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ANALYSIS OF FORMAL AND INFORMAL FINANCIAL SECTOR ON INCOME INEQUALITY AMONG MICRO AND SMALL SCALE ENTREPRENEURS IN JALINGO, NIGERIA

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Abstract

This study examined the relationship between formal and informal financial sector on income inequality among micro and small scale entrepreneurs in Jalingo, Nigeria. Data analysis was based on the questionnaire retrieved from 184 and 726 small and micro-entrepreneurs, a total of 912 obtained from the 229 and 794 sample determined by the Cochran's simple random sampling formula. Probit results show that respondents who obtain micro-credit from deposit money banks (DMBs), microfinance banks, and relatives are less likely to be poor, with 16.9%, 11.8%, and 6.8% probabilities, respectively. Also, respondents with monthly (43.88%), quarterly (48.56%), and yearly (37.08%) access to microcredit are less likely to be poor. The probabilities of a respondent having monthly and quarterly access to microcredit as a result of an increase in interest rates are 1.39% and 0.51%, respectively. The heteroskedasticity robust standard analysis was done and statistical significance was at p≤ 0.05. The study conclude that deposit money banks, microfinance bank and other microcredit sources should enlarge their territories so as to reach for poor people and give more microcredit access to entrepreneurs.

Keyword: Microcredit; Income Inequality; Micro and Small Scale Entrepreneur; Probit and Regression Model.

Introduction

These micro financial institutions (MFIs) assert that they are providing individuals with useful capital at interest rates that are not exorbitant, unlike the informal lenders within these developing nations. The poor tend to have limited access to services from formal financial institutions in less developed countries due to, some reasons such as the lack of physical collateral, the cumbersome procedure to start transactions with formal banks, which would discourage those without education from approaching the banks, and lack of supply of credit in the rural areas related to urban biased banking networks and credit allocations (Imai and Azam, 2010). According David and Eyo (2014), thus, most micro-credit entities adopt the solidarity approach, this involves lending to a group of 5-20 individuals. These individuals pursue common economic objectives and micro-enterprises activities. The group provides joint guarantee for each other's loan. The essence of the group solidarity approach is to guarantee loan to each member of the group. The aim of the group solidarity is to promote common goal for the member which are working to achieved the same economic interest, which facilitate the solution of common problem affecting them, the group has a leader who has management skills that help in group membership selection and confident in one another to the extent that access to credit for any member of the group depends on the consent of all members of the group.

The gap between the rich and poor began to be wider, this created what is referred to as income inequality. Higher levels of poverty and income inequality have been found to be detrimental to people opportunity, quality of life, countries growth and security (Ravallion, 2009). Income inequality globally and within many countries has decreased but in some countries it has risen (World Bank, 2016), the sustainable development goal 10 is to reduce inequality within and among countries. According to (Baumol and Blinder, 2010), causes of income inequality could be differences in ability, because people have different capabilities. Hence it should not be surprising that some people are more adept at earning income, it is clear that some types of inventiveness are richly rewarded by the market, and the same is true of that elusive characteristic called entrepreneurial ability and also differences in intensity of work, some people work longer hours than others or labour more intensely when they are on the job. Ability in risk taking, luck, inherited wealth, schooling and other types of training has also result in certain income differences that is largely voluntary. The effects of income inequality among micro and small scale entrepreneurs could result into poverty and which micro-credit can be used to reduce the income disparities among them, if the loan is properly utilized in the right direction. This study will contribute to literature and further make clarification on the comparism of formal and informal financial sector income inequality among micro and small scale entrepreneurs in Jalingo, Taraba state. This is the second poorest state in Nigeria (NBS, 2019).

