

THE EFFECTS OF INFORMAL FINANCIAL INSTITUTIONS ON MICRO AND SMALL SCALE ENTERPRISES IN JOS METROPOLIS OF PLATEAU STATE

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ABSTRACT

Micro and Small-Scale Enterprises (MSEs) in developing countries act as catalysts in the development process. They play significant roles in the economic activities of these countries. Nigeria as a developing country requiring sustained economic growth must pay attention to the MSE sector and harness the great potential of this sector as they contribute in providing income for many low income households, employment generation, and improving local technology especially in the informal sector: This study examined the effects of Informal Financial Institutions (IFIs) on Micro and Small Scale Enterprises in Jos Metropolis. A stratified random sampling technique was used and data was collected by administering 100 well structured questionnaires to collect primary data through field survey. Data analysis was based on descriptive statistical tools and Logistic Regression Analysis. The research findings revealed that frequency of meetings and membership size of informal financial institutions positively affect capital acquisition of micro and small scale enterprises while interest rates negatively affect capital acquisition of micro and small scale enterprises in Jos Metropolis Local Government. The study concludes that informal financial sector contribute to capitalization and subsequent financial intermediation of micro and small scale enterprise in Jos metropolis. The study recommended that integration of informal financial institutions into the central wheel of economic growth will play a vital role of invigorating the financial status of micro and small scale enterprises which will in turn, expedite the improved standard of living in Plateau state.

Keywords: *Informal Financial Institutions, Micro and Small Scale Enterprises, and Financial Intermediation.*

INTRODUCTION

Finance is globally, a driving force to all economic units. Though a very crucial instrument, finance is often in short supply to the needing units. The shortage of finance to the needing units necessitated the existence of financial intermediaries, which according to Oloyede (2019) involves the mobilization of savings of an economy and their channeling into productive investment projects. The financial system incorporate institutional arrangements that facilitate economic growth by their funds mobilization, lending abilities, advisory role, savings encouragement habit and the channeling of those funds into deficit units, where those investment needs call for attention. These institutional arrangements are broadly classified into the formal and informal financial institutions. In Nigeria, the formal financial institutions (FFIs) are regulated by the Central Bank of Nigeria while the informal financial institutions (IFIs) evolve through cultural practices and mutual cooperation of the people (Oloyede, 2021). Informal financial institutions are institutions that are not directly controlled by the government such as money lenders, cooperative societies, thrift and loan societies and local bankers. On the other hand, micro and small scale enterprise as defined by the National Council of Industry using employment and capital assets of an enterprise, states that micro enterprise is one with labour size not more than 10 (ten) workers and a working capital of not more than N 1.5 million, excluding the cost of land, while small scale enterprise is one with up to 100 workers and working capital not exceeding N50 million (CBN, 2022).

Alabi, Alabi and Ahiawodzi (2017) noted that Micro and Small-scale Enterprises (MSEs) are commonly believed to have very limited access to deposits, credit facilities and other financial support services provided by FFI, this is because these MSEs cannot provide the necessary collateral security, employment and credit records. In addition, the high transaction cost involved in monitoring and enforcing small loans to MSE which may be in places beyond the reach of most FFI makes it difficult for the poor to access financial assistance from FFIs. The absence of FFIs in rural areas and the frustration of access to credit by the poor and MSEs compel them to resort to different forms of non-banking and informal arrangement to access funds for their operations. These informal arrangements consist of loans by money lenders, traders, landlords, friends and families that promote the informal markets (Gizo, 2021).

Despite the Government's emphatic campaign of self-employment as a tool to curb poverty, minimize unemployment to its bare-minimum and eliminate the social vices that comes with it, financial difficulties are still noted to be an overriding impeding factor. There exists an enthusiastic appetite for self-employment but this is hampered by lack of financial backup for capitalization, many people are captured in the vicious cycle of poverty, which tends to prevent their savings mobilization, capable of financing their businesses. To this effect, informal financial institutions, through its activities provide an easier way to refill the capitalization gap without much condition attached (Zira, 2022). The question however is, to what extent has IFI affected the development of MSE in Jos Metropolis of Plateau state? Also, what factors affect the capitalization of MSEs in Jos Metropolis?

