Journal of Sustainable Development in Africa (Volume 14, No.2, 2012)
ISSN: 1520-5509
Clarion University of Pennsylvania, Clarion, Pennsylvania

SHYLOCK VS. ANTONIO: INFORMAL MONEY LENDING IN RURAL COMMUNITIES IN THE JAMAN NORTH DISTRICT, GHANA

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ABSTRACT

This paper examines lending and borrowing in a rural setting, and the implications for microfinance schemes in the Jaman North District of Ghana. Using a qualitative research methodology, the study purposively selected two lenders and eight borrowers from two rural communities in the District. It was found that rural farmers borrow at an interest rate of 100% per annum, and in default lose their cocoa farms (one of their major livelihood asset). Meanwhile, respondents are aware of the existence of bank loans at lower interest rates, but are not willing to access it due to perceived complexities. However, none of the respondents had a bank account, or is aware of micro-finance department/unit of rural banks in the District. It is recommended that rural banks in the District should engage in diversified sensitization approach which seeks to demystify the perceived complexities and enhance behavioural change and hence improve the sustainability of the livelihoods of rural dwellers.

Keywords: Moneylenders, borrowing, loan, default, Ghana

INTRODUCTION

Agriculture is a major contributor to developing countries' economy and the important role of credit in agricultural enterprise development and sustainability cannot be overemphasized. Thus, in developing countries, most of the population earns its living from agriculture, either directly or indirectly. However, agricultural income has been found to be inherently uncertain due to weather, pests, disease, fires and variability of prices, all of which are capable of generating fluctuations in farmers' incomes even when output is stable. For instance, for many of rural people, who are mainly dependent on agriculture, a poor harvest or a low harvest price can threaten disaster, even if, on average, agricultural incomes are sufficient to provide a sustainable standard of living for them. In such circumstances, the protection of living standards requires that resources be transferred across time, from good years to bad years (Deaton, 1992), and sometimes through borrowing.

Borrowing has been and still is one of the immediate traditional means of dealing with livelihood shocks and vulnerabilities associated with agricultural activities. A loan involves the exchange of current resources for future resources, and therefore involves a promise. Resource transfers over time are essential in the seasonal agricultural economies of the rural areas of many poor nations (Aryeetey and Udry, 1995). The provision of credit has increasingly been regarded as an important tool for raising the incomes of rural populations, mainly by mobilizing resources to more productive uses. As development takes place, one question that arises is the extent to which credit can be offered to the rural poor to facilitate their capability of initiating an entrepreneurial activity. The generation of self-employment in non-farm activities requires investment in working capital. However, at low levels of income, the accumulation of such capital may be difficult. Under such circumstances, loans, by increasing family's scope of financial resources, can help the poor to accumulate their own capital and invest in income- and employment-generating activities (Hossain, 1988).

Meanwhile, the often generalised image of the poor as short-term maximizers has led to the unfortunate overgeneralisation that poor people cannot at present practice sustainable development. Access to financial services by smallholder farmers is normally seen as one of the constraints limiting their benefits from credit facilities. However, it has been argued that, in most cases, the access problem, especially among formal financial institutions, is one created by the institutions mainly through their lending policies. This is displayed in the form of prescribed minimum loan amounts, complicated application procedures and restrictions on credit for specific purposes (Schmidt & Kropp, 1987), especially for consumption activities. Offei (1965) provides three reasons why rural persons have poor access to formal credit facilities – the lack of collateral security, the fragmented nature of farms, and the risk that they will divert their loans to consumption items. Subsequently, the three primary sources of credit for rural persons are private informal institutions and individuals, co-operatives, and some public institutions, some of which are mostly flexible in the requirements for loans.

One of such agents who frequently provide credit to the rural people in times of shocks and vulnerabilities is the informal moneylender. Adjetey (1978 cited in Aryeetey, 1994) places informal moneylenders in two categories: those who are licensed to operate under the Moneylenders Ordinances of 1940 and 1957 of Ghana, and those who do business without official authority. The latter group (the focus of this study) tends to dominate the business and operates primarily among farming communities. In some cases, some of people are not themselves professional moneylenders, but because of their good financial standings in their respective communities, people resort to them for loans as and when the need arises. Most of these moneylenders operate their lending businesses alongside other businesses, and profits are often switched between the two, depending on which needs re-capitalization (Aryeetey, 1992).