Theoretical Literature

2.1.1 Microfinance

A little sum of money loaned to an individual or group of people without collateral is known as micro-credit (United Nations, 2004). If an entrepreneur can borrow from a certain source of micro-credit, he or she is said to have access to that source. The extent of access to micro-credit is defined by the maximum amount an entrepreneur can borrow (its credit limit). When an entrepreneur doesn't have access to financing or can't borrow as much as they desire, they are said to be credit limited (Diagne and Zeller, 2001). An entrepreneur who receives a loan from a credit agency may be found to be more productive, although this is not always the case. Because entrepreneurs with more desire and ability are more likely to seek out loans, loans lead to higher production. Microcredit is a notion that has been around for a long time. According to Brandt (Epifanova and Klepikova, 2012), documentation of poor-loan documentation has been noted in Europe from the 18th century. They give a number of examples. For one thing, Jonathan Swift established a fund to grant money "in tiny sums of five and ten pounds, to be repaid weekly, at two or four shillings, without interest" to "poor industrious tradesmen" (Brandt et al, 2012). The Irish Reproductive Loan Fund Institution was founded in 1822 with the goal of assisting the needy by granting small loans of less than 10 Euros in today's money.

Furthermore, 19th-century German credit cooperatives provide as an example of historical microfinance; these cooperatives functioned as a modern micro-credit self-help group in which the entire cooperative was given a loan and was collectively liable for repayment (Brandt et al., 2012). Finally, in colonial India, (Wolcott, 2009) presents an early example of microfinance in which very small loans were granted to persons in need without the need for collateral. Microcredit is not a new phenomenon. Microcredit emerged as a "contemporary" phenomenon in the 1970s. Muhammad Yunus, a native of Bangladesh trained in the United States who later became a professor at Chittagong University in Bangladesh, is a frequent proponent of the modern notion of micro-credit. When Yunus lent a modest sum of money from his pocket to a craftswoman he trusted to repay him in 1974, the now-famous Grameen Bank was born. Grameen Bank has gained a lot of worldwide attention since then, and Yunus was awarded the Nobel Peace Prize in 2006 (Yunus, 2003). Grameen and the numerous organizations that have adopted its model claim to be a significant source of poverty alleviation, but many Micro Finance Institutions (MFIs) also claim to empower women, especially in patriarchal nations like Bangladesh. In contrast to the informal lenders in these developing countries, these institutions claim to provide individuals with meaningful capital at reasonable interest rates. In less developed countries, the poor have limited access to formal financial services due to factors such as a lack of physical collateral, the lengthy procedure for initiating transactions with formal banks, which discourages those without education from approaching banks, and a lack of credit supply in rural areas due to urban biased banking networks and credit allocations (Imai and Azam, 2010). According to Eyo and David (2014), as a result, most micro-credit institutions use the solidarity approach, which entails lending to a group of 5-20 people. These people work together to achieve common economic goals and run micro-businesses. For each other's loans, the group gives a mutual guarantee. The goal of the group solidarity strategy is to ensure that each member of the group receives a loan. The group has a leader who has management skills that help in group membership selection and confidence in one another to the extent that access to credit for any member of the group depends on the consent of all members of the group.

2.1.2 Micro-Credit Sources

Concepts of micro-credit sources are outlined below in relation to this study:

(I) A Private Money Lender is a person who lends money to others privately.

A private money lender is an individual who lends money without being affiliated with any organization.

A trust deed for the purpose of financing a project. Formal (hard) money lenders are more conservative than private money lenders (www.corporatefinancialinstitute.com). Private moneylenders are in business to earn higher-than-average returns on their investments.

(ii) Loan from family and friends

This is a loan agreement in which family and friends agree to borrow money from micro-entrepreneurs for the purpose of starting a business. There may or may not be a formal contract involved in this agreement (Business Loans, 2017).

iii) Microfinance Institutions

This is a financial institution that serves the underprivileged, who are historically underserved by regular financial institutions. Microfinance differs from other formal financial products in three ways. The first is the small size of the loans provided and/or savings collected; the second is the lack of asset-based collateral; and the third is the ease of operations (CBN, 2005).

(iv) Industry Bank (BOI)

The Bank of Industry (BOI) - Microfinance Bank Limited is a Nigerian limited liability company that was established in 2002 under the Companies and Allied Matters Act and is governed by the Nigerian Central Bank. The bank provides a wide range of financial services to micro, small, and medium-sized businesses, as well as individuals and organizations of low-income workers. It provides asset finance loans, consumer loans, and group loans with a maximum loan amount of N500, 000 per company. It also attempts to encourage saving among the Nigerian society's unbanked productive poor (BOI Annual Report & Account 2016).

