. To test whether there is a significant difference in the number of respondents that save with banks and those that save elsewhere we adopt the Chi-Square ($\chi^2$) statistics reported in Table 1(b).

**TABLE 1(A): INFORMAL AND FORMAL SECTORS' SAVINGS LINK**

| | Saving with Banks | | Total |
|---|---|---|---|
| | **Yes** | **No** | |
| **ROSG** | **44** | **16** | **60** |
| **MAG** | 47 | 13 | 60 |
| **C&T** | 36 | 14 | 50 |
| **SSO]** | 28 | 2 | 30 |
| **TOTAL** | 155 | 45 | 200 |

Source: Field Survey (2009)

**TABLE: 1(B)**

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) |
|---|---|---|---|
| Pearson Chi-Square | 5.802[a] | 3 | .122 |
| Likelihood Ratio | 6.966 | 3 | .073 |
| Linear-by-Linear Association | 2.245 | 1 | .134 |
| N of Valid Cases | 200 | | |

a. 0 cells (.0%) have expected count less than 5. The minimum expected count is 6.75.

From Table 1(b), it is apparent that the computed value of χ2 is 5.802. At 0.05 level of significance and with 3 degree of freedom, the critical value of $\chi^2$ is 7.81. Since the critical value is greater than the computed value, then the number of members that maintained savings in the banks is very significant relative to those who do not. We therefore reject the null hypothesis that there is no savings link between formal and informal financial sectors in Nigeria.

Table 2(a) also tests the credit link between the formal and informal financial sector in Nigeria. The table indicates that majority of members of various informal groups indicate that they do not obtain credit from banks. To test whether there is significant difference in responses we also adopt the $\chi^2$ statistics, which is reported in Table 2(b)

**2(A): INFORMAL AND FORMAL SECTORS' CREDIT LINK**

| | Saving with Banks | | Total |
|---|---|---|---|
| | Yes | No | |
| **ROSG** | **4** | **56** | **60** |
| **MAG** | 0 | 60 | 60 |
| **C&T** | 9 | 41 | 50 |
| **SSO** | 3 | 27 | 30 |
| **TOTAL** | 16 | 184 | 200 |

Source: Field Survey (2009)

**TABLE: 2(B)**

**Chi-Square Tests**

| | Value | df | Asymp. Sig. (2-sided) |
|---|---|---|---|
| Pearson Chi-Square | 12.319[a] | 3 | .006 |
| Likelihood Ratio | 15.472 | 3 | .001 |
| Linear-by-Linear Association | 3.046 | 1 | .081 |
| N of Valid Cases | 200 | | |

a. 4 cells (50.0%) have expected count less than 5. The minimum expected count is 2.40.

Table 2(b), shows that the computed value of χ2 is 12.319. At 0.05 level of significance and with 3 degree of freedom, the critical value of $\chi^2$ is also 7.81. Since the critical value is less than the computed value, then those who obtained credit from formal sector are not significant in essence we accept the null hypothesis that there is no credit link between the formal and informal groups in Nigeria.

This study has revealed that while there is a saving link between formal and informal financial sector in Nigeria, the credit links between these two groups have been absent. Several reasons may be suggested for this, which among others include: lukewarm attitudes of banks to lend to informal group in absence of collaterals, preferential treatment to prime customers of banks, credit rationing in banks and unfavourable terms of credit. It therefore implies that more needs to be done in order to improve the credit link between the two sectors.

**CROSS TABULATION OF SOME OF THE VARIABLES**

**TABLE 3(A): EDUCATIONAL QUALIFICATION & THE USE OF BANK**

**Crosstab**

Count

| | | Do you save your takings in the bank? | | Total |
|---|---|---|---|---|
| | | yes | no | |
| Educational Qualification | No formal educ. | 1 | 4 | 5 |
| | primary schl. leaving cert. | 7 | 2 | 9 |
| | WAEC | 24 | 5 | 29 |
| | OND/NCE | 67 | 22 | 89 |
| | B.Sc/B.A/B.Eng/HND | 54 | 10 | 64 |
| | PGD | 2 | 2 | 4 |
| Total | | 155 | 45 | 200 |

Source: Field Survey (2009)

To analyze the impact of education on the use of banks, it was observed that the higher the level of education of the respondents the more they save with the banks. 0.6% of the respondents with no formal education save their deposit in the bank, 4.5% of the respondents with first school leaving certificate save with the bank, while, 15%, 43%, 34% and 1.2% of the respondents with WAEC, OND, B.sc and Post graduate respectively save their deposit with the bank. The reason for the low percentage of the postgraduate is because they are not many among the respondents.

