

Jo★
**JOURNAL
of
SUSTAINABLE
TROPICAL
AGRICULTURAL
RESEARCH**

2002 • VOLUME 4

An international and interdisciplinary academic journal for the publication of critical reviews, analytical expositions and research reports in all areas of tropical agriculture and related disciplines.

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Lawrence Etim (PhD)
Editor-in-Chief

ISSN 1596-079X

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LINKING FORMAL AND INFORMAL FINANCE INSTITUTIONS FOR SUSTAINABLE MICROFINANCE SYSTEMS AND ECONOMIC DEVELOPMENT IN NIGERIA

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ABSTRACT

The provision of adequate funds for investment in microenterprises has remained an intractable problem in Nigeria. Government's response to this has been the setting up of such small scale enterprises financing institutions such as the Nigerian Agricultural Cooperative and Rural Development Bank and other credit delivery entities, encouraging the establishment of community banks, among others. This paper examines these programmes and indigenous informal finance arrangements. It suggests the integration of time-tested successful indigenous methods such as "etibe" and ajo ojojumo" into these formal institutions in order to achieve sustainable micro-finance system, economic growth and development.

Keywords: Linking, finance institutions, development, Nigeria

CITATION

Umoh, G. S. 2002. Linking formal and informal finance institutions for sustainable microfinance systems and economic development in Nigeria **Journal of Sustainable Tropical Agricultural Research**. 4:94-100

INTRODUCTION

Micro-enterprises or small-scale business have been identified as the engine of growth of most developing economies. In Nigeria, micro-enterprises are particularly important given their sheer large number and the number of persons who earn a living from them. Such small-scale businesses as agriculture, petty trading, crafts, food processing, transportation, etc. account for the sustenance of over 60% of the entire Nigerian population. Funds extended to these enterprises for the operations are often termed micro-credit. It is small in volume and targeted at small-scale businesses.

Micro-credit has been identified as "a compelling anti-poverty and development strategy". Odejide (1997) summarized the following as qualifying micro-credit as a tool for sustainable development: (a) Micro-credit programmes are sustainable in developing countries (Rhyme and Vogel, 1994; Awolowo – Dosumu, et al, 1997). (b) Micro-credit models have exhibited a high level of replicability. The replicability of micro-finance or micro-credit models cut across ethnic, cultural and geopolitical barriers and have spread rapidly around the world in many cases implementing innovations and adaptations that are necessary in the different contexts (SEP/UNIFEM, 1996 Micro-credit Summit, 1997). (c) Micro-credit programmes stimulate savings and asset accumulation (d) Micro-credit programmes are vehicles for achieving a variety of desirable social developments.

Within the Nigerian context, several authors have acknowledged the roles and potential roles of micro-credit in enhancing the activities of micro-enterprises. Iniodu and Ukpak (1996) writing on the relevance of rural finance for efficient management of agricultural development in post adjustment Nigeria, noted that a poorly developed financial system (including Micro-finance system) is obstacle to the development of wealth, enhancement of socioeconomic welfare and promotion of human dignity. Successive Nigerian administrations have recognised problems encountered by small scale entrepreneurs in securing adequate funds from mainstream financial institutions for their activities. Thus, some micro-credit schemes and programmes have been instituted with the sole aim of addressing the credit need for this group. However, records show that the performance of these schemes/programmes are far from being satisfactory. The need to make micro credit available to micro-enterprises to achieve development, the inability of the formal financial sector to satisfy the financial demand of the micro-enterprises, the potentials of the indigenous (traditional) micro-finance system to fill this gap, have together, rekindled interest on the possibility of linking the formal and informal credit institutions. Okorie and Miller on the one hand and Chukwu (cited in Berko, 1991) on the other, writing in 1976 and unknown to each other, suggested that *Esusu* clubs (*Etibe*) can be used by lending institutions to extend credit to people (Okorie and Miller, 1976, Chukwu, 1976). Recent studies in this direction have been articulated by Berko (1991) and Aryeteey (1996).

A survey of available literature reveals that the issue of linkage of formal and informal financial institutions has not received sufficient attention, empirical research in Nigeria. A few studies (Soyibo and Raheem, 1994; Olomola, 1998; Soyibo *et al*, 1999) only recommended the need to link the two. There is therefore, the urgent need to articulate how this can be done. This can move the concept further from theoretic to practice. In this paper, we x-ray some of the Nigerian government instituted micro-credit schemes/programmes, and the Community Bank, identifying their weaknesses. We also highlight various types of informal financial institutions indigenous to Nigeria. Finally, we suggest the integration of formal and time tested, indigenous micro-finance institutions to achieve sustainability of micro-finance system and economic development.