(v) The Society of Co-operatives

Cooperatives are intentional organizations founded by people for the purpose of mutual aid, and their goals are fulfilled through self-help and group work (Ogidi, 2017). The registration of cooperatives with the government is a requirement. The minimum number of people required should not be fewer than ten. The capital is raised from the members, also known as the share capital. Farmer/agricultural cooperatives, consumer cooperatives, community cooperatives, worker cooperatives, housing cooperatives, credit unions, civic society, second and third-tier cooperatives, and so on are all examples of cooperatives.

Inequality of Income

This is an economic notion that affects some parts of the population more than others, resulting in huge wage gaps. It also refers to how income is dispersed throughout the population; the less equal the distribution, the higher the income inequality. Wealth inequality, or the unequal distribution of wealth, is frequently associated with income inequality. Different ways of dividing populations can be used to highlight different levels and types of income disparity, such as income inequality by gender or race. (2020, Carol)

Income Inequality Measurements

Economists and statisticians employ this method. The Gini coefficient and the Lorenz curve are two examples of measurements that can be used to assess the extent of income inequality in the population.

The Gini Index was established in the early 1900s by Italian statistician Corrado Gini to help quantify and compare income inequality levels across countries. The Index can vary from 0 to 100, with a higher score indicating greater income disparity among a country's population and vice versa. According to World Bank data, South Africa has one of the highest levels of income inequality, with a Gini Index of 63.0. The United States has a Gini Index of 41.5, according to the World Bank. Ukraine has the world's lowest Gini Index reading of 25.0, according to the World Bank. Income inequality dispersion is a topic of continuing research for both local and global governments. The IMF and the World Bank have set a goal to help increase the income of the bottom 10% of earnings in all nations seeking global assistance. As part of a global push for financial inclusion, advancements in financial technologies and processes are also helping to improve the banking services of the world's lowest-income earners (Carol, 2020). The Lorenz curve is a tool for displaying data such as this. To create a Lorenz curve graphically, first draw a square with vertical and horizontal dimensions equal to 100 percent. We use all of the data we have to record the percentage of these families (or individuals) who receive on vertical (Baumol et al., 2010).

The Lorenz Curve's Properties

1. It starts at the beginning, with zero families having zero income.

2. It always comes to a halt in the square's upper right corner.

3. The Lorenz curve would be a straight line connecting these two places if income was divided equally.

4. In a real economy with significant income disparities, the Lorenz curve will sag downward from this perfect equal distribution line (Baumol et al., 2010).

Causes of Income Inequality

Ability differences: Everyone is aware that people have varying abilities. Some people can sprint faster, jump higher, ski better, do math faster, write faster, and so on. As a result, it should come as no surprise that some people are better at making money. However, economists, sociologists, and psychologists disagree about what kind of skill is crucial to generating money. The kinds of abilities that lead to academic achievement appear to have some influence, but not a significant one. Inherited intelligence is the same way (IQ). It is undeniable that some sorts of ingenuity, as well as that elusive trait known as entrepreneurial skill, are highly rewarded by the market (Baumol et al., 2010).

Differences in work intensity: Some people work longer hours or labor more furiously while on the job than others. As a result, there are some income disparities that are essentially voluntary.

Risk-taking: The majority of those who have amassed big quantities of money have done so by taking chances and investing their money in a risky business. Those who succeed at gambling become affluent. Those who attempt to fall get bankrupt. Most people, of course, would rather not take such a risk and end up somewhere in the middle. Another way that income disparities originate by deliberate efforts is in this way (Baumol et al., 2010).

Compensating salary disparities: Some jobs are more difficult, risky, or unpleasant for other reasons than others. In order to persuade people to do these professions, a monetary incentive is usually provided. Factory workers who work the night shift, for example, usually earn more than those who work during the day.

Schooling and other sorts of training: It is well acknowledged that disparities in education are a major factor of income disparities. However, there are both voluntary and involuntary parts to this reason. Young men and women who opt not to attend college are making voluntary decisions that have an impact on their earnings. Many people, however, never have the opportunity to choose; their parents simply cannot afford to send them, and the resulting wealth disparity is not voluntary.