### TABLE 3(B): EDUCATIONAL QUALIFICATION AND HOW RESPONDENT KEEP THEIR SAVINGS

**Crosstab**

Count

| | | If no, how do keep your money safe? | | | Total |
|---|---|---|---|---|---|
| | | keeping it in the house | save with another group | save with cooperatives | |
| Educational Qualification | No formal educ. | 2 | | 2 | 4 |
| | primary schl. leaving cert. | | | 2 | 2 |
| | WAEC | 1 | 1 | 3 | 5 |
| | OND/NCE | 4 | 3 | 14 | 21 |
| | B.Sc/B.A/B.Eng/HND | | | 11 | 11 |
| | PGD | 2 | | | 2 |
| Total | | 9 | 4 | 32 | 45 |

Source: Field Survey (2009)

It was observed even among those that do not save with the bank, as their level of education increased they save with other organizations such as cooperative societies but not banks.

### TABLE 3 (C): EDUCATIONAL QUALIFICATION AND SOURCE OF BORROWING

**Educational Qualification And Source of borrowing**

| | | | Source of borrowing | | Total |
|---|---|---|---|---|---|
| | | | other groups | cooperative societies | |
| Educational Qualification | No formal educ. | Count | 2 | 3 | 5 |
| | | % within Source of borrowing | 9.1% | 1.9% | 2.7% |
| | primary schl. leaving cert. | Count | 3 | 6 | 9 |
| | | % within Source of borrowing | 13.6% | 3.7% | 4.9% |
| | WAEC | Count | 7 | 20 | 27 |
| | | % within Source of borrowing | 31.8% | 12.3% | 14.7% |
| | OND/NCE | Count | 4 | 76 | 80 |
| | | % within Source of borrowing | 18.2% | 46.9% | 43.5% |
| | B.Sc/B.A/B.Eng/HND | Count | 6 | 53 | 59 |
| | | % within Source of borrowing | 27.3% | 32.7% | 32.1% |
| | PGD | Count | | 4 | 4 |
| | | % within Source of borrowing | | 2.5% | 2.2% |
| Total | | Count | 22 | 162 | 184 |
| | | % within Source of borrowing | 100.0% | 100.0% | 100.0% |

Source: Field Survey (2006)

Considering the impact of the level of education on the source of borrowing, it was observed that the respondents with higher level of education borrow from cooperative societies instead of other informal groups. Meaning that if the conditions in the banks were favourable they would have borrowed from the banks.

### TABLE: 3 (D)

**Profession of members & Informal group**

Count

| | | Informal group | | | | Total |
|---|---|---|---|---|---|---|
| | | Rotational savings& credit institutions (Esusu) | Mutual Aid group(Ajo) | Credit & thrift society | semiformal savings orgs. | |
| Profession of members | Retail traders | 38 | 48 | 16 | 15 | 117 |
| | farmers | 5 | 5 | 10 | 3 | 23 |
| | Artisans | 14 | 6 | 12 | 3 | 35 |
| | Entrepreneurs | 2 | 1 | 2 | 4 | 9 |
| | others | 1 | | 10 | 5 | 16 |
| Total | | 60 | 60 | 50 | 30 | 200 |

Source: Field Survey (2009)

A further analysis of group members by trade and vocation revealed that retail traders form the majority in all the informal groups; this may be due to the fact that most of the questionnaires are filled in market palaces, then the artisans and farmers followed respectively.

**TABLE: 3 (F)**

**Do you save your takings in the bank And the formal sector respondents relate**

Count

| | | Which of these formal sector do you relate mostly? | | | |
|---|---|---|---|---|---|
| | | commercial banks | community banks | savings & loans institutions | Total |
| Do you save your takings in the bank? | yes | 95 | 23 | 37 | 155 |

Source: Sample Survey (2009)

Among the groups that save with the banks it was revealed that 95(61.2%) relate with commercial banks, 37(23.8%) relate with savings and loans institutions, while 23(14.8%) relate with community banks. The credit side of the market will have to be improved as many of the groups in the informal sector are in dare need of credit facilities for expansion and growth.

