Global Scientific JOURNALS

GSJ: Volume 8, Issue 9, September 2020, Online: ISSN 2320-9186
www.globalscientificjournal.com

THE ROLE OF INFORMAL FINANCIAL SECTORS IN DOMESTIC FUND MOBILIZATION IN THE EASTERN REGION. (A CASE STUDY OF KENEMA, KAILAHUN AND KONO DISTRICTS IN SIERRA LEONE).

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Abstract

Since the informal finance got into the financial system in Sierra Leone, small and medium business organizations and individuals have been seeking ways and means of introducing it to promote financial deepening and efficiency. This study was set to investigate the role of informal financial sectors in domestic fund mobilization in the eastern region of Sierra Leone, comprising three districts; Kenema, Kailahun and Kono. The study targeted market women. The data was gathered through the use of questionnaire and face-to face interviews. The analysis was done through the special package for social sciences (SPSS) that culminated into frequency tables and graphs. According to the findings, majority of the women are engaged in single collector type of Osusu clubs. They got their startup capital from owned savings and gifts from relatives and financed their lump sum expenditure through these clubs although some have savings at the bank. Their day-to-day expenditures are financed through the profit from the business. The study revealed that the collectors are not regulated and do not pay taxes on their earnings. To a large extent the existence of large informal financial sectors is due to repressive financial systems, where high interest rate ceilings are set and credit allocated only to those who have the collateral requested. Such an endeavor has resulted to a large proportion of the populace being excluded from utilizing formal credit services.

Therefore it was recommended that a system be put in place by government for regulatory purposes for the collectors not to engage in defrauding the market women and pay taxes on their

earnings as finance without regulation ends up with fraud. Also the banks should relax policies for access of loan to medium and small businesses including market women.

Introduction

This paper examines why and how informal finance fits into the financial system of Sierra Leone. The subject matter of this paper follows on from a body of literature that emerged in the late 1990s relating to sub-Saharan African (SSA) economies specifically to Ghana, Nigeria, Malawi, and Tanzania on the impact of liberalization reforms on the financial sectors of these economies. The main focus of these studies was to assess the impact of financial liberalization and informal finance on economic growth in SSA. (Aryeetey (1994, 1996), Aryeetey at al (1997), Soyibo (1996a, 1996b), Chipeta and Mkandawire (1996a, 1996b) and Bagachwa (1995, 1996)

According to the financial repression hypothesis, the existence of large informal financial sectors is due to repressive financial systems. That is, where interest rate ceilings are being set and credit allocated by the state, a large proportion of the populace is being excluded from utilizing formal credit services-including the poor, micro and small businesses or generally sections of the populace who do not have ties to the political elites. As a result, this section of the population has no alternative but to turn to informal means of accessing credit such as family, friends or being part of informal savings and credit clubs such as Rotating Savings and Credit Associations (RoSCAs), Susu groups or Osusu groups (as they are, known in Sierra Leone) and Tontines.

The solution is to liberalize the financial systems of these economies by letting interest rates be market determined, thus increasing competition amongst formal financial institutions. This will then promote financial deepening and efficiency and in the process, eliminate the use of informal finance. The ultimate gain from financial liberalization will be economic growth (Mckinnon (1973), Shaw (1973) and Fry (1988),)

Why Do Informal Financial Systems Exist?-The Theories

Chipeta and Mkandawire (1996a) and Soyibo (1997) summarise the main schools of thought and theories relating to the origins of informal finance. Broadly these include: (a) The Institutionalists theories (Nissanke and Aryeetey, 2006, 2008), (b) The Imperfect Information Hypothesis (Hoff and Stiglitz, 1990) and (c) The Structuralist school of thought (Hugon, 1990).

The Institutional Economists' School Of Thought

The pioneers of the institutionalisms school of thought argue that informal finance or fragmented financial sectors exist due to institutional constraints faced by formal institutions that operate in African financial systems. The constraints include the lack of appropriate mechanisms to deal with the management of financial risks, enforcement of contracts and screening and monitoring of loans. This then results to a fragmentation of the financial system, because formal institutions are likely to only serve clients that pose minimum risk and costs to them. The other clients will have to look to informal sources to satisfy their financial services needs. The proposed means of addressing these institutional constraints according to Institutional economists includes integrating or linking the formal and informal sector. They argue that this will result in improving the effectiveness of informal finance and also increase financing to small and medium-sized enterprises and the low income populace.