INSTITUTIONAL MICROCREDIT SCHEMES/PROGRAMMES IN NIGERIA

The Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB): The Nigerian Agricultural, Cooperative and Rural Development Bank Limited (NACRDB) is a development finance institution set up, in 1973 specifically to deliver credit to the Agricultural sector of the economy. It is a merger of Nigerian Agricultural and Cooperative Bank (NACB) and the People Bank of Nigeria (PBN). NACB had the following Schemes; On-lending, Direct Lending; Small-holder Direct Loan Scheme, Special Small Holder Loan Scheme; Workers Scheme; Marketing Loans. Of all these, the Small-holder Direct Loan Scheme; and Special Small Holder Loan Scheme are of direct relevance to our discussion.

Small-Holder Direct Loan Scheme: The scheme was designed to directly reach small farmers. The aim was to meet the increasing demand of the small scale farmers who produce over 90% of the food and fibre of the economy. The security requirements such as Certificate of Occupancy of the direct lending, is waived for borrowers. A farmer is only required to satisfy the operational staff that: (a) He is largely full time farmer with farmland belonging to him or his family or that he had permission to use it (b) He is resident in the village where the farmland is located (c) Can produce two guarantors to guarantee the loan.

The second requirement for the small-holder direct loan scheme contradicts the principle and spirit of the land use policy of 1978. The policy was put in place to enable enterprising farmers in "land hungry" areas to move to land abundant areas to pursue agricultural activities. The requirement tends to discriminate against "commuter farmers" i.e farmers who do not reside permanently in the communities where they have farms. It is common knowledge that in Nigeria some farmers reside in towns or other communities and commute between their residence and farm locations. Equally, the conditions for the small holder direct loan scheme seems to lose sight of urban farming, whereby most farmer just make use of any land they can lay their hands on. Such activities are encouraged by the fact that the urban farmer lives and work where there are unused plot e.g. school fields are converted to garden, etc.

Special Holder Direct Loan: This is a special on-lending scheme designed to reach the small scale farmers. The disbursement is supervised by the State Ministries of Agriculture and directly controlled by the office of the state Governors. The tenures of loans under this is one year. Further loan is not made to a state government until the previous one is finally repaid.

The handicap in this scheme is that NACB does not have rural branches. Therefore, the "real holders" can hardly be reached. Where they are reached, delays arising from the distant (from the NACB state headquarters to rural communities) may make it difficult to meet the financial needs for given farm operations.

The People's Bank of Nigeria (PBN) on the other hand was a specialized development bank. Its target beneficiaries were the poorest of the poor including widows, the unemployed, farmers and the handicapped. The bank had an integrated national structure with one head office, six zonal offices, each headed by an Area Coordinator, and a number of branches. Each branch was managed by a Branch Manager in conjunction with a People's Bank Community Relations Committee (PBRC) The targeting mechanism of the bank involved mounting enlightenment campaign and encouraging qualified participants to open accounts with it. To obtain loan, however, a prospective loanee operates an account for at least six months. He/she then applies for loan with particulars of intended use. The application goes to the PBRC for initial vetting. If recommended for approval, it is sent to the Zonal office from where it finally goes to the Head Office for final approval. Decision-making process was participatory. It involved the People's Bank community Relation's Committee members drawn from customers and local communities, the Branch managers, among others.

Beneficiaries of the People's Bank are given the initiative to determine projects to be funded. They also decide their loan expenditure patterns. Field officer's are primarily responsible for project monitoring and evaluation activities. Monitoring reports are submitted to the Zonal office on monthly basis. Inter-agency co-ordination of programs is effected through a National Microcredit Consultative Forum.