OBJECTIVES OF THE STUDY

This study has broad and specific objectives which it strives to realize. The broad objective is to examine the effects of informal financial institutions on micro and small-scale enterprise in Jos metropolis, and the specific objective includes:

- i. To examine the impact of financial institutions on micro and small scale enterprise in Jos metropolis
- ii. To evaluate the impact of informal financial institution on micro and small scale enterprise in Jos metropolis.
- iii. To examine the causal relationship between informal financial institution on micro and small scale enterprise in Jos metropolis.

LITERATURE REVIEW

Conceptual Review

Informal Financial Institutions

Informal Financial Institutions are institutions that embraced all financial transactions that take place beyond the functional scope of various countries banking and other financial sector regulations (Aryeetey, 2021). Informal Financial institutions are not organized on formal arrangements, hence, in their different forms; they are best distinguished by their mode of

operations and the specific features they adopt. It is to this backdrop that Nweze (1995), classified Informal Financial Institutions to include financial self-help groups and individual financial brokers. While the later comprise of daily deposit scheme and financial business groups such as moneylenders and pawnbrokers, the former has savings and credit associations (SCAs) among others, he classified them further to include Daily Deposit Scheme which is a savings scheme where people contributes varying amounts daily to the organizer. The money is kept in safe custody of the organizer from which it may be loaned out as short-term loans till the end of the month when the amount contributed is returned to the contributors. Rotating Savings and Credit Associations (ROSCAs) is another scheme where each participant contributes a fixed amount to form a lump sum at regular intervals. This amount of pooled fund is received by a member at a time and in a sequential manner, gets to everybody. Meetings could be on weekly basis, market days, fortnightly, monthly, and quarterly or on yearly basis. ROSCAs are popularly known as "Adashi" by the Tiv people. In Non-Rotating Savings Associations (NRSAs), each member contributes a variable sum of money at regular intervals. The total sum is deposited with the treasurer and individuals' total contributions are paid back to him at the end of a predetermined savings period but credit functions are visibly absent. Other forms are Non-Rotating Savings and Credit Associations (NRSCAs) which functions like the NRSA but with additional function of granting loan to members from the pooled funds and other Sources such as fines, fee, levies interest and joint labour amongst others, loans are expected to be paid back within one year. They are popular known as "Bam" Finally, there is the Co-operative Thrift and Credit Societies which are interchangeably called "multi-purpose" by the Tiv people. Thrift societies. They are the largest, well organized and most standardized informal institutions in the fringe unorganized market. They offer loan whose maturity period extends beyond a year with a comparatively higher pool of loanable funds in the informal financial market.

Micro and Small Scale Enterprises

Micro and Small Scale enterprises are concepts that defy Universal definitions, both among academicians and practitioners. Despite the relativity and dynamism, one could reasonably classify them to include small number of employees, relatively small size or capital outlay, sales value, financial strength and independent ownership. More specifically, the adopted definition of Micro

and Small in this study is the one streamlined at the 13th council meeting of the National Council of Industry (CBN, 20), held in July: Micro, Small and Medium enterprises (MSMEs) were defined as follows:

Micro/cottage industry: enterprises with a labour size of not more than ten (10) workers or total cost (including working capital but not including the cost of land) not more than N1.5 million.

Small scale industry: Enterprises with a labour size of 1-100 workers or a total cost (including working capital but excluding cost of land) not exceeding N50 million.

Medium scale industry: Enterprises with a labour size of 101 to 300 workers or a total cost (including working capital but excluding cost of land) of over N50 million but not more than N200 million.

Large scale industry: Enterprises with labour size of over 300 workers or a total cost (including working capital but excluding cost of land) of over N200 million.

Theoretical Review

Financial Dualism Theory: This theory was developed by Professor H. Myint in 1971 and it offers justification to the complementary existence of financial institutions in Nigeria. The theory presupposes the co-existence of organized (formal) and unorganized (informal) money markets in less developed countries. Though the organized money markets (particularly Banks) have spread very rapidly, Myint traced their failure in the traditional sector to high overhead cost and red-tapism in dealing with small borrowers according to rules of credit worthiness amongst others. (Jhingan, 2004).

The Financial Repression School: This school of thought was developed from the works of McKinnon (1973) and Shaw (1973). They perceived self-financing to be the rule in low-income countries because financial intermediation is inadequate between savers and those with profitable investment opportunities. The school's proposition found that large reserve requirement imposed by regulatory authorities with the consequence to shift in the allocation of investible funds from the formal financial market to government reduces the flow of funds into banks thus, creating a credit gap. They summarized that the financial repression school acknowledge the emergence of

informal financial markets to fill the credit gap and serve as an alternative vehicle for saving and sourcing of credit.

