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The Role of Informal Credit among Small-scale Farmers for Rural Development in Otuoko Local Government Area of Benue State, Nigeria

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Abstract:

The research examined the role of informal credit on small-scale farmers for rural development in Otuoko local government area of Benue State, Nigeria. Purposive random sampling was adopted in selecting 80 respondents (people who collected loan from informal credit sources). Structured questionnaire was administered to the respondents. Data collected were analysed through descriptive statistics. Results of the findings showed that 62.25% of the respondents obtained information on informal credit from other borrowers, 56.25% used the borrowed money to pay other debts, 45.75% of the respondents married more wives and 56.25% were harassed by lenders when they delayed in paying the money borrowed. It is recommended that the lenders should reduce the harassment on borrowers and there should be uniformity in the charging of interest rate.

Keywords: Role, informal, credit, small scale, farmers

1. Introduction

Credit is the means by which entrepreneurs are able to acquire commodities against a promise to repay later. Thus, credit is based upon confidence in that when an individual or organization borrow money the loan is made upon a promise of repayment by the borrower at a stated time and under stated condition of repayment. Informal credits are transactions that operate outside government control and regulation, as in contrast to the regulated money market and the formal banking system, informal credit markets exist in various forms; rotating credit associations, trade credit, indigenous banking to mention but a few (Shui-Yan, 1995).

Lending implies that the lender has surplus purchasing power while the borrower has a deficit, acquired and uses the surplus belonging to the lender. Inadequate financial capital has been one of the major constraints of agricultural production in many developing countries including Nigeria. Farm families in the Nigeria are characterized by low capital incomes. Despite the development of profitable new technologies by research and the demonstration of their feasibility by extension, widespread use is still hampered because the numerous small-scale farmers lack funds to purchase the inputs required to adopt new technology (Karatu *et al.*, 2007).

In order to solve the problem of inadequate supply of production credit to the agricultural sector, government instituted some policy measures such as sectoral prescription for agricultural loans, Agricultural Credit Guarantee Scheme Fund (ACGSF) and the Rural Banking Scheme to mention but just a few. Their overall objectives were to increase the flow of credit supply by commercial banks to agricultural sector. Despite all these measures put in place the general performance of commercial and agricultural banks in agricultural lending has been found to fall below the minimum target set by the Central Bank of Nigeria. Several reasons have been presented for the non-satisfactory performance of the banks in implementing prescribed sectoral loan allocations which include profit maximization, concessionary interest rate structure, high cost of credit administration to numerous small holder farms; inadequate spread of bank branches especially in the rural area and lack of enforcement of prescribed penalties against defaulting banks (Isijola, 1992).

The negative experiences faced by farmers and entrepreneurs in the formal financial market have brought a renewed interest in the operations of the informal financial market and its place in the mobilization and allocation of funds (Srinivas, 1991). Formal credit institutions are bogged down in their functions by government regulatory controls, interest rate limits, loan ceiling, collateral requirements, high administrative and procedural costs (Srinivas, 1991). These processes consequently reduce their share of credit market leaving a huge gap in the demand and supply of credit (Hoff and Stiglitz, 1994). This is where the informal credit market

moves with the advantages of unregulated money supply, easy accessibility, easy liquidity, low administrative and procedural costs, little or no collateral, and flexibility in interest rates and repayment schedules (Srinivas, 1993).

Informal credit operations are therefore highly heterogeneous, with a wide variety of operations and services, lending and borrowing, using a high variety of debt instruments (Grmidis, 1990). Srinivas (1991) the common elements which run through informal credit arrangements is their informality, adaptability and flexibility options. This reduces their transaction cost and gives those comparative advantages and economic rationale over formal finance. Informal credit sector remains a strong presence in many developing economies delivering finance to the poor on frequently extraordinary terms and access to other financial services to the rural poor (Essien *et al.*, 2013). According to Srinivas (1993), the informality in informal finance is characterized by unregulated and non-subsidized finance, easy accessibility in very small size and short periods, low administrative and information costs, little or no collateral, flexible and variable interest rates, highly flexible transaction and repayments tailored to individual needs. However, as a result of the above characteristics, flexibility dominates informal credit operations and this enables them to reach borrowers beyond the profitable reach of the formal sector with lower transaction costs.

Many factors such as level of education, marital status, family size, cash balance, and collateral have been found to have influence on farmers' access to agricultural credit provided by commercial banks. Foltz (1999) credit is generally recognized as important tool for expanding food production and modernizing agriculture. Adopting new technology requires the use of some improved inputs, when the inputs are not available on the farm they must be purchased. In Nigeria, several government development programmes and policies had been evolved over the years and were targeted at rural transformation. These include Operation Feed the Nation (OFN) in 1976, Agricultural Development Project (ADP) in 1978, National Accelerated Food Production Programme (NAFPP) in 1970, Green Revolution Project in 1976, Directorate of Food, Roads and Rural Infrastructure (DFRRI) in 1986, National Fadama Development Projects (I, II and III) among others. All these had been put in place by past and present governments with a view to promoting agricultural and rural development in Nigeria.