The actions of lenders depend on the amount of information they have about their clients and the enforcement power they possess. It is the different degrees of information and enforcement power that enables the informal moneylender to perform a better screening of clients, possibly offer better incentives to make repayment more likely, and solve the enforcement problem by compelling repayment (Hoff & Stiglitz, 1990). However, the main challenge of these money-lending activities in rural setting is the fact that there is a great deal of heterogeneity among farmers in any village. While lenders might have a good idea about the average characteristics of the pool of potential borrowers, they may not have complete information concerning the characteristics of any particular borrower. This may lead to problems of adverse selection (Aryeetey & Udry, 1995). Thus, lenders tend to give loans to people who have the potential for repayment.

In Ghana, successive governments, Non-Governmental Organisations (NGOs) and the private sector have implemented various agricultural and rural credit schemes as a means to address perceived shortage of rural credit, stimulate rural employment and productivity. For example, rural banks were introduced into Ghanaian rural areas, ostensibly to improve the availability of credit to farmers. This is because microfinance is expected to be one of the most important tools against poverty in rural areas where credit markets tend to be less developed due to information asymmetries and the lack of enforcement (Hoff and Stiglitz 1990; Armendáriz de Aghion & Morduch 2005). In the Jaman North District of Ghana, there are seven (7) formal financial institutions, comprising four (4) rural banks, one (1) commercial bank and two (2) credit unions. In addition, there are nine (9) financial institutions in the Jaman South District (the mother district of Jaman North) which are equally accessible (at least physically) to the farmers in the district. Each rural bank offers micro-finance schemes, with the aim of supplying credit to rural dwellers, who are predominantly farmers, at a market interest rate of between 25% and 35% per annum. However, a preliminary survey revealed that there are a good number of individuals, particularly farmers, who still borrow from their colleagues or moneylenders at an extremely high interest rate per annum. This observation raises a number of questions, notable among them being: Is it that the farmers are not aware of the existence of these banks? And what are the attitudes and perceptions of farmers towards banking and bank loans? The main objective of the study is to examine informal lending and borrowing in a rural setting, and the implications for microfinance schemes in the Jaman North District of Ghana. Specifically, the study seeks to explore the nature of loan agreement between farmers and moneylenders, examine the implications defaulting, and explore farmers' knowledge and perceptions of banking and bank loans.

CONCEPTUAL ISSUES

The first part of the title of this article was derived from a comedy (The Merchant of Venice), believed to have been written between 1596 and 1598 by William Shakespeare. The principal characters were Shylock (A Jewish money lender) and Antonio (A merchant of Venice). Antonio borrowed money from Shylock, and the condition for the loan as proposed by Shylock was: if Antonio is unable to repay it at the specified date, he (Shylock) may take a pound of Antonio's flesh. When the agreed date passed without repayment, Shylock had Antonio arrested and brought before court to demand Antonio's pound of flesh. Since Shylock refused any form of payment, the court allows Shylock to extract the pound of flesh. At that very moment, Antonio was saved by a lawyer, who pointed out a flaw in the contract: the bond only allows Shylock to remove the flesh, not the "blood", of Antonio. Thus, if Shylock were to shed any drop of Antonio's blood, his "lands and goods" would be forfeited under Venetian laws. [This paper therefore reflects few Shylocks vs. many Antonios].

The concept of informal financial sector describes those financing activities that are often unrecorded but take place outside official financial institutions. Informal financial activities predate the formal financial systems, are often "unrecorded and unregulated" but legal (Soyibo, 1994). The informal rural financial institutions are not only as old as rural communities; they are also arranged around socio-cultural activities of particular communities. They are flexible in operation, while enforcement of contracts is usually based on group trust and other indigenous legal and social institutions. The operation of these institutions is more prevalent in rural and semi-urban areas (Iganiga & Asemota, 2008).

Most informal lenders believe that the flow of loan applications fluctuates considerably in a year. In rural areas, the flow of applications coincides primarily with the land-clearing and planting seasons in March and April. In urban areas, however, the largest number of loan applications come in December and January, when many consumers must borrow either for Christmas spending or to restore their consumption to pre-Christmas levels (Aryeetey, 1994). Whereas formal lenders rely more on project screening, informal lenders rely more on the character and history of the borrower, particularly on personal knowledge of the borrower (Atieno, 2001).

