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# An Analysis of the Effects of Informal Capital Market on the Nigerian Economic Growth

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**Abstract**

The need for the development of capital markets-whether formal or informal can be overstressed. That they operate separate the functions of savings from investment is very important, facilitating the continuous process of arranging asset portfolio for savers also helps in the process of economic development.

The structural imbalance in Nigeria's financial system has led to the strong emergence of informal capital markets. In the present set-up, it has been realized that the economy can hardly progress satisfactorily without them.

In conclusion, the markets are being faced with barrage of problems, it is hoped that if these problems are effectively tackled the informal markets might be able to perform a more pronounced role in the economic development drive in Nigeria.

**Keywords:** Informal market; Nigeria; Economic growth; Financial market

## Introduction

Recent literature on economic growth contains an extensive volume of conflicting growth and development theories. While some of the theories point to the lack of cooperating factors in the development process, some others stressed a lack of sufficient capital and highly skilled labour inputs.

Hagen however attributes sustained economic growth largely to the discovery and devising of new forms of organizations or methods of procedure which make the society efficient in production. Apart from Hirschman and a few others who played down the relative importance of capital in capital in economic development, most theories are agree on the fact that a continuous improvement in the savings - Investment process will foster economic development [1-3].

Financial markets can be broadly classified into Money and Capital markets. Although there is no strict line of demarcation between these two markets, on conceptual basis, Money markets are those markets for short term credits (markets for Central Markets banks money Treasury bills and certificates e.t.c.) while Capital markets are avenue for raising long term credit ( markets or government securities Corporate Bonds, Corporate shares, Mortgage loan e.t.c)" [4,5].

In a Modern economy, the capital markets functions in two ways:

α) Making it possible to separate the functions of savings from the investments

β) Facilitating the continuous process arranging asset portfolio for savers

In Nigeria, some markets operate alongside these formal ones. They are both partly recognized (and hence partly regulated) or as in some cases not regulated at all. These markets are the Informal Capital markets.

## The Informal Markets

The activities in the informal markets are geared toward economic growth of the Nigeria economy. They however differ in composition and structure. The Markets consists of Artisan/Trades' daily contributions (AJO) and, Age/Work group contributions (ESUSU), Money lenders, Cooperative Thrift and Credits unions, just to mentioned a few [6-8].

This group hardly submits any reports to the monetary authorities; hence it has been extremely difficulty for researcher to come-up with realistic data on their activities. However, one thing is certain; the numbers of participants are very huge in relation to the population. The reason for this is not far-fetched, about 60% of Nigerians live in the rural areas, while the remaining 40 % living the urban areas participate in one way or the other in these markets.

### Artisan/Traders daily contribution (AJO)

It is a common practice in Nigeria to find collectors (usually someone known in the area), going about on their motor cycles, bicycles, (or even cars), collecting daily contributions from artisan and traders. By agreement, between the collectors and the traders, the daily contributions are at the end of the month to be returned less commission( usually a day's contribution) The amount contributed per day depends on the financial strength of the contributor usually it is between N1,000 to N10,000. At the end of the day, the collector uses the money either for his own private investment or lends to people who are in need of capital, usually with interest. He then makes sure that the money is ready at the end of the month. It is noteworthy that contribution can borrow against their "Yet to be contributed money [9-12]".

### Age/Work group contributions (ESUSU)

The names "ESUSU" is of Yoruba origin, over the past two decades, it has become a habitual practice in the urban areas especially in some offices. As the name implies, this is a contribution scheme between people in the same age-group and or/ people in the same work group. A fixed amount of money, at fixed period is contributed and given t

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just a member in rotation. It is not considered as a loan but a way of making a substantial sum of money available to each member at a time, for pressing needs, like payment of School fees, purchase of household goods, and a host of other uses as the member may need it for [13,14].

The above scheme is of short term duration the long term contribution in this group is yet to be experienced in Nigeria. In Liberia, this practice is common among the "DRU" people. Some 5 to 10 members form a group and pay monthly contributions into a group and pay monthly contributions into a common fund over a period of one year. The funds usually invested are thus distributed among members sharing a proportionate part of the interest earned [15].