Inherited wealth: Not all income is earned via labour; some is earned through the investment of money, and some is inherited. While this cause of inequality does not affect a large number of people, a large number of America's super-rich inherited their wealth.

We can't end our list without addressing the importance of luck. Some of the wealthy and some of the impoverished arrived by a combination of good and bad luck. Instead of finding water, a farmer discovers oil. On the stock market, an investor strikes it rich. The student prepares for a high-paying job only to discover that the chance has vanished while she is still in college. A construction worker is laid off for a year as a result of a recession that he had nothing to do with causing. Many of the significant wealth disparities between persons are just coincidental (Baumol et al., 2010).

Methodology

For Comparism analysis of formal and informal financial sector on income inequality among micro and small scale entrepreneurs in Jalingo, Nigeria, the study employed frequency distribution table and Gini Coefficient Determination.

To achieve this objective, income inequality among the micro and small entrepreneurs will be measured using the Gini coefficient and the Sen-Shorrocks-Thon Index.

Gini Coefficient Determination

Gini coefficient is a measure of the degree of inequality in the distribution of income among micro and small-scale entrepreneurs. The equation of the coefficient is expressed as;

$$Gini = \frac{1}{2n^2\bar{Y}} \sum_{i=1}^{n} \sum_{j=1}^{n} \left| Y_i - Y_j \right|$$

Where;

$Gini$ = *Gini Coefficient*

$\bar{Y}$ = *mean income of the respondents*

n= *total number of respondents*

y_i = *Income of the respondent i*

y_j = *income observation of all other observations*

$$GINI_i = \beta_0 + \beta_1 MCR_{volume_i} + \beta_y X_i + \varepsilon_i$$

$GINI$ =The Gini index, ranges from 0 (perfect equality) to 1 (perfect inequality).

MCR_{Volume} =*the amount of micro-credit obtained by the individual entrepreneur*

X_i = *indexes factors that influence income inequality, such as firm size, level of education, poverty, assets, etc.*

β_y =*indexes coefficients of factors that influence poverty*

Source of Credit

Table 1 shows the respondents source of credit. The result shows that 8.7% of the respondents obtain microcredit from deposit money banks (DMB) sources, 4.6% from the bank of industry (BOI), 41% from microfinance banks (MFB), 8.6% from agriculture banks, 8.9% from cooperative, 27.6% from money lenders, while 0.7% respondents obtain microcredit from relatives. From the result, the majority of the respondents obtain microcredit from Microfinance banks.

Table 1. Source of Credit

Source of Credit	*Frequency*	*Percent*
Deposit Money Bank	79	8.7
Bank of Industry	42	4.6
Microfinance banks	374	41.0
Agriculture Bank	78	8.6
Cooperative Bank	81	8.9
Money lenders	252	27.6
Relations	6	0.7
Total	912	100

Source: Field survey (2021)

Repayment Period

Table 2 shows the repayment period of microcredit finance. The result shows that 19.6% of the respondents repay the credit at 3months after collection, 5.9% repay after 6months, 59.6% repay in 12 months while 14.8% repay credit more than one year after collection of credit. From the table, the majority of the respondents repay credit 12 months after collection.

Table 2: Repayment Period

Repayment Period	*Frequency*	*Percent*
3 months	179	19.6
6 months	54	5.9
12 months	544	59.6
More than one year	135	14.8
Total	912	100

Source: Field survey (2021)

Effects of the volume of microcredit on income inequality among the micro and small-scale entrepreneurs