According to Deaton (1992), individuals in poor countries borrow and lend money, and perhaps do so to prevent shortfalls in consumption. As a result, many consumers may never wish to borrow; people who are patient, or for whom the return on assets is sufficient to overcome their impatience, will tend to postpone consumption, building up assets as they go, so that temporary short-falls of income are unlikely to pose a problem, except perhaps early in life. But for those who are impatient, or who are poor enough to feel that future consumption is an inadequate reward for postponing current consumption, lack of borrowing facilities will be a real disadvantage. For such consumers, it is essential to hold some assets that can be used to buffer consumption when incomes are low (Deaton, 1992).

Besley (1994) has classified major features of rural credit markets that can be used to explain the existence of formal and informal credit markets in Africa. Among these are the existence of collateral security and covariant risk. Collateral security is often beyond the reach of many borrowers in rural areas. But even where this is not the case, Besley (1994) indicates that the ability of the lender to foreclose is often limited, making enforcement of loan repayment difficult. Such difficulties help to explain the use of informal financial markets, which use social sanctions to ensure enforcement. In rural areas, shocks in incomes that create borrowers' potential to default will affect the operation of credit markets. In most rural economies, borrowers are faced with risks arising from uncertainties about their incomes. By diversifying their loan portfolios, lenders can avert such risks. However, credit markets in rural areas are segmented, with lenders' loan portfolios being concentrated on borrowers facing common shocks to their incomes.

Indeed, the interest rates charged by different informal lenders vary considerably (between 50% and 100%). But, it is unclear how moneylenders determine interest rates, and that their rates are not negotiable (Aryeetey, 1994). Meanwhile, moneylenders have been criticized for charging rather high interest rates and thereby hindering the well-being of the rural and semi-urban populace by limiting their access to credit. Moreover, they are indifferent to the purpose of the borrowing and by lending for consumption activities (like burial ceremonies), they put the poor in more future problems (Ojo, 1996).

Information constitutes a crucial element for bringing awareness and knowledge upon which major financial decisions can be made. Therefore, to analyse the knowledge and attitudes of farmers towards banking and bank loans, the Pred's (1967) Behavioural Matrix guided the study (Fig. 1). According to the model, a decision-making situation is a function of the quantity and quality of information available in a given set-up. Thus, the readiness of rural farmers to open bank accounts and go for bank loans depends on the quality and quantity of information they possess regarding banks and the nature of their activities. For example, if farmers have poor quality information about banking such as those relating to the view that bank loans are complicated or banks only give loans to "government workers', then they will go to moneylender, no matter the interest rates charged. The model explains that in a given time and space, some individuals may utilise information optimally based on the quality of information they have (Bnn). They constitute the rational decision makers in economic theory. On the other hand, those without quality information may not be able to make rational decisions (B11, B12, B21, B22). However, others may not have adequate information but would be able to make rational decisions (B1n, B2n) whilst others may obtain optimal information but make irrational decisions (Bn1, Bn2, Bn3). In between these groups are a myriad of combinations of decision makers based on the quality and quantity of information available to them.