It has been observed that the PBN was initially successful in its savings mobilization efforts, by granting loan and advances. However, it did not take long before poor funding and management plagued the scheme (Ogwumike and Ekpenyong, 1995). From all indications, the success of the People's Bank was not expected to last. This conclusion is drawn from the fact that it was made to depend on grant from Federal Government. Government, especially during the past military administrations tended to play down the importance of time in its dealings and renege in its contracts. Again, the scheme was formulated with a strong components of the "top down" approach which has been criticized at various fora for delaying the growth processes (Umoh and Ibanga 1997, Ekong, 1997). This criticism is particularly valid in Nigeria where funds from government for development or other projects are considered a "national cake" that should be shared and ultimately not used for the projects such was meant. Equally worthy of note as one of the shortcomings of the PBN scheme is the very long decision-making process. From loan application to the Branch Manager, to initial vetting by PBRC, to the Zonal office for recommendation and finally to the Head Office for final approval. This process obviously negates the need to reduce the bureaucratic process which is known to discourage genuine entrepreneurs from benefiting from credit from the formal financial institutions. It should be recall that most of the potential beneficiaries of the PBN credit are farmers, (most of whom reside in the rural areas) whose activities must be done at appropriate time since farming in Nigeria is weather dependent. The PBN and NACB were merged in 2000 AD. This automatically means realignment of objectives and approaches with a focus on the small scale entrepreneurs – farmers and non-farmers alike.

The Community Bank: A Community bank is a commercial bank which serves only one community and which exploits its advantages of local knowledge and trust of the community. The Nigerian version of community bank was designed to correct the anomalies of the specialized banks/financial institutions which tended to ostracized the rural/grass root communities. Established in December, 1990, the community bank in Nigeria has as its objectives the promotion of rural development through the provision of finance and banking services inculcating the habit of banking in rural people, fostering the spirit of community ownership, and generation of credit from within the communities. The banks provide credit, deposit, accept and provide banking and other financial services to its embers, largely on the basis of self-recognition and personal credit worthiness. They also perform some non-banking services. It is the Community Banks National Board that gives matching loans to new banks, undertakes banking inspection, and organizes public enlightenment campaigns.

To obtain loan from the community bank, a customer is expected to apply. Such application is appraised by the Credit Development Officer, and then the Manager. It is then approved or rejected, depending on the applicants creditworthiness. Loan amounts range from N1,000.00 to N50,000.00 at a time to a borrower. The period of repayment is between three to ten months.

The present state of the community Bank in Nigeria clearly shows that there was something wrong with its formulation and implementation. Although some of the banks were close to the grassroots they were not effectively linked or integrated with the grassroots financial structures such as the *etibe* or *ojo ojojumo* which are time-tested indigenous savings mobilization and credit extension entities that have served rural communities for centuries. The banks also, in the main, adopted the conventional, urban banking methods which are not compatible with ways of the ruralites. These, coupled with the distress in the financial sector, lower public confidence in the system, and weaken their deposit mobilization efforts (CBN, 1996). Recent assessment by Olayemi (1999) confirms declining performance of the surviving community banks.

The Family Economic Advancement Programme (FEAP): The Family Economic Advancement Programme (FEAP) was established principally as a poverty reduction programme by Decree 11 of August 12, 1997. Its aim was to be achieved through the provision of capital by way of loans directly to people at ward level to enable them set up and run cottage enterprises.

The Federal Government provided the funds for the initial commencement of the programme to the participating banks under the supervision of FEAP Board through FEAP Secretariat. Subsequent funding was to involve the participation of states, local governments, the private sector, international agencies and organizations as well as ploughed back income earned by FEAP.

To benefit from FEAP facilities, participating groups of individuals were required to organize themselves into respective cooperative societies before they can register with FEAP. All prospective beneficiaries were, among others, required to: (a) Have a minimum of five and a maximum of twenty-five members (b) Have been duly registered by the Registrar of Cooperatives and subsequently register with FEAP (c) Open savings account with a participating bank nearest to its locations and save at least 10% of desired credit

facility (d) Cross guarantee each other for the groups facility (e) Deposit the groups registration certificates with the Registrar of Cooperative and FEAP with the Participating Bank through which loan is sought (f) Be identified by a reputable leader in their community (g) Have their integrity vouched for by their ward head (h) Have their applications screened by their ward and Local Government Coordinating Committees, respectively and get same recommended to the FEAP's Board through the Technical Advisory Committee of the Participating Banks.