The Neo-Structuralist models: In these models, informal credit markets occupy a prominent place in any modern developing economy. Such markets play two important roles; in commodity markets, they are taken to determine the marginal cost of funds relevant for private spending and saving decision while in financial markets, they represent an alternative mode of financial intermediation available to private savers. The school proposes that the existence of informal finance is a product of forces other than economic forces (Soyibo, 1994). The neo structuralists view the informal financial markets as subordinate and implementer to the formal financial markets.

These theories all point to the fact that informal financial markets exist in low income countries to serve as alternative mode of financial intermediation. The World Bank, (1994) affirms that these informal financial systems commonly assist MSEs particularly, market traders, house wives and artisans to accumulate funds through daily or weekly deposits that are returned at the end of a specified period minus a small fee. These theories also point to the fact that the existence of informal financial is a not only the product of economic forces, but other factors such as the social and demographic factors. Thus, Bhasin and Akpalu, (2001) identified age of operator, business experience, level of education, training programmes, credit, and contact with the lender as factors that significantly affect Micro-Finance Enterprises and the efficiency of Micro-Enterprises in Cape Coast. This study therefore examined the extent IFIs affects the development of MSEs and identify the factors that affect the capitalization of MSEs in Jos Metropolis.

Empirical Review

The provision of micro loans and financial services to the poor entrepreneurs to start or expand an income-generating small business is one of the most significant anti- poverty tools identified. However, these small businesses find it difficult to access micro loans and financial services from formal financial institutions. According to the Central Bank of Nigeria (CBN, 2020), 64.1% representing 56.3million people in Nigeria have no access to formal financial services.

This shows that most of the entrepreneurs have remained outside the fold of formal financial system and so, lack the opportunity to deposit their small savings and to access loan for business activities from these institutions. On the other hand Gbandi and Amissah (2014) reported that in 2009, the informal finance sector (IFS) provided more than 70% of the funds to the Small and Medium Scale Enterprises (SMEs). What this means is that operators of the SMEs have easy access to funds from IFS. Several works have been carried out by researcher on the effect of informal and formal financial institutions on micro, small and medium-scale enterprise.

Ernest (2016), in an assessment of formal and informal financial institutions in developing countries reported that, due to the problem of poor information system, institutional weakness, legal framework and the cost of screening, monitoring and enforcement of loans in the formal sector, informal financial institutions are better positioned to offer financial services as they utilize personal relationship, social sanctions and various collateral substitutes to serve market segments that remain beyond the reach of the formal sector. Awe (1998), in a survey conducted among Lagos island communities to investigate complementary and competitive links between the informal financial sector and the formal sector discovered that, majority of both business and non-business household save with the informal financial institutions. Though the amount saved was surprisingly less than the savings of the majority with the formal financial sector. In terms of number of small and medium scale enterprises (SME) and amount borrowed, the survey discovered that the informal financial sector out-performed the formal sector.

Atieno, (2021) assessed the role of institutional lending policies among formal and informal credit institutions in determining the access of small-scale enterprises to credit in Kenya. The results of the study show that the limited use of credit reflects lack of supply, resulting from the rationing behaviour of both formal and informal lending institutions. The study concludes that given the established network of formal credit institutions, improving lending terms and conditions in favour of small-scale enterprises would provide an important avenue for facilitating their access to credit. Olushola and Olushola (2019) analyzed the growth in investment of Micro and Small Scale Enterprises Intermediated by the informal credit market in Oyo State of Nigeria. Using a multi-stage sampling technique, the result indicated that size of lending, experience in lending business have positive and significant impact on growth in investment of micro and small scale enterprises.

Policy aimed at making fund increasingly available to small scale enterprises was recommend to boost growth in small and micro enterprises.

Sambe, Korna and Abanyam (2020) in analyzing the effect of informal financial institutions on the socio-economic development of Adikpo town showed that Informal Financial Institutions were more effective in reducing poverty among non-members. Furthermore, the institutions guaranteed that members will have more access to credit than non-members and lastly, informal financial institutions were effective in promoting investment among members as compared to non-members. It was therefore concluded that Informal Financial Institutions have been effective in promoting socio-economic development of the town.