## Money lenders

A money lender ought to be understood from the point of view of a person who gives out money to individuals as a business, or for the purpose of making profit. But as is to be revealed, a moneylender means much more than that.In the case of Eboni Finance and Securities Ltd. v Wole-Ojo Technical Services Ltd. & 2 ors19, the Court of Appeal held, inter alia, that:

The definition of a money lender under the law is wide. It encompasses every person whose business is that of money lending and any person who lends money on interest or who lends a sum of money in consideration of a larger sumbeing repaid [16].

A similar definition was given, again by the Court of Appeal in the case of Veritas Insurance Co. Ltd. v Citi Trust Investments Ltd, where the court stated, on the meaning of money lender, that:

…any person who lends a sum of money in consideration of a larger sum being repaid is deemed to be a moneylender until the contrary is proved…

Section 31 of the Moneylenders Law provides thus:

Moneylender includes every person whose business is that of money lending or who carries on or advertises or announces himself or holds himself out in any way as carrying on that business, whether or not he also possesses or owns property or money derived from sources other than the lending of money and whether or not he carries on the businesses as a principal or as an agent; but shall not include –

α) any society registered under the Co-operative Societies Law; or

β) anybody Corporate, incorporated or empowered by special Law to lend money in accordance with such Law; or

χ) any person bona fide carrying on the business of banking or insurance or bona fide carrying on any business, not having for its primary object the lending of money, in the course of which and for the purposes whereof he lends money, or

δ) any person or body corporate exempted from the provisions of this Law by order of the Commissioner; or

## Cooperative societies

This form of informal capital markets can be categorized into two

**Cooperative thrift societies:** The Cooperative Societies form the nucleus of informal capital markets. All the other group exhibit cooperative societies traits but the above mentioned categories are distinct for the fact their existence is recognized by the Government, even though they do not account to the government. It must be noted however that cooperative societies engaged in other ancillary activities but such might not be necessary in the context of this paper.

**Cooperative credit societies:** The formation of credit societies stems from the common economic needs of members. The societies are geographically located, usually run by the traders and Artisan members. These societies usually pool their resources together. Any member in need of capital can obtain assistance at an interest usually lower those obtained in other credit institutions.

In some case, they help in raising their member's standard of living by opening "Consumers' Cooperative Store". In Uganda, For instance, Government financial aid to Produce Cooperative is through the Cooperative Credit Scheme.

A similar suggestion has been made to the Nigerian Government in the past, especially in the Agricultural Credit Guarantee Scheme execution. The idea though laudable, has not been fully embraced.

**Cooperative thrift societies:** In these societies, members are encouraged in practicing thrift and depositing with their societies savings, with a promise of liberal interest rates comparing favorably with those paid by commercial banks.

Thrift societies especially in the rural areas have helped to raise the marginal propensity to save significantly. In most companies (Private and Public), junior are automatically assumed to be members. A fixed amount agreed upon by the society is deducted every month from each member's salary. Any member in dire need of funds can then borrow from this fund (subject to the set limits) at a rate on interest usually lower than those obtained in the commercial banks.

# Informal Capital Markets and Economic Developments

Various reasons have been adduced for the emergence of the informal capital markets. Some attribute it to the absence of financial intermediaries, especially banks in the rural area. Even in places where there are Banks-Courtesy of the Financial Government Rural Banking Scheme, the vigorous process of depositing and getting credit facilities is frustrating. The banks are in addition not aggressive in their savings mobilization policies [17-20]. The usual style of "Armchair banking" still holds. In recent times, except under compulsion people are always very reluctant when it comes to using the Banks. The informal capital markets thus offer gains both to the participants and the economy as a whole. The gains generally include the fact that:

α) Those people otherwise considered ineligible in the formal markets can get the needed credit through the informal markets, thus improving the process of credit creation needed for economic development

β) The markets have helped to raise the Marginal propensity to save. For instance, without the Daily contribution scheme, most of the traders and artisans are not likely to save a single "Kobo". Same thing applies to Cooperative Thrift Societies. In the age/work group contribution (ESUSU), the large sum of money provided the "man in need" helps a great deal in alleviating the suffering of low income earners. The money is usually used for the purchase of essential items, increasing the consumption of goods and services. This will boost the level of investment which will in turn lead to economic growth.