The Family Economic Advancement Programme, like most other micro financing or micro-credit programmes was well intended, but again, policy instability, which saw to the scrapping of FEAP, has robbed Nigeria of the opportunity of fully assessing its performance after a reasonable period of operation. Nevertheless, a critical look at the structure of FEAP and procedure for granting loan, would reveal that it was tailored as other government programmes, and not made to last. For instance, the operational bases of FEAP are the state capitals, thus making it difficult for those in the rural areas (the intended beneficiaries) to be aware, not to mention fully participating in the programmes. The complex stages a potential participating group has to pass through before being granted loan suggest that the small scale entrepreneurs would definitely be left out. Field observations show that it was mostly the elitist groups-retired officers and wives of highly placed individuals who could meet the requirements and successfully pass through the very complex loan granting procedure.

The financing positions of some of the micro-financing programmes discussed so far are presented in table 1. Computation of the percentage change in the loans and advances reveal fluctuating and unimpressive performance. This is a clear testimony of the need to look inward, use what we already have to achieve what we want: Integrate our traditional micro-credit extension systems to earn sustainable development.

Table 1: **Loan and Advances (Nm) to Microenterprises by Community Banks, People's Bank and NACB***

	1993	1994	1995	1996	1997	1998	% change over preceding year				
							1994	1995	1996	1997	1998
Community Bank	708.2	1147.8	1366.4	1480.1	1501.2	1946.0	62.1	19.0	8.3	1.4	29.6
People's Bank of Nigeria	167.3	178.2	340.0	350.0	360.1	400.5	6.5	90.8	2.9	2.9	11.2
Nigeria Agricultural and Cooperative Bank	602.2	771.4	230.1	282.4	197.0	351.9	28.1	70.2	22.7	5.2	18.5

*Only Loans and Advances to small Holder Scheme are considered.

Source: Computed from Central Bank of Nigeria's Annual Reports and Statements of Account (various issues)

INDIGENOUS INFORMAL MICROFINANCE INSTITUTIONS

Odejide (1997) notes that there is a strong tradition of credit and savings in Nigeria which has for centuries supported informal sector activities. These include the well known revolving credit associations. (*Esusu* (Yoruba), *Etibe* or *Afe* (Ibibio), *Adashi* (Hausa). It is also known by various names in many parts of the world e.g. *tontine* (Cameroun), *Ko* or *Musin* (Japan), *Sheetu* (Sri Lanka), *Ekub* (Ethiopia), *Hui* (Nepal), *Osusu* (Gambia). This and other savings mobilization and credit delivery entities are frequently cited as indigenous practices in West Africa. Berko (1991) identifies seven types of microfinance institutions indigenous to Nigeria particularly Eastern Nigeria. These include: (a) Savings/Rotating Credit Association (SAROCA) (b) Savings, Contingency and Rotating Association (SACROCA) (c) Savings, Loans and Rotating Credit Association (SALROCA) (d) Fixed Savings Association (FISA) (e) Fixed Saving and Internal Loans Association (FISILA) (f) Savings and Open Loans Association (SOLA) (g) Traditional Mobile Saving Bank

(TRAMOSABA). The characteristics and operations of these indigenous Micro-finance institutions are highlighted below.

The Saving/Rotating Credit Association (SAROCA): This is the most popular in the rural communities. In SAROCA, each member contributes an equally fixed amount on a given day, or within a given limited period. A member who considers himself financially buoyant can choose to contribute twice or thrice the agreed amount. Such a member is said to contribute two or three "hands" as the case may be. The total contribution is handed out to one person, or sometimes to a few members at the same time. A member who obtains such an amount is regarded as having obtained an interest-free advance or credit and must continue to pay his/her handout. The member who contributes two or three "hands" is entitled to three handouts. The selection of the member to receive a handout at a time is often done through balloting. However, individual member may be requested to identify when he needs his/her hand.

The SAROCA is mainly practiced among people whose money needs do not coincide, or where it is possible for more members to defer projects requiring funds to future dates. Where there is a coincident of interest, such is resolved democratically. It is sometimes possible for members to swap positions even after the "positioning" had been done. This usually occurs if a member is faced with urgent financial need e.g. burial, marriage, court or police case, or if a member feels the time he selected does not coincide with his target expenditure period.

Savings, Contingency and Rotating Credit Association (SACROCA): This is much like SAROCA. However, in SACROCA, a small fraction of about 5% of each member's contribution is used to create a contingency fund from which loans may be obtained. Such loans, usually are small amounts, short-term (sometimes till the next meeting) and interest free. Usually, members get the whole of their contributions at the end of the cycle.