## RECOMMENDATIONS

1. The fact that there are no credit link between the formal and informal financial sectors of the economy implies that the informal sector depend only on the capital they can generate in their business for growth and expansion. That is why they remain small and mostly insignificant. The government should bridge this gap by ensuring that informal financial market operators are link up with formal financial sector operator so that they can access more credit. They can be service through the microfinance banks.
2. The banks should remove the stringent conditions and excessive documentation that discourage operators in the informal sector to seek bank loans. The commercial/Universal banks can use the informal financial service provider to mobilize funds in the rural area and reach out to many other in need of credit to close the finance gap in the rural areas.
3. The semi formal groups such as cooperative societies and rotational savings and loan group should endeavour to develop their cooperative finance activities so that they can pool resources and operate as a formal institution but with very close links with the informal groups. This will increase the outreach level of these groups.
4. Although there is a strong linkage between the formal and informal savings institutions in Nigeria more effort should be made to mobilize savings in the rural areas because of the need to channel fund into agricultural business that exist in that part of the nation.
5. Other forms of formal non-bank financial intermediaries such as discount houses, leasing companies, finance companies, etc should be encouraged to operate in the rural areas providing other forms financial services along with the microfinance institutions to increase sources of finance in the rural areas. Since most of the people with financial constraints dwell in the rural areas.
6. It is important both to include informal institutions in financial development strategies and to link them more closely with the formal financial system in order to both increase savings mobilization and make more funds available to high-return investments in informal activities.
7. An adequate process should be put in place to monitor and record activities in the informal sector of the economy both financial and otherwise. The CBN and other relevant body should ensure that reliable data are scientifically collected to have a basis for policy formulation.
8. Favourable macroeconomic policy, especially in the area of favourable legislative framework, access to credit and favorable economic environment should be made available for the progress of the informal sector. The idea is not to eliminate the informal groups because that is not possible but to help them link up with the formal groups that have larger funds especially now after the bank consolidation for on-lending to microentrepreneurs.
9. The informal financial intermediaries that intend to carry on re-lending in the informal financial market should be encourage and properly package to access development finance loan which are given at concessionary interest rate.
10. The government should make more credit available to development banks and cooperative banks since they have objective of penetrating and developing the small and informal businesses in the country.

## CONCLUSION

These is no doubt that a financial gap continue to exist for small businesses, which generally need larger loans at lower rates than informal agents can provide but they lack proper record and collateral necessary to access bank loans. However, it is important to include informal financial institutions in financial development strategies and to link them with the formal financial system in order to increase savings mobilization and increase their access to credit. The omission of the informal financial sector in the main stream of the economy call for concern as it is obvious that the informal sector represents a large section of the economy.

The weak credit link between the formal and the informal financial agents suggest that few informal financial intermediaries were successful in getting loan from the formal financial intermediaries to onward lending to borrowers in the informal financial market. The outcome of this study agrees with the experience documented by the studies on Sub Sahara Africa, by Aryeetey (1992), Hyuha (1993), Chipeta and Mkandawire (1992) and Aredo (1993) sponsored by the African Economic Research Consortium (AERC) which addressed the problem of financial sector integration by investigating whether there are links between the formal, semi-formal, and informal financial sectors. Though most commercial banks will not want to lend funds to the informal sector but government policy such as imposition of credit ceiling and strict open market operation will further reduce availability of credit to informal agents or make the cost of borrowing very high and out of reach of the informal sector agents.

Though the neoclassical logical argument that once the returns on assets in rural institutions are positive, the entire financial sector would integrate itself for funds to flow to the most profitable enterprises, urban and rural. This is yet to be seen in Nigeria's case, which means that deliberate effort has to be made by Nigerian government through its regulatory authority to integrate informal financial sector into the mainstream formal financial sector and improve access to finance for micro and small business operators in Nigeria.

Informal institutions use specialized techniques to address the problems of information, transaction costs and risks in serving households and micro businesses that prevent banks from serving these market segments in African countries. But the high localization of informal agents and lack of access to formal finance limits the extent of financial intermediation by informal agents. Hence it is important both to include informal institutions in financial development strategies and to link them more closely with the formal financial system in order to both increase savings mobilization and make more funds available to high-return investments in informal activities.

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