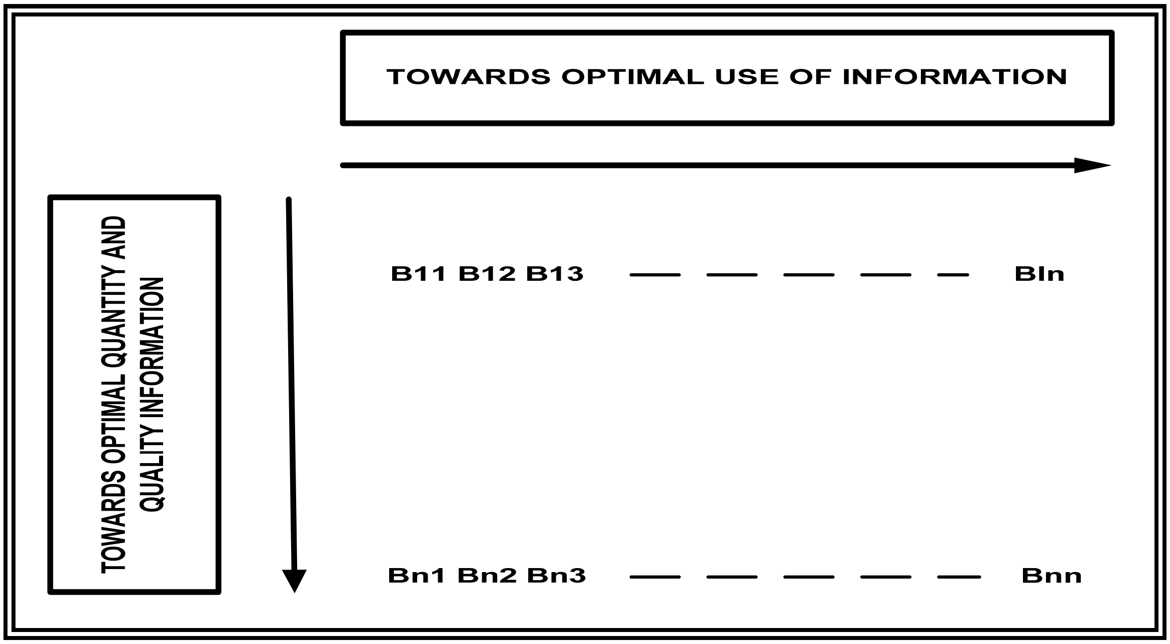

Figure 1: Behavioural matrix model

Source: Pred (1967)

The model is appropriate in examining the quality and quantity of information available to farmers regarding the existence of bank level financial services and micro-finance schemes. However, the behavioural matrix does not spell out other variables that are responsible for the utilisation or non-utilisation of the information even if quality information is available.

METHODS

The study employed purely qualitative research approach in the collection and analysis of data. Qualitative approach is mainly descriptive and involves the collection and analysis of data that is concerned with meanings, attitudes and beliefs, rather than quantitative method that results in numerical counts from which statistical inferences can be drawn (Ogier, 2002). In consonance with the qualitative approach, purposive sampling technique was used to select the respondents. One lender and four borrowers each were purposively sampled from two villages (Dawiri and Mayera) in the Jaman North District of the Brong-Ahafo Region (see Figure 2). These villages were purposively selected due to their heavy reliance on agriculture, particularly cocoa farming in the Western Region of Ghana.