Savings, Loans and Rotating Credit Association (SALROCA): In addition to the characteristics of SACROCA, SALROCA has another feature. That of a conscious attempt being made to create loans fund. Thus, apart from receiving their normal rotational handouts, a member may also raise a loan from the loans fund.

Fixed Savings Associations (FISA): In FISA, there is no rotation of handouts but the occasional contributions of each member is kept safe, usually by the leader or treasurer or by several members to ensure security (Berko, 1991). At the end of a fixed period, every member receives the total of his/her contributions. This is usually practiced by people whose money needs, such as money for special occasion – Christmas or Sallah or for payment of school fees or for farming activities, coincides. The arrangement here is similar to savings in a fixed deposit account in a bank.

Fixed Savings and Internal Loans Association (FISILA): FISILA is close to FISA in its operation, except that a fraction of the member's fixed savings is set aside for loans to members. There is a self-imposed reserve or liquidity ratio of about 1:1 as total loans, each time, do not exceed 50% of total savings.

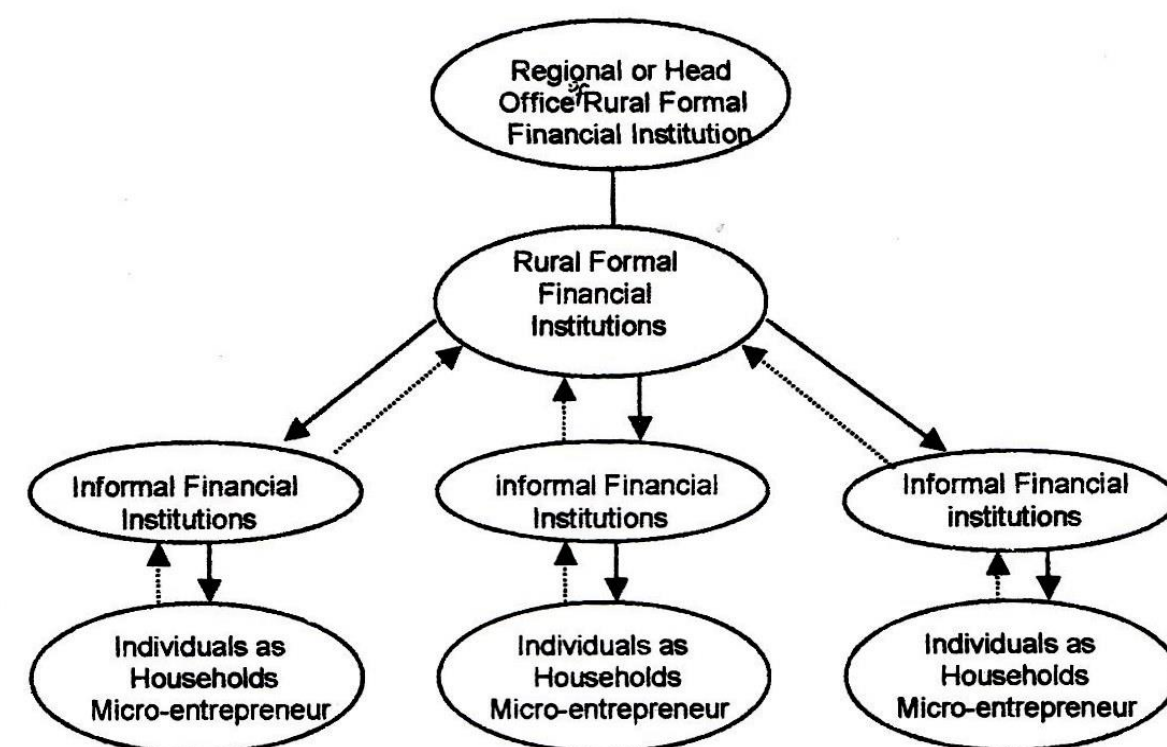
Savings and Open Loans Association (SOLA): The distinguishing feature of SOLA is that unlike other associations that business is done only with members, in SOLA, loans can be given to non-members as well. **Traditional Mobile Savings Banks (TRAMOSABA):** In this arrangement, a self appointed organizer or a business man or his/her agents goes round everyday to collect saving or the savers go to the organizer to pay their savings. At the end of the month or agreed upon period, the contributor receives his/her total savings less the commission which the organizer is paid. The commission could be the value of a day's saving. Unlike other types of credit and saving arrangement, in TRAMOSABA, there is no group effort as there is no formation of association. Contributors may not even know each other. Thus savings are strictly on individual basis.