The hypothesis presented applies to most underdeveloped financial sectors across sub-Saharan Africa and therefore contributes to our understanding of the continued existence of informal finance.

The Imperfect Information Hypothesis

Hoff and Stiglitz (1990) put forward a hypothesis for the existence of informal financial markets which considers the type of financial sector that will exist in environments characterized by imperfect information and imperfect enforcement of contracts. They argue that under such circumstances, differences in costs and characteristics of different types of financial transactions are created which leads to different sections of the system specializing in certain types of transactions. This gives rise to an informal financial sector that exists alongside the formal sector. The hypothesis goes further to note that due to imperfect information and enforcement of contracts, the economy is faced with the challenges of moral hazard, asymmetric information, adverse selection and adverse incentive. This paper notes that this school of thought offers similar reasoning to the institutional economists for the existence of informal financial activities within an economy given that it also emphasizes on the role of factors including imperfect information and enforcement of contracts in promoting financial transactions taking place outside the formal financial system. However, it goes further to acknowledge that the problems such as moral hazard and adverse incentive are faced by both the formal and informal sectors. This hypothesis is relevant to the current financial system that exists in most Sub-Saharan Africa economies. The sub-saharan African economies lack mechanisms and tools such as wellfunctioning credit reference bureaus to screen potential customers. Financial institutions in underdeveloped financial systems have to rely on qualitative methods to screen potential clients. Thus, they have to charge high interest rates as a way of excluding clients that are usually regarded as not being creditworthy; and also to make up for the high transaction costs they incur.

The Structuralists' School Of Thought

The structuralists believe that the informal sector is subordinate to the formal sector. The informal financial sector exists for example, not because of excessive government regulation- claimed by the financial repression school, but to serve a social purpose. Through the informal financial sector, incomes are being redistributed from the "haves" to the "have nots" in communities. It serves a purpose of meeting short term liquidity needs of those who need it in society. The social purpose of informal finance is also reiterated by Von Pischke (1991) in defence of the usefulness of informal finance.

This paper welcomes the notion of "going beyond the economics". This is because in some cases it is a useful way of analyzing certain phenomena, especially with regards to African economies where data is scarce and experiences with policy implementation are not properly documented.

Informal Finance: The case of Sierra Leone

This paper suggests that informal finance in Sierra Leone cannot be fully understood without having an insight into the formal financial sector including its institutions, markets, services, transactions and practices. In addition to the theoretical explanations for the emergence of informal finance that have been discussed above, the analysis that follows would reveal the country's specific factors that have led to the continued existence of the informal financial sector alongside the formal system in Sierra Leone.

The evolution of the formal financial system is discussed in relation to three distinct eras; that is (a) Pre-independence, 1800 to early 1960s (b) Post-independence, late 1980 to early 1990s and (c) post-war period up until 2016. The analysis will highlight the implications for the use and existence of informal finance during these different periods.

Pre-Independence; 1800 to Early 1960s: A Foreign Dominated Financial System

Sierra Leones formal financial system emerged from the setting up of a banking system that existed during the colonial era. In 1898, The Bank of British West Africa Limited was the first commercial bank to be established in Sierra Leone. Leigh (2004) and Rogers (2006) explain that, it was set up mainly "to provide banking facilities for British trading companies and the colonial administration". This was followed by the setting up of the West African Currency Board (WACB) in 1912 which mainly served the purposes of a central bank. The WACB operated from London, with the Accountant General in the respective colonies acting as the main counterpart to the British headquarter..

In 1917, the Barclays Bank was established to provide banking services to British entities in Sierra Leone. Leigh (2004) points out some limitations of the aforementioned commercial banks and this paper argues that these limitations had some implications for the use of informal finance during this era. Leigh (2004), points out that the banks that existed at that time did not provide credit to Africans (referring to Sierra Leoneans) because: (a) they did not keep accounts of their commercial activities, (b) they did not have the appropriate collateral required for loans, and (c) also Africans were allegedly unreliable when it came to financial matters. This paper thus concludes that from the onset, major sections of the indigenous population were excluded from the formal financial system. In such a financial system, the financial needs of the local populace would have to be met by informal forms of finance including being part of community loan and saving groups or borrowing from friends and family.