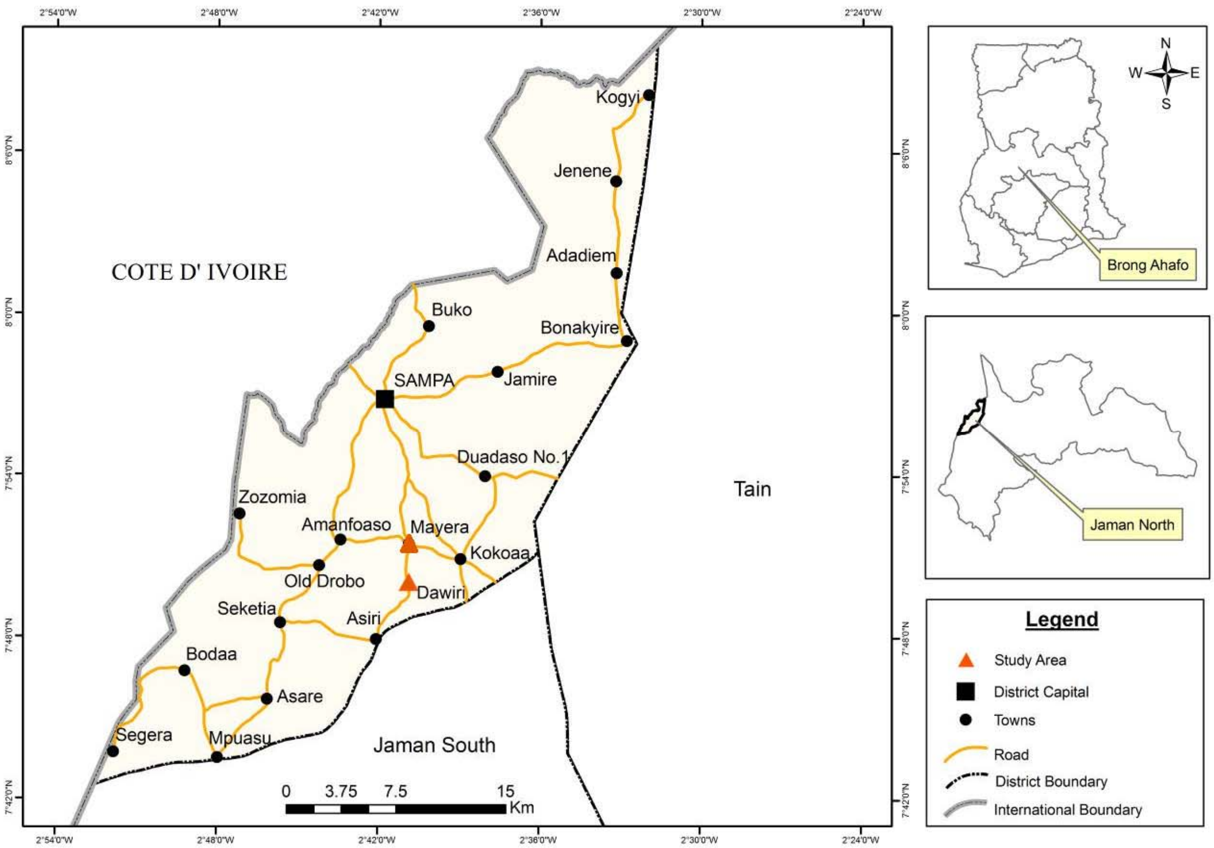

Figure 2: Map of Jaman North District Showing the study areas

Source; GIS Unit, Dept. of Geography and Regional Planning, University of Cape Coast, Ghana

Data were gathered in August, 2010, and the main data collection method employed for the study was the In-depth Interview (IDI). It was more practical to formulate the interview guide, and to obtain more detailed information where necessary. According to Bernstein (2004), people will always provide much more information in a one-on-one discussion than they will in a public forum. Although interviews cannot substitute for more public forms of participation, they often provide information that cannot be obtained any other way. To ensure validity and reliability, the responses provided by the interviewees were repeated by the interviewer for the interviewees to confirm or modify. This was to ensure that the interviewees understood the issues very well and that their responses would not be misrepresented by the interviewer.

The data from the interviews were categorised into appropriate themes and analysed accordingly. As indicated by Carspecken & Apple (1992 cited in Sarantakos, 1997), in most cases, the processes of qualitative approach bring together collection and analysis of data in such a way that identifying data automatically leads to their analysis, which in turn directs the researcher to the area in which new data should be sought and identified, in order to be analysed again.

RESULTS

Socio-demographic characteristics of respondents

The two lenders for the study were all men, both married and were aged 38 years and 57 years respectively. The eight (8) borrowers (6 males and 2 females) were between the ages of 35 years and 60 years, primarily farmers and were generally illiterates (Table 1). Household sizes were relatively high because most of the males have more than one wife. The number of loans contracted from informal money lenders for the past ten (10) years ranged between one (1) and three (3).

Table 1: Socio-demographic characteristics of borrowers

ID	Sex	Age	Marital status	Main occupation	Educational level	Household size	No of loans in the last 10 years
A	Male	60	Married	Farming	None	6	2
B	Male	56	Married	Farming	None	6	3
C	Female	47	Widowed	Farming	Primary	4	1
D	Male	49	Married	Farming	None	7	3
E	Male	41	Married	Farming	Primary	5	2
F	Male	42	Married	Farming	None	8	3
G	Male	35	Married	Farming	Middle School	5	2
H	Female	56	Divorced	Farming	None	7	1

Source: Fieldwork, 2010

Nature of loan agreement and its implication for defaulting

Though lending and borrowing occur between and within every societal class of people, those occurring among cocoa farmers are critical due to the seasonal nature of their major source of livelihood. As a result, most repayments of loans are scheduled between November and December, a period labelled as major “cocoa season”. Reasons for borrowing are diverse, ranging from paying hospital bills through financing funeral activities to supporting farming activities (Table 2). Whereas formal loan agreement indicates the principal amount and the interest payable by the borrower, it was found that the loan agreement in this rural setting is always written to portray that there was no interest rate charged, as indicated by a 56-year borrower and corroborated by a 38-year lender:

Whatever amount of money that I borrow, I will have to pay double (100% interest) when the agreed time is due. For example, I borrowed GHC 200.00, but on the agreement note it was written that I borrowed GHC 400.00.