Methodology

The study was conducted in Jos Metropolis. Jos Metropolis was created during the Local Government reform under the military government of General Yakubu Gowon in May 1967 and it was made capital of Benue-Plateau state in 1967, and became the capital of the new Plateau state in 1975, Jos has become an important national, administrative, commercial and tourist centre. It has a landmass of 104km with a population figure of 917,289 as at 2006 population census. The research design employed in the study was the survey method, specifically; a cross-sectional survey was used as the survey design. The population of the study comprised of all Micro and Small Scale Enterprises in Jos Metropolis. These included commercial motorcycling (Okada), 250, manufacturing and repairs 310, Super markets/provision stores 380, petty trading 110, restaurants 80, carpentry work 95 and tailoring 88, the total population is 1443. A sample size of 100 respondents in the ratio of 50:50 was drawn from Jos North and Jos South, the two geographical Zones in Jos Metropolis. Using stratified random sampling technique, the study instrument included a semi-structured questionnaire with both closed- ended and open-ended questions. The analytical tool used was descriptive statistics and logistic regression model.

Variable	Population	Sample size
Commercial motorcycling	250	18
Manufacturing and repairs	310	22

Super markets/provision stores	380	25
Petty trading	110	11
Restaurants	80	7
Carpentry work	95	9
Tailoring	88	8
Total	1443	100

Source: field survey, 2023

Results and Discussions

Table 1: Involvement and distribution of respondents in Informal Financial Institutions

Membership Involvement in IFIs		
Membership Status	Number of respondents	Percentage (%)
Yes	89	89
No	11	11
Total	100	100
Distribution of Respondents among IFIs		
NRSCAs (BAM)	49	55.06
ROSCAs (Adashi	29	23.59
Cooperative Thrifts	12	11.48
Daily Savings	5	5.62
Money lenders	2	2.25
Total	89	

Source: Field Survey, 2023.

Results from Table 1. Show respondents' involvement in Informal Financial Institutions. Out of the hundred (100) respondents surveyed, 89% belong to an IFIs while 11% are not involved in any IFI. Considering the random distribution of questionnaires therefore, the above figure shows that majority of the people in the study area are members of IFIs.

Under the distribution of respondents among IFIs, It is obvious from the table that, the most popular among Informal Financial Institutions in the area under survey is the Non-Rotating Savings and Credit Associations (NRSCAs) group which had a little over 55% while Moneylenders are the least patronized having just about 0.02%.

Table 2: Distribution of Respondents Utilization of Informal Loans for Development

Uses	Number of Respondents	Percentages (%)
Business/Trading	54	60.68
Farming	12	13.48
Education	11	12.36
Medical Care	7	07.87
Domestic Uses	3	03.37
Others	2	02.25
Total	89	100

Source: Field Survey, 2023

To satisfy the research objective that seeks to find out the investment areas of informal loans in the study area, respondents responses showed that a little over 60% of the loans goes into trading which justify that IFIs are effective on business financing. Also, is farming investment area in which these funds are another put to use.

The logistic regression model incorporate the dichotomous or dummy endogenous (dependent) variable. The implicit form of the logistic model is given as: $\ln(P/1-P) = Z = \alpha + X + u$

Where Z =the probability, which measures the total contribution of the independent variables in the model and is known as the logit.

α = the intercept which is also the value of Z when the value of all the other independent variables is zero.

X =explanatory variables

=coefficient which describes the size and nature of the contributions of X to Z. A positive means that X increases the probability of the outcome; a negative means that X decreases the probability.

u=the error term.

The explicit form of the logistic regression model shall therefore be expressed as $Z = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + u$

Where:

Z= Capital acquisition status of micro and small scale enterprises from Financial Institutions. One (1) entails full capital acquisition from Informal Financial Institutions to start up or invest in the enterprises while zero (0) shows no/zero capital acquisition from Informal Financial Institutions.

β_0 = Regression constant/intercept.

β_i =(where i=1,2,3, 4, 5,6) i.e. parameters to be estimated.

X_1 =Age of the respondent

X_2 = Size of the Informal Financial Institutions (number of participants)

X_3 = Success to informal loan (1 if yes and 0 if otherwise).

X_4 = Interest rates on Informal loan.

X_5 = Number of annual sittings/meetings of the Informal Financial Institutions.

X_6 = savings deposited with Informal Financial Institutions.

u = Stochastic error term.