Although, Nigeria is predominantly a rural country, concerted efforts to develop the rural sector is relatively a recent phenomenon in the country's development process. For the first decade of her independence, Nigeria's policymakers neglected the rural sector and concentrated the country's resources on urban industrial development. The glaring disparities in the provision of basic infrastructural facilities between the urban and rural communities could be solely responsible for the relative under-development of most rural areas of the developing countries (Sule, 2006).

Rural development encompasses a range of approaches and initiatives aim to improve the welfare and livelihood of people living in rural areas. These approaches pay attention to social issues particularly community organizing. There will be no rural development without change in the agricultural sector which is the main income earner of people in the rural area. The major characteristics of rural and agricultural development include change in standard of living, knowledge, health, skills, culture, attitudes, innovation acceptance and improved income level.

Informal credit constitutes the major sources of credit to rural farmers in many parts of Nigeria. The small-scale farmers are faced with credit problems, from both institutional and non-institutional sources. From the institutional sources; credit supply is generally scarce and unreliable and consequently very expensive. From the informal sources on the hand, it is believed that interest rates charged by local money lenders are excessive and are often over 100 percent a year. Yet money lenders still attract many farmers since they do not demand for collateral security and the ease of getting such loan which is usually on the spot without any formal contact (Idachaba, 2006). Rural environment sometimes referred to as the countryside is a place where daily activities are focused on exploiting natural resources in fields such as agriculture, fishing, logging or mining.

Various forms of credit markets tackle financial problems differently. Faced with a wide array of potential borrowers, the formal banking system tends to tackle the selection and enforcement problems by making these borrowers homogeneous, for example, by imposing stringent collateral requirements or by requiring borrowers to provide carefully documented evidence showing their intention and ability for repayment (Floro and Yotopoulos, 1991).

The formal banking system can only cater to the needs of a limited portion of the population; enterprises or individuals who can provide collateral or documented credit references. Credit needs of the poor and many small entrepreneurs will remain unsatisfied through the formal banking system. These people mostly are unable to provide collateral, or the loans they need are so small that administrative costs for lenders outweigh expected returns. While small borrowers generally encounter difficulties in obtaining credit from formal financial institutions in developed economies, those in developing economies face even greater obstacles because banking systems in these economies tend to be more rigid and small firms generally lack accounting records (Shui-Yan, 1995). The general objective of the study is to assess the role of informal credit in rural development while the specific objectives are to describe the sources of information on informal credit, identify priority areas for use of informal credit, ascertain how informal credit could accelerate rural development and find out problems encountered by the borrowers.

2. Materials and Methods

Otupko is one of the 23 Local Government Areas (LGAs) in Benue State. It is located between longitude 7°45' to 18°15' East and latitude 7.0° to 7°45' North. It has an estimated population of about 236,587 (NPC, 2006). It experiences dry and rainy seasons, the inhabitants of Otupko take farming as their major occupation. Farmers cultivate crops like yams, maize, cassava, millet, sorghum, rice and groundnut. Among the farmers, a few diversify their farming activities by keeping livestock alongside crop production activities. Examples of animals kept on small-scale are goat, sheep, cattle, pigs and poultry. Purposive random sampling was adopted, 10 council wards were selected, in each of the council wards selected 8 respondents (people who collected loan from informal credit sources)

were selected thus, making a total of 80 respondents. Structured questionnaire was administered to the respondents. Data collected were analysed through descriptive statistics.

3. Results and Discussion

Source of Information	Frequency	Percentage
Other borrowers	50	62.50
Friends/relations	23	28.75
Money lenders	7	8.75
Total	80	100

Table 1: Distribution of Respondents According to Sources of Information on Informal Credit

Results in Table 1 showed that other borrowers 62.25%, friends and relations 28.75% and money lenders 8.75%. Majority 62.25% of the respondents obtained information on informal credit from other borrowers. This is an indication that informal credit/borrowing has existed for long and many people have utilized the facility. Before the advent of formal credit system, informal borrowing has existed and served many people. Because of cumbersome procedures involved in the formal credit system like filling of forms, provision of collateral by prospective borrowers, high cost of management among others, many people prefer to borrow from the informal credit sources most especially those that cannot read or write.