Table 2: Implications of borrowing and defaulting

ID	Actual amount borrowed (GHC)	Amount in agreement (GHC)	Present amount (GHC)	Years elapsed	Purpose of last loan contracted	Mode of payment of last loan
A	500.00	1,000.00	8,000	4	Support travel	Sold cocoa farm to lender
B	200.00	400.00	3,200	4	Hospital bill	Leased cocoa farm for 5 years
C	200.00	400.00	1,600	3	Funeral	Leased cocoa farm for 3 years
D	150.00	300.00	1,200	3	Support business	No payment yet
E	150.00	300.00	600	2	Funeral	Sold my car
F	100.00	200.00	400	2	Farming	No payment yet
G	100.00	200.00	800	3	Farming	No payment yet
H	50.00	100.00	200	2	Buy food	My brother paid

Source: Fieldwork, 2010

Even though, the interest is per annum, payable in December or January each year (harvest seasons), people still pay 100%, whether the money was borrowed two or three months to the end of the year. As a result, unlike formal loan agreements that require collateral or guarantors, the agreement in the selected rural communities requires a witness each from the lender and the borrower, and of course the knowledge of the lender about the activities undertaken by the borrower in order to assess the potential for repayment.

In default, a new arrangement is written and the amount is doubled. The initial amount grows exponentially, as indicated by a 60-year old respondent:

If I am not able to pay, the amount is doubled. This doubling principle will continue every year until I am able to pay the money. For me, I borrowed only GHC 500.00 four years ago to support my son's travel abroad but I had to pay GHC 8,000.00. So I sold one of my cocoa farms to the lender for GHC 10,000.00.

When the money grows to some level, there are different arrangements for repayment. The most prominent being: borrowers selling their farms or leasing their farms to lenders to defray debt (Table 2). In situations where the borrower leases his/her farm to the lender, some flexible agreements may state the number of years the lender has to harvest the cocoa to defray debt. However, in a more desperate situation, the lender takes the farm for an unspecified number of years until he considers the debt defrayed.

Moreover, leasing a cocoa farm to a lender has its own implications for the maintenance of the farm, as stated by a 56-year old respondent:

Leasing of farms to lenders is the most common way of paying off debts. Sometimes you may borrow from somebody who comes from a different town but has a cocoa farm closer to yours in the Western Region. The main disadvantage of the leasing is that the lender does not take good care of the farm. All he needs is to get his money from the farm and abandon it for you. At best, by the time you get your farm back, the yields from the farm had dropped drastically, and at worst, most of the cocoa trees had died off completely.

However, due to the high interest rates charged and the risk of not getting loans in future, there is generally low default rate in the rural areas. On the part of money lenders, they seldom experience defaults, because it is a matter of rolling short-term loans into long-term loans, keeping the yearly interest rate the same. As stated by a money lender:

I don't normally worry too much about default because I always lend money to people who are creditworthy. So even, if it takes ten (10) years, I know I will get my money back; it just a matter of writing new agreement each year. However, if a borrower does not pay back his/her loan, he/she cannot come back to me again when he/she needs money. Besides, I can take legal action against him/her to get my money back.

Moneylenders giving money to only those who have the ability to repay is in conformity with the adverse selection thesis of Aryeetey & Udry (1995), and that where lenders do not have adequate information about their clients, lending is not likely to take place.

Borrowers' knowledge and attitudes towards formal financial services

All the respondents demonstrated knowledge of rural and community banks and credit unions giving loans but were not willing to take loans from these institutions because they perceive the process to be too cumbersome due to delays and collateral. However, none of the respondents had bank account at the time of data collection, implying that they cannot access a formal loans facility from the bank. Again, none of them was aware of the existence of micro-finance schemes of the rural and community banks.

Generally, respondents have negative attitudes towards bank loans due to perceived complexities (relating to delays and collateral) in taking bank loans. Of course, some of these perceptions are formed as a result of personal experiences, but most of them result from word-of-mouth from friends and relatives. For example, when asked whether they are aware that bank loans have relatively lower interest, one borrower indicated:

For me, when I need money, how to get it early and solve my problem is my main preoccupation. Even if banks have lower interest rates, you cannot get the money as early as you would wish. For instance, my brother has an account with a bank, but when he needed an emergency loan for hospital bill for his wife's surgery (but now has health insurance card), he had to fall on a moneylender due to the delays and the difficulty in acquiring a bank loan. If you save with a bank and cannot get help when the situation demands it, then what is the essence of keeping a bank account? Apart from that, I don't have any property to be used as collateral to go for bank loan, even if they will give it to me on time.