Post-independence, late 1980 to early 1990s and post-war period up until 2016: The Rise Of Domestic Banks' Participation In The Formal Financial System

Upon gaining independence in April 1961, Sierra Leone formal financial system was reformed to the extent that domestic participation was encouraged. This period also saw the establishment of a variety of institutions and accompanying services and instruments in the financial system. Leigh (2004) states that one of the objectives of the banks was making profits for its shareholders in relation to its required liquidity ratio. The amount of liquid assets held by banks during this period was high owing to the liquidity ratio stipulated by the central bank. This paper argues that the amount of liquid assets held had a bearing on the amount of loans that could have been made available to the general public. In addition, in order to make profits on the small amount of loans that were being offered, the interest rates charged on these loans were very high. Under such circumstances, the use of informal credit in particular was inevitable.

In terms of existing literature, there there is none specifically on informal finance in Sierra Leone. However, a leading Sierra Leonean historian, Alusine Jalloh has some work on this subject. His work specifically relates to the role of informal credit in the politics of Sierra Leone. During the period prior to financial liberalization, those who did not acquire credit from the formal sector (since credit was directed) including small and medium enterprises might have sought finance from informal sources such as family, friends and the political elites. Jalloh (1999, 2003) documents how informal credit was used by politicians to gain popularity with voters. Sierra Leone's financial system was repressed during this period and large sections of the populace could not access formal finance as deduced from the discussions above. It is evident that the politician business men must have served as informal sources of credit for the poor and small businesses. Jalloh (2003), reports that informal credit included both trade credits (for rice) and cash. Thus, this paper infers that the role of informal finance in politics represented both a demand for and a supply of informal credit in Sierra Leone, hence contribution towards the use and relevance of informal finance during this period.

The other way of improving access to formal finance during the late 1980s to mid 1990s was the setting up of eight rural banks. Fraser (2012) explains that this was done in order to provide financial services (more of credit) for those rural businesses that commercial banks did not extend credit services to. However, the rural banks operated under difficult circumstances and did not "deliver the goods" as intended by the Bank of Sierra Leone which ploughed a significant amount of resources to establish these banks. For example, an examination of the performance of the Yoni Rural Bank by Jabati and Heidheus (1995) finds that it did not perform well in terms of reaching its target group and loan operations. On the whole, a very small proportion of the target group was being served with a loan portfolio which was dominated by agricultural businesses and as a result, the loan demands of the commerce sector, for example, were not being met.

Statement of the Problem

Sierra Leone implemented several such economic and financial policy reforms during the 1980s and 1990s. Fowowe (2008), Kargbo and Adamu (2009) and Kargbo (2010), highlighted that financial liberalisation in Sierra Leone included bank denationalisation and restructuring, interest rate liberalisation and removal of directed credit. In addition, one of the country"s largest post-war joint donor-government access to finance projects to date, Microfinance Investment and Technical Facility (MITAF) had as part of its core objectives to increase access to formal finance while transforming credit allocation to a market based system" (MITAF 1, project document). Following this wave of liberalisation reforms of financial sectors in SSA, empirical studies such as Aryeetey and Nissanke (1998) and Aryeetey et al (1997) focused on assessing the impact of financial liberalisation on growth in SSA. In the process, they also sought to find out the impact these reforms had on the financial sectors in these economies since this was to be the channel through which economic growth was to be achieved. The liberalization reforms were meant to improve the efficiency of the formal financial systems making them more capable of serving all sections of the population.

However, irrespective of all these interventions there still exists increasing lack of access to formal finance due to unnecessary bottle necks. As a result majority of loan seekers have recourse to informal finances to embark on productive economic activities. This research therefore aims at providing empirical data on the Sierra Leone situation.

Objectives of the study

The main objective of the study is to ascertain the impact of informal financial sector on domestic revenue mobilization and specifically:

- To investigate the status quo of the informal financial system in the eastern region.
- To establish the empirical data on the structure of the informal financial sectors in the eastern region.
- To establish the link that exists between the formal and informal financial sectors.
- To establish the challenges militating against revenue mobilization in the informal financial sector.
- To proffer some recommendations where necessary

METHODOLOGY

Study area

The study covered market women in Kenema, Kailahun and Kono districts in the eastern region and was focused on money lenders, collectors and osusu schemes in 2019 The inhabitants of the eastern region are of the Mende, Kono and Kissy ethnic groups, but all speak Krio; a derivative of English known as a lingua franca.

Research design

This study was a descriptive research set out to assess the effect of informal financial sector on domestic resource mobilization in the eastern region.