LINKING FORMAL AND INFORMAL FINANCIAL INSTITUTIONS

Figure 1 illustrates how informal financial institutions can be linked with formal institutions. The linkage works this way: Individual persons (as household or micro-enterprises) come together to form their informal financial institutions (IFs) e.g. *Etibe*. These IFs can be linked to a rural financial institutions (RFIs) (e.g. NACRBD) which itself is likely to have an administrative and operational linkage to its regional office or headquarters. This type of linkage encourages a two way flow of activities. In the first place, the formal institutions can direct credit to the microenterprises through the channel. The flow of funds could start from their regional or head offices. Secondly, savings mobilization could also be effected. This would work well under Fixed Savings Association (FISA), Fixed Savings and Internal Loans Association (FISILA), Savings and Open Loans Association (SOLA) and Traditional Mobile Banks (TRAMOSABA). It is to be noted that even the Savings/Rotating Credit Association do have pooled funds which they used to celebrate a successful cycle of operation. Such pooled funds could conveniently be lodged with the rural formal financial institutions. This arrangement is feasible and viable with the use of NACRBD branches. But it needs to have more rural branches.

The formal financial institutions can complement the activities of the Traditional Mobile Banking. This would involve officials of such institutions identifying customers and going around to collect an agreed amount from such customers at an agreed date. Depending on the nature of the business of the customer. For traders, collection could be daily. For farmers, the collection period should be arranged to coincide with harvesting and marketing of produce. For fishermen, the daily fishing activities must be taken into consideration. It is important that the business cycle of the various target groups be given serious thought in planning savings mobilization programmes. The formal institutions can train the informal groups to effectively carry out this function and thus concern themselves with safe keeping the collections for the informal financial institutions. Linking the informal to formal financial institutions as suggested here has several benefits. First, when FIs safe keep collection from IFIs, the problem of theft of money, or loss of money through fire outbreak as is often the case in fishing settlement can be avoided. Second, the FIs official can use the opportunity of their interaction with members of informal financial association, to advise/train them on efficient financial management, and productive investment. Above all, such healthy association of formal and informal institution can ultimately strengthen the latter, thus making for a healthy and sustainable micro-finance system.

Fig. 1 Linkage Between Formal and Informal Financial Institutions



Key:

- > Line of linkage between Formal and Informal financial Institutions/Flow of Credit
 - - -> Flow of Savings

Issues of Sustainability and Economic Development

Most government rural financial institutions, or institutions directed at poverty reduction have been either supported by government or development agencies. The current thinking in micro-finance circles is that financial institutions should be sustainable. Sustainability requires financial institutions and programmes be viable. Self sustainability is the ability of financial institutions to generate enough income to cover at least, the opportunity cost of production and its asset and also being able to honour all its liability as and when due. The common quantitative indicator of viability is subsidy dependence index (for details see Yaron, 1992). The linkage between formal and informal financial institutions can enhance the sustainability of micro-finance system: (a) it would boost savings mobilization and credit delivery arising from (i) reduction in administrative cost for the micro-finance institutions (MFIs); (ii) encouragement of voluntary savings among rural population; (iii) improvement in loan/credit processing procedure, among others. In addition, a wider clientele can be reached due to increased flow of funds within the micro-finance system. Such increase flow

of funds is capable of boosting investment thus helping to push the development frontier one or two notches higher.

Conclusion

There exist overwhelming evidence that the sustainable development of Nigeria's economy particularly the rural economy requires steady supply of funds to the operating enterprises. There is also ample justification to believe that the traditional savings associations if well managed, have the potentials of mobilizing reasonable funds for rural enterprises. These associations have learnt to manage their own funds and have exhibited the spirit of self-reliance beyond all reasonable doubt (Berko, 1990). They should be able to manage funds which are obtained from external sources under strict business relationship (Seibel, 1990). Our suggestion here, is for the use of successful existing associations (it is possible to identify them) and not to ask for the formation of more. Such arrangements have been exploited in the past by corrupt individuals to collect money for projects which are never executed. Experience has shown that the rural people, especially, the illiterate ones are honest, serious and hardworking. This linkage can work in Nigeria. It has worked in other countries including Rwanda and Germany. We should however, not make the mistake of giving credit to the association before they mobilize sufficient savings.

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