

The factors causing informal sector more attractive in rural financial markets as providers of credit

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The fundamental objective of this study is to identify the factors behind the rural people's attraction to the informal lending institutions operating in the financial market. Data were collected through a structured questionnaire and informal interviews from 500 selected households in Thanamalvila, Badalkumbura and Bibila Divisional Secretary areas in Monaragala district. According to the findings, the informal lending institutions have granted a large number of small denomination loans to a large number of borrowers even though the formal lending intuitions still dominate the rural credit market catering to the highest percentage of rural credit needs. Informal lending institutions operate as a network of highly integrated social relationships. Therefore rural people, depending on their production and consumption patterns, are used to obtain loans in small amounts too often repeatedly with short breaks. In contrast, borrowing from a formal institution is a legal contract where the borrower is bound by dual obligations: on one hand with the credit institution and on the other hand with the guarantor for which rural people show a little bit of hesitation. Furthermore, the level of education too was found to be less important or perhaps immaterial in presence of highly integrated social relationships well accepted by informal credit institutions. Unlikely in the formal sector, the purpose of borrowing is also not critically evaluated in the informal sector. A significant number of loans were found to have been obtained without mentioning any specific purpose. The operating procedures practiced by the informal sector are much familiar to the rural society. Determining of the loan amount, the rate of interest, terms and conditions for loan repayment and any extension to the repayment period solely depend on the joint decision making by the lender and the borrower. Accordingly, we see that social relationships are of the utmost importance in operating the informal financial sector and it enhances its attractiveness. As these relationships are seen in the form of a well-connected network, giving sufficient emphasize to strengthen such social relationships becomes a very vital factor to be considered in rural credit policy formulation

Key words: Informal sector, Micro finance, Rural financial markets; Credit policy; Social relationships