These findings are consistent with Aryeetey's (1994) assertion that perceived difficulties deter farmers from accessing bank loans, and also Aryeetey's (1992) findings that when people are in need of loans, their decisions are influenced by where to get it than how much interest is charged. That is, once satisfaction derived from the access to the credit is equal to the price of credit, a rational consumer will agree to make purchases.

DISCUSSION

To improve the sustainability of rural development and livelihoods, this study sought to explore information lending and borrowing in rural Ghana, and how their challenges can be minimised by formal financial institutions. Borrowing in rural communities is generally male dominated activity. However, the two female borrowers in this study were either divorced or widowed, and therefore are heads of their households. This might have contributed to their independent decision to borrow because in rural setting, it is more common for men to borrow substantial amount of money than women. The reasons for contracting loans from informal moneylenders are mainly for consumption activities (funeral, travel, hospital bills etc), and not for investments. As a result, formal financial institutions might not find it worthwhile injecting funds into such activities.

The nature of loan agreement and the interest charged by moneylenders in two villages in particular are influenced by a number of factors, the most prominent being the risky environment within which lenders operate. Thus, most of the farmers rely on their cocoa farmers for repayment of loans, and that a poor harvest in a particular resulting from pests and diseases will have the potential of delaying repayment. In the view of Aryeetey and Urdy (1995), if a loan transaction occurs in a risky environment and if a complete set of markets for contingent commodities does not exist, then the promised transfer of future resources may not be certain. The character of the loan transaction will then be influenced by the risks faced by the parties involved, and by their knowledge of each other and the activities they undertake (Aryeetey and Udry, 1995). Though, the interest rate charged my the moneylenders is high, farmers in need of credit for "survival" are more concerned about access to the credit than the price of credit (interest rate). This is in consonance with a popular saying in Ghana "if you get what you need, no matter the cost, it seems more like a gift". The actual burden is only felt when it is time for repayment. This explains why farmers continue taking loans from informal moneylenders though they know the interest rates are extremely high.

The fact that most of the respondents had very limit knowledge about the operations of the formal financial institutions in the District is an indication that they will not access loans from such institutions. In the context of Pred's Behavioural Matrix, these people will not make rational decisions by going for bank loans at lower interest rates because they have inadequate and poor quality information. To ascertain this, the study sought to explore the future borrowing plans of respondents. In a response to the question, will you still borrow from these lenders in times of needs? One respondent remarked:

I pray that I don't experience any serious financial hardship again, but if it occurs, I have no other place to turn to, so I will still have to borrow from them. I don't have what it takes to get a loan from a bank or any financial institution. I know that banks normally give loans to government workers.

The issue is that helpless people with no option or perhaps inadequate information about options available to them will rush to anybody for loan at extremely high interest rates, which have the potential of crippling borrowers for the rest of their lives.

CONCLUSIONS AND RECOMMENDATIONS

While loans from informal lenders in the rural areas of the Jaman North District are readily available as and when needed, the interest rate charged is extremely high, about threefold of the rates charged by formal financial institutions. However, farmers prefer seeking credit from informal money lenders due to perceived delays and complexities, lack of required security and lack of or inadequate information about credit in the formal financial institutions. This situation stifles sustainable rural development and therefore threatens the sustainability of rural livelihoods.

To ensure sustainable rural development and expand financial opportunities for rural dwellers, this paper posits that, as the lawyer saved Antonio from Shylock, so should rural banks save poor rural farmers (Antonios) from these informal moneylenders (Shylocks). Rural and community banks should therefore engage in diversified sensitization approach which seeks to demystify the perceived complexities and enhance behavioural change. This is particularly important for rural dwellers, most of whom are academically and financially illiterate. While most rural people borrowing for consumption purposes, financial literacy and loans for off-season income-generating activities will empower such farmers to be more credit worthy, and hence improve the sustainability of their livelihoods.

Although, the small-scale nature of this study makes it is impossible to draw general conclusions about how borrowing affects cocoa farmers' wellbeing in the long term, it does highlight the need to take seriously the dynamic and temporal nature of lending and borrowing in rural settings and how it tends to threaten the livelihoods of rural dwellers, particularly the vulnerable. It is therefore recommended that a more comprehensive baseline survey be conducted to assess the financial literacy and credit needs of potential clients in rural areas. This could be supported by rural and community banks in their respective areas of jurisdiction. Thus, while educating people financially, the banks benefit from an opportunity to broaden their client base.

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