In the informal credit system, on the spot assessment of prospective borrowers is carried out, no time is required for processing of documents. The failure of formal credit sources to deliver to a large proportion of people in the rural area has caused an increase in the patronage to informal credit sources by rural farmers and other entrepreneurs. The finding collaborates (Haque *et al.*, 2014) who reported that despite the apparent availability and low interest rates, formal financial services, such as those offered by formal credit sources were not the first option of fishers in Brazil when they needed credit. Okojie *et al.* (2013) also reported that lack of bank account, collateral and information regarding the procedure for accessing credit from formal sources limits rural dwellers access to credit from formal sources. Similarly, (Essien *et al.*, 2013) stated that informal credit sector remains a strong presence in many developing economies offering financial and other services to the rural poor.

Priority area	Frequency	Percentage
Payment of debts	45	56.25
Buy farm inputs	17	21.25
Payment of children school fees	12	15.00
Others	6	7.50
Total	80	100

Table 2: Distribution of Respondents by Priority Area for use of Informal Credit

Results in Table 2 indicated that payment of debts 56.25%, buy farm inputs 21.25%, payment of children school fees 15.0% and others 7.5%. Majority 56.25% of the respondents used the money borrowed to pay other debts. This could be attributed to the urgent need to pay debts that might have lasted for long which compared the borrowers to borrow money from informal credit sources to pay such debts because the process of obtaining loan from the informal credit sources is faster than other sources. Apart from that, the recent global economic melt-down has affected commercial banks; therefore, there are more stringent conditions of obtaining loans from formal credit sources now more than before. The recent economic melt-down has affected both individuals and organizations such that the debts of people who took loans from commercial banks have accumulated over the years amounting to huge sum of money and banks have taken over property that were presented as collaterals. Individuals who owned banks have resorted to borrowing from informal credit sources to solve some pressing problems.

Activity	Frequency	Percentage
Marry more wives	35	43.75
Expansion of the farm enterprise	30	37.50
Assist in payment of children school fees	9	11.25
Others	6	7.50
Total	80	100

Table 3: Distribution of Respondents According to how Informal Credit Could Accelerate Rural Development

Results in Table 3 depicted that marry more wives 43.75%, assist in payment of children school fees 11.25% and others 7.5%. Reasonable proportions (43.75%) borrowed money from the informal credit sources to marry more wives. In Africa, marrying of many wives is an important aspect of social life for rural people (peasant farmers). Wives and children are valuable assets to them; from their point of view, having a large family is a social status which is admired by almost all farmers in the rural area. Apart from social status in the society, wives and children assist on the farm thereby making farming a family business and reducing the burden of hiring labourers. This finding is similar to (Adinya *et al.*, 2013) who stated that the problem of lack of access to formal credit services

to rural people have limited their capacity to participate in many aspects of social life. This has made the rural people to form informal credit (rotation savings/Esusu) which is peculiar to their own needs.

Problem	Frequency	Percentage
Harassment of debtors	45	56.25
Arbitrary fixing of interest	20	25.0
High interest rate	9	11.50
Variation in payment period among borrowers	6	7.50
Total	80	100

Table 4: Distribution of Respondents by Problems Encountered by Borrowers

Results in Table 4 showed that harassment of debtors 56.25%, arbitrary fixing of interest 25.0%, high interest rate 11.25% and variation in payment period among borrowers 7.5%. A major (56.25%) proportion of the borrowers were harassed by the lenders. The lenders feel that harassment as a public disgrace would hasten the payment of the debt. Almost all human beings hate public harassment; therefore, lenders employ the use of harassing the borrowers to threaten them to pay the debt. When people are harassed publicly they tend to be more careful especially concerning the issue which led to their harassment. This finding contradicts (Ammani, 2012) who reported that because of the conditions required for obtaining credit from the formal credit sources, the rural population is left with no other option than to resort to informal credit sources which are regarded as exploitative because they charge higher interest rates much to the disadvantages of the rural people.

4. Conclusion

Credit availability to rural people is justified when they are faced with low saving capacity, poorly developed rural financial markets and limited availability of appropriate farm technologies whose adaptation is constrained by shortage of funds. Credit has become a critical factor in modelling the growth of agricultural productivity and development of rural economy which consists mainly of agriculturally based economic activities. Nigerian government established many Credit Guarantee Schemes to provide credit to rural people who are mainly farmers; however, the nature and the operation of the formal credit sources have failed to provide credit to rural people, hence the increase in the patronage to informal credit sources by rural farmers and other entrepreneurs. Most of the borrowers of informal credit obtained information from other borrowers; the credit is used for payment of debts and to marry more wives. It is recommended that the lenders should reduce the harassment of borrowers and there should be uniformity in the charging of interest rate.

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