Response Analysis of the Effects of microcredit on poverty and inequality

Table 3 shows the effects of microcredit on poverty and inequality among micro and small-scale entrepreneurs, 71.8%, which accounts for the majority of the respondents strongly agreed that there is high prevalence of poverty in Nigeria, while only a few disagreed with the notion. In the same vein, 381 respondents which represent 41.8% disagreed with the notion of high awareness of microcredit, while only a few were undecided in their opinion. Similarly, 33.2% of the total respondents disagreed with the notion of easy repayment method, while only a few strongly agreed with an easy repayment period. About 60.7%, which constitutes the majority of the respondents agreed that microcredit has made an impact on their business while only a few making up 0.7% of the total respondents strongly disagreed. Also, the majority of the respondents are of the opinion that microcredit has improved their family income and only a few respondents strongly disagreed with the notion. Similarly, the majority of the respondents agreed that microcredit has improved their standard of living and income after accessing microcredit, reduced income inequality in their business and also increased their household meal intake while only a few respondents of the total population strongly disagreed with these opinions. Lastly, the majority of the respondents also agreed that microcredit improved the quality of education of their children and only a few were undecided.

Overall, the majority of the respondents agree that microcredit has reduced poverty and the income inequality among micro and small-scale entrepreneurs. The analysis emphasizes the effects of microcredit on poverty and inequality among micro and small-scale entrepreneurs. By indication, the majority of the respondents agreed that access to microcredit has made and impact on their business, which has improved their income and in turn, improved their family income, standard of living, the quality of education of their children and increased their household meal intake. Also, many respondents equally agreed that access to microcredit has income inequality in their business thereby reducing poverty.

Table 3. Effects of microcredit on poverty and inequality among small scale farmers

Items	Strongly Disagreed	Disagreed	Undecided	Agreed	Strongly Agreed	Total
Poverty is highly prevalent in Nigeria	0(0)	12(1.3)	12(1.3)	233(25.5)	655(71.8)	912(100)
The awareness of micro-credit loan is high	146(16)	381(41.8)	24(2.6)	307(33.7)	54(5.9)	912(100)
Micro-credit has made an impact on your business	6(0.7)	88(9.6)	68(7.5)	554(60.7)	196(21.5)	912(100)
The method of repayment is easy	165(18.1)	303(33.2)	82(9)	284(31.1)	78(8.6)	912(100)
micro-credit has improved your family income	12(1.3)	113(12.4)	173(19)	424(46.5)	190(20.8)	912(100)
Your standard of living has improved	6(0.7)	106(11.6)	122(13.4)	465(57.0)	213(23.4)	912(100)
Micro-credit has reduced income inequality in your business	48(5.3)	67(7.3)	162(17.8)	456(50.0)	179(19.6)	912(100)
Your income has improved after accessing micro-credit	6(0.7)	156(17.1)	43(4.7)	457(50.1)	250(27.4)	912(100)
micro-credit has improved the quality of education of your children	0(0)	94(10.3)	93(10.2)	447(49)	278(30.5)	912(100)
micro-credit increases the meal intake	21(2.3)	73(8.0)	43(4.7)	481(52.7)	294(32.2)	912(100)

Source: Field survey (2021)

The effects of volume of microcredit on income inequality for Micro entrepreneurs

Table 4 shows a negative and significant effect of microcredit from the deposit money bank on income inequality. At 1 percent level of significance, microcredit from deposit money bank decreases income inequalities by 0.009%. This shows income inequality reduces as micro entrepreneurs obtain microcredit from the deposit money banks, Also, a unit increase in the volume of microcredit from the bank if industry and microfinance banks increase and decrease the Gini index by 0.14% and 0.10% respectively at 1% level of significance. By implication, microcredit from bank of industry has welfare effect on the micro entrepreneurs, while microfinance microcredit increases the income inequality. However, there is a positive and significant effect of poverty on income inequality at 1 percent level of significance, which means that poverty increase income inequality by 0.008%. The R squared is 67.71%, which indicate that about 68% of the variation in the Gini index is explained by all the independent variables and there are 726 numbers of observations and the p-value of the F-statistics indicates that the model is fit and statistically significant at the 1 % level of significance. In summary, the volume of microcredit from the deposit money banks, microfinance banks and from money lenders reduces income inequality among the micro entrepreneurs, while microcredit from the bank of industry and poverty have significant and positive effects on income inequality among the micro entrepreneurs.