χ) Apart from lending at low rate of interest by cooperative societies, essential raw materials are usually procured for members. This gesture alone is believed to be capable of stimulating growth through the continuous operations of small scale enterprises.

## Problems Confronting Informal Markets

The problems are numerous and somewhat multidimensional. However, these vary from one to another individual groups/societies as per mentioned earlier

## ESUSU

Under this scheme, the savings mobilized are not large enough. It is often discouraged (especially in the offices) by members failing to meet up the contribution when due. It is common to find members complaining about such things as naming ceremony, burial ceremony, illness etc. All these excuses, in most cases, are not true. The fact that the contribution are not invested in the formal markets where interest could be paid, has been discouraging more people from joining. It follows that a wise member who collects the contribution first and invest in the formal markets immediately gains so much in terms of interest. Conversely, the last man gains nothing in comparison to the first man, even if he invests immediately, the first collector too will have the chance to reinvest in the market.

### Daily contribution scheme (AJO)

The collector under AJO Scheme may abscond with the money collected if they choose to do so. No meaningful step has been taken in avoiding this by the government, so the contributors have to rely on the collector's integrity. The Collector on their, do not invest in project that can foster economic growth, rather they lead the money collected for commercial oriented projects that can be self-liquidating.

Although, the amount involved in this scheme cannot be accurately determined, it is hoped that with an addition (in the form of interest) on contribution instead of deductions (commission), more savings could be mobilized. But this is hampered by the failure of contributors to used banks.

### The money lender

The money lenders, despite legislation constitute the greatest nuisance in the market. The interest charged on lending is no-where near the stipulated rates. The rates are so ridiculous that unless one is left with no alternative, it is not reasonable to get credits from them.

Most of the lenders operate illegally and their recourse for retrieving loans is also illegal. Most of them use brutal means at times physically assaulting the defaulters or indiscriminate seizure of properties of defaulters.

## Cooperative societies

The greatest problem of cooperative societies is the fact that they are operationally limited to their geographically zone. The implication of this that is availability of funds is limited to channels available in the areas. The problem is further compounded by the inability of Microfinance to perform their original functions, which entails channeling funds to recognized cooperative societies. But the requirement of the Bank Act 1969 requiring all banks operating in Nigeria to register alike forestalled this.

The cooperative banks were not exempted in the harsh conditions set out by the Act; hence they had to operate as commercial banks. This has been a major setback for the development of cooperative societies in Nigeria.

Allegations of corrupt practice by officer of these societies are also uncommon in some situations. This reduces the credibility of this scheme.

With the exception of cooperative societies which have 'Skeletal accounting procedures", the other schemes have no systematic records of keeping accounts, no goods records, no auditing processes and legal actions are hardly taken against members in case of fraud.

## Conclusion and Recommendations

Having considered all the problems confronting the smooth operation of the informal markets, possible solutions are proposed in the form of recommendations.

The government' should as a matter of urgency wade into the informal capital i.e. it should be seen as an important aspect of the financial system. Rules and regulations should be laid down for them, especially now that the economy really needs all the help it can muster towards development.

The government should enact a decree countering the provision of the 1969 Banking Act with respect to Microfinance banks. They should be made to give necessary assistance to Cooperative societies and hence utilize growth potentials that abound in the societies.

The Cooperative societies, themselves, should leave their management in the hands of dedicated (preferably professionals) managers.

The Commercial banks should stop their "Armchair banking" by moving into the rural areas voluntarily and encouraging the dwellers to save more. For instance, they can get the Daily Collector together; offer them tangible returns for the daily lodgments. This will increase investible funds for the banks.

All the money lenders must be compelled to register and renew their licenses yearly probably by a control unit from the Federal ministry of Trade and Commence. The unit should enlighten the public about their right especially as it affects dealing with money lenders. Any one treated indecently should report at once to the law enforcement agencies. If all the above suggestions could be taken into consideration, then Nigerian would have paved way for a true integration of informal capital markets and thus ensure a more meaningful growth in her economic developments.

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