Population, sampling procedure and sample size

The population of women according to the 2015 census in the eastern region is 827,838. It is difficult to specifically state the population of market women in these districts, as no research has been done to ascertain that. Therefore a total of 250 market women of the headquarter towns of Kenema, Kailahun and Koidu were targeted for this study with a sample size of 152 (according to the Morgan's table).

Instrumentation and data collection

Primary data was collected with the aid of questionnaires and interviews (face-to-face). The interview was conducted in Krio, a local lingua franca. The questions were mostly close-ended type to enable the respondents to answer the questions without difficulty. Where necessary, open –ended question were asked. The collected data was coded and analyzed using the SPSS (Special Package for Social Scientists)

Results and Discussion

This section presents the analysis and findings. The responses have been interpreted carefully with tables developed where necessary. All the participants, 152 of them responded to most or all of the 66 questions developed in the questionnaire. All of the respondents were market women of whom 62 (41) have been in trade for 6 to 10 years and 45 (29%) have been in business above 15 years as shown in table 1 below

No. of years beginning to trade

No of yrs.	Frequency	Percentage	Cumulative percentage
1 - 5	10	7	7
6 - 10	62	41	48
11 - 15	35	23	71
Above 15	45	29	100
	152		

In terms of educational background, 52 (34%) have completed primary school and 60 (39%) not completed primary school while 8 (10%) have gone beyond secondary school. The rest 32 (21%) have never attended a formal institution. The majority 69 (44%) are involved in selling local food items, while others are involved in the trade of imported items, be it clothing, food items and footwear.

For source of startup capital, 60 (39%) got their capital from owned savings at home, 57 (37%) from gifts from relatives, loans from patents or relatives constituted 7% as shown in the table 2 below.

Source of capital for startup

Source	Frequency	Percentage	Cumulative percentage
Own savings at home	**60**	**39**	**39**
Own savings at bank	**5**	**3**	**42**
Loan from parents/relatives	**10**	**7**	**49**
Money lender	**6**	**4**	**53**
Bank	**7**	**5**	**57**
Credit union	**7**	**5**	**63**
Gifts	**57**	**37**	**100**
	152		

The participants were asked whether they belong to any Osusu schemes during their trading, and 145 (95%) responded that they do belong to osusu clubs, while 7(5%) said they do not belong to any club. Out of the 145, 116 (80%) belong to te type 2 osusu scheme while 29 (20%) belong to the type 1 Osusu scheme as shown below:

Type of Osusu	Frequency	Percentage	Cumulative %
Type 1	29	20	20
Type 2	116	80	100
	145		

The Type 2 osusu is when monies are collected by an individual either on a daily basis and given to an individual of the club with a compensation of a whole day's contribution by the receiving member (Bode) or the amount collected on a monthly basis and distributed to the membership at the end of the year. Here taking of loan is not compulsory, but a member who takes a loan gets 80% of the interest and 20% is distributed among the members including the loan taker. The Type 1 osusu is when an individual collects money on a weekly basis and gives as loan to a member for a minimal interest. Here taking of loan is compulsory by every member. The interest is distributed equally among members at the end of the year.

In order to finance these activities, most of the women become members of Osusu clubs comprising a lot of members. Table 3 below shows the strength of membership of the clubs.

No. of members registered with Osusu club

	Frequency	Percentage	Cumulative percentage
5 - 20	45	31	31
21 - 40	36	25	56
41 - 60	57	39	95
More than 60	7	5	100
	145		

The market women cited the reasons below for being part of Osusu schemes;

i. Easy access to money when needed 74%

ii. Social reasons 26%

They were also asked whether paying charges (locally called Bode) to collectors do not deter them in joining osusu club. The response was 100% no and they stated that they were generally satisfied with the Osusu club they are part of although they responded that if the bank doubled their interest rate, they will endeavor to save at the bank.

CONCLUSION AND RECOMMENDATION

The following conclusions were drawn from the study:

I The market women of the eastern region got their start up capitals from relatives and friends and lump sum expenditures are financed largely through owned savings at home, at bank and Osusu clubs while the day-to-day expenditures are financed through profits they earned from the business

Ii They prefer saving with the Osusu clubs than with the bank because of ease of access and for social purposes

It is therefore recommended that;

I the banks encourage traders by reducing the red tape in opening accounts and reducing the interest rate for loan facilities.

Ii A regulatory system be put in place to register these clubs to safeguard earning of the citizens and to pave way for payment of taxes on the earnings.

iii. The bank should find a way to increase interest on savings so as to capture more traders to do business with the bank**.**

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