Table 4. Effect of volume of microcredit volume on income inequality for micro entrepreneurs

Gini index	Coef.	T	P>|t|
Log of Volume of credit from Deposit money bank	-0.00009	-4.520	0.000***
Log of Volume of credit from Bank of industry	0.00014	4.300	0.000***
Log of Volume of credit from Microfinance bank	-0.00010	-6.270	0.000***
Log of Volume of credit from Agricultural bank	0.00000	0.120	0.903
Log of Volume of credit from Cooperative bank	0.00000	0.020	0.983
Log of Volume of credit from money lenders	-0.00029	-12.510	0.000***
Volume of credit from relation	-0.00004	-1.010	0.313
Poverty	0.00008	2.610	0.010***
Constant	0.00539	11.960	0.000
R-squared	0.6771		
Number of observations	726		
F(8, 177)	88		
Prob> F	0.0000		

Note: *** *p<0.01*, ** *p<0.05*, * *p<0.1*
Source: Author’s computation from STATA 15, (2021)

The effects of volume of microcredit on income inequality for small entrepreneurs

Table 5 shows that the R squared is 50.65%, which indicate that about 51% of the variation in the Gini index is explained by all the independent variables and there are 186 numbers of observations and the p-value of the F-statistics (170.85; 0.0000) indicates that the model is fit and statistically significant at the 1 % level of significance. The coefficients indicate that there are negative and significant effects of volume of microcredit from different sources on income inequality. Specifically, a unit increase in the volume of microcredit from the deposit money banks, agricultural bank, money lenders and from relatives decreases the Gini index by 0.012%, 0.004%, 0.002%, 0.011% and 0.006% respectively at 1 percent level of significance. This analysis indicates that the volume of microcredit from deposit money banks, agricultural bank, cooperative society, money lenders and from relatives are welfare enhancing as they decrease income inequality among small scale entrepreneurs. However, volume of microcredit from the bank of industry and microfinance banks increases income inequality, this situation may be attributed to high interest rate attach to their microcredits.

Table 5. Effect of volume of microcredit volume on income inequality for small entrepreneurs

Gini Index	Coef.	Std. Err.	T	P>|t|
Volume of credit from Deposit money bank	-0.00012	0.00002	-7.58000	0.000***
Volume of credit from Bank of industry	0.00003	0.00001	1.78000	0.0750*
Volume of credit from Microfinance bank	0.00004	0.00001	3.36000	0.001***
Volume of credit from Agricultural bank	-0.00004	0.00001	-2.82000	0.005***
Volume of credit from Cooperative bank	-0.00002	0.00001	-1.30000	0.19400
Volume of credit from money lenders	-0.00011	0.00001	-7.38000	0.000***
Volume of credit from relatives	-0.00006	0.00002	-3.59000	0.000***
Poverty	0.00002	0.00002	-1.20000	0.23200
Constant	0.00388	0.00017	22.76000	0.000***
R-squared	0.50650			
Number of observations	186			
F(8, 177)	170.85000			
Prob> F	0.00000			

Note: *** *p<0.01*, ** *p<0.05*, * *p<0.1*
Source: Author's computation from STATA 15, (2021)

Conclusion

From the sources of credit table, the financial institutions were broken into two parts; formal and informal institutions. The formal institutions consist of deposits money banks, bank of industry, microfinance banks and bank of agriculture with 8.7%,4.6%,41%,8.6% while the informal institutions consist of cooperative banks, money lenders and relation with 8.9%,27.6% and 0.7%. This analysis indicates that the volume of microcredit from deposit money banks, agricultural bank, cooperative society, money lenders and from relatives are welfare enhancing as they decrease income inequality among small scale entrepreneurs. However, volume of microcredit from the bank of industry and microfinance banks increases income inequality, this situation may be attributed to high interest rate attach to their microcredits. In summary, the volume of microcredit from the deposit money banks, microfinance banks and from money lenders reduces income inequality among the micro entrepreneurs, while microcredit from the bank of industry and poverty has significant and positive effects on income inequality among the micro entrepreneurs.

Recommendations

The government should provide lower interest rates loans facility to micro and small scale entrepreneurs through formal financial institutions to reduce poverty and encourage the growth of micro and small scale enterprises in the economy, and also establishment of financial institutions in the areas where they are not established to encourage access to loanable funds in the community.

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