A priori Expectations

The expected behaviors of the coefficients of independents on the dependent variables appear thus:

$\beta_1, \beta_2, \beta_3, \beta_5 > 0 > \beta_4$

Table 3: Results of the Logistic Regression Analysis

Variable	Coefficient	Standard error	Z-Statistic	Probability
X1	0.822778	0.113613	7.241941	0.0008
X2	2.013592	0.387882	5.274666	0.0031
X3	0.285347	0.067486	4.326647	0.0305
X4	-5.836938	1.065716	-5.477010	0.0028
X5	1.238735	0.211258	5.860735	0.0074
X6	0.656227	0.217997	3.014337	0.0390
C	1.230042	0.358706	3.466745	0.0402

McFadden R Squared 0.729299 Prob(LR Statistic) 0.001026

LR Statistic 53.95196 Log likelihood -36.81570

Discussion of Findings

The result in Table 3 shows that the demographic variables, respondent's age and membership size of IFIs are positive and increases the likelihood of capital acquisition for micro and small scale enterprises. This means as people grow older, they get more interested in participating in contribution and savings club; this enables them to pull their resources together so as to meet up with their day to day challenges. This is in line with the findings of Bhasin and Akpalu (2021) who found that age significantly affect the technical efficiencies of hairdressers, dress makers and wood-processors. The size of the IFI is positive and significantly influences the capital acquisition status of micro and small scale entrepreneurs, this means that as the size of the IFIs gets bigger, more money will be pulled together and loaned out this is in line with the submission of Gbandi and Amissah 2014.

The degree of success to informal financial loan (X_3) is positive (0.285) and exhibit the likelihood for capital acquisition by member entrepreneurs in Jos Metropolis Local Government. That is, the more an entrepreneur is successful in acquiring loan, the more the capital acquired is used to start or invested in an already existing business this is supported with the work of Korna and Abanyam 2020.

The interest rates on informal loans (X_4) shows a high negative coefficient (-5.837)

(LR Statistic) 0.001026

Log likelihood -36.81570

this may be as a result of the absence of a formal financial institutions in Jos Metropolis, the IFIs have the monopoly of savings and granting of loans to their clients, thus charging high interest rates.

The number of annual meetings (X_5) is positive (1.239) and offers a significance influence on the capital acquisition of micro and small scale enterprises from IFIs. The more frequent people meet for transaction, the more funds are mobilized to grant loan applications this is intendants with the work of Zira, 2022.

Lastly, the positive value of the coefficient of savings deposited with IFIs (0.656) tends to increase loan-able funds with the probability that micro and small scale enterprises will utilize to increase their financial base. The McFadden R-squared shows that explanatory variables jointly account for approximately 72.93% variation in capital acquisition status of micro and small scale enterprises. The remaining 27.17% is captured in the stochastic error term.

Non Rotating Credit and Saving Associations "BAM" is the most patronized informal financial institution in the study area. Loans from these IFIs are mostly invested in micro and small scale businesses even though farming is the main occupation of the people. This shows the willingness of people to embrace other sources of income to augment the income they get from farming. Frequency of meetings positively influence the capital acquired from Informal Financial for investment in businesses. Interest rates negatively influence capital acquisition of micro and small scale enterprises this is supported with the work of Atieno, 2021.

Conclusion and Recommendations

Conclusion

The study concludes that Informal Financial Institutions contribute to capitalization and subsequent financial intermediation of MSEs in Jos Metropolis. Membership size of IFIs,

frequency of meetings and savings positively influence the capitalization of MSEs while interest rates negatively influence the capitalization of MSEs. The increased membership participation in informal financial institutions will encourage funds to be pulled together, this will contribute to revitalizing the informal financial sector. It will go a long way in promoting economic growth in Jos Metropolis.

Recommendations

The following recommendations are suggested based on the research findings:

- i. Micro and small scale institutions should be encouraged to join Informal Financial Institutions as this will encourage them to save, thus making more funds available to be loaned out for investment.
- ii. The government should regulate the interest rate charged by IFIs operating in the informal sector to reduce the financial burden on MSEs.
- iii. Finally, at least one modern micro- finance bank or cooperative bank be instituted in Jos Metropolis to capture funds emerging from IFIs, business operations and individuals in the area. This will encourage saving and long term loans since almost 90% of loans disbursed by IFIs in the study area mature within one year.

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