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Factors Associated with People's Reliance towards Informal Financing Methods in Rural Community of Sri Lanka

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Abstract- This study was focused on investigating factors associated for people's reliance on informal financing methods by Sri Lankans with special reference to rural community in Rathnapura District. To achieve the objectives of the study, data was collected through survey questionnaire from a sample of 250 respondents and data was analysed using Chi – Square test. The results of the research show that there is a significant association between educational level, occupation, income level, financial behavior, personal financial attitudes, financial literacy, trust and reliability on reliance on informal finance. In addition the results showed that people highly depend on informal finance and most preferable financing source is loan from family/friends.

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Abstract- This study was focused on investigating factors associated for people's reliance on informal financing methods by Sri Lankans with special reference to rural community in Rathnapura District. To achieve the objectives of the study, data was collected through survey questionnaire from a sample of 250 respondents and data was analysed using Chi – Square test. The results of the research show that there is a significant association between educational level, occupation, income level, financial behavior, personal financial attitudes, financial literacy, trust and reliability on reliance on informal finance. In addition the results showed that people highly depend on informal finance and most preferable financing source is loan from family/friends.

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I. Introduction

Personal financing is very important issue in today's world. People pay attention to different kind of financial affairs. They do not only focus on short term financial affairs but also long term financial affairs. There is a tendency that people invest and save money for retirement plans, family's future home, and children education in order to upgrade their standard of living. In order to achieve these personal goals they use various types of financial instruments. Financial instruments are legally recognized documents that have monetary value. Bonds, equities shares, debentures and checks are examples for financial instruments. Agreements made to exchange finances without reference to legal restrictions are informal financial instruments. These are mainly used among people who do not have access or cannot afford formal systematic savings and credit facilities.

The cost of transacting informal financial instrument is lowered by the direct interaction between sellers and buyers. There are no official criteria to qualify for applying informal financial service because informal financial instruments are easily accessible to all (Adams, 1991). All informal financial agreements are depending on negotiation and there are no set standards for informal financial instruments to measure up to when the financial services are needed, because they can provide flexible services according to personal needs. Even though formal finance institutions are fairly spread and located across Sri Lanka people still tend to rely on informal finance to manage their finances. Stynwand (2008) has revealed that easy access, ability to obtain funds speedily and the absence of collateral requirements play a key role in motivating households to use informal sources. But there can be other reasons why people of rural community of Sri Lanka relies more on informal finance. Though there are number of papers available in informal financial methods it is rare to find the literature related to informal finance in Sri Lanka. Thus the objectives of the study is, to investigate factors associated with reliance on informal financial services and to examine different informal financial sources which rural community mostly use in in Sri Lanka

II. Literature Review

Informal financial institutions and informal financial methods have been defined by variously researchers. Ayyagari et al. (2010) have categorized the various sources of financing. Those categorizations are bank financing that includes (1) local commercial banks and foreign commercial banks; (2) informal finance that includes financing from informal sources such as a money lender or an informal bank; (3) operations finance that includes trade credit; equity finance; (4) investment funds that includes investment funds or special development financing or other state services and (5) internal finance that includes internal funds or retained earnings, loans from family and friends. Adam (1991) has classified informal finance sector in to three main categories, namely non commercial finance, commercial finance, group arrangements. The first category is where money lending happened among close relatives and friends with little or no interest being charges. Secondly funds are lent and borrowed to finance the buying or selling of goods whether for consumption or investment purposes. Final category group arrangements refer to rotating savings and credit associations.

Many studies argue that the existence and smooth function of an informal finance market is just important as the formal finance market. For example, Besley and Levenson (1996) have argued that despite

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Global Journal of Management and Business Research (C) Volume XV Issue XI Version I Year 2015

an underdeveloped formal financial sector, countries like Taiwan grew due to informal institutions. Ayyagari et al. (2010) further argue that informal finance plays a complementary service to formal finance sector by serving the lower end of the market, which consist of parties who cannot access the formal financial system due to the lack of growth opportunities or poor credit ratings etc. Also the deformation in the formal banking sector contributes to the dynamism of the informal credit market, where people borrow from family members, friends, enterprises, rotating savings and credit associations , moneylenders (loan sharks), and informal banks (Degryse et al.,2012). Reidel et al. (2007) have discovered that Chinese private firms rely less on bank loans to finance investments, and more on retained earnings and informal finance, especially obtained from family members and friends.

Financing methods are available to Sri Lankans through many formal and informal sources. Government schemes, banking schemes, non government schemes, and corporate schemes can be identified as formal sources. Cheetu system, money lending, local credit groups, personal borrowing, bartering and pawning can be identified as informal sources in Sri Lanka. Among those informal sources, Cheetu system is one of the most popular modes of informal savings without expecting any interest in return. According to Fernando (1986) cheetu system defined as a rotating credit association in which a group of participants make regular contributions to a fund which is given as a lump sum to each member in turn. It is a system of credit group where borrowing and loan repayment responsibility is first and for most on organizer and next of the entire group to ensure conformity on the part of the borrower. There are two kinds of cheetu organizations in Sri Lanka. Those are cheetu by drawing lots and the auction cheetus.(Fernando, 1986)

a) Factors affecting for reliance on informal Finance

Through investigation of previous literature it was realized that Education Level, Income Level, Gender, Occupation, Financial Behaviour, Financial Attitudes, Financial Literacy, Trust and Reliability might have an impact on the peoples reliance on informal financing methods. Review on literature related to each of these factors would provide a fair justification to consider them as factors in Sri Lankan context as well.

According to Wells (2006) the effects of education on income inequality are affected by the level of economic freedom in a country, and specifically, that more economic freedom may limit the leveling effects of secondary enrollments. These findings imply that the level of economic freedom must be considered when creating policies intended to reduce inequality that other complex relationships between education and economics must be considered when studying income inequality. David and Adriana (2006) suggest that increasing levels of education lead to different thinking and decision-making patterns.

Income level has been considered by some researches as a factor that effect in financial decisions in related studies. Melzer (2011) shows that payday loans (typically small, informal loans that carry a high interest rate), increase the difficulties for low-income households to meet payments for their mortgage, rent, and utility bills, while doing little to alleviate any immediate economic hardship. Godwin and Koonce (1992) shows that money managers with higher net incomes have been found to exhibit more implementing behaviors, while level of income had no effect on planning their financial behaviors.

A study done on venture capital investment by Bruni et al. (2005) has found that informal venture capital markets may not be characterized as gender-differentiated market, and there is no support for an essentialist argument that there are fundamental gender-based differences between women and men angel investors. Francis, et al. (2014) study findings reveals that there might be a gender difference in behavior when of financial officers with regard to reporting. Female financial officers found to be more conservative in their financial reporting. Also they find strong support for the notion that female financial officers are more risk averse than male financial officers, which leads female financial officers to adopt more conservative financial reporting policies.

Models of occupational choice have stressed the importance of asymmetric information or exogenous borrowing constraints (Banerjee and Newman, 1993) According to Chiswick and Mincer (1974) human capital economists stress the importance of post school training investments and at least recognize the fact that these investments vary across occupations.

Behavioral finance is the study of the influence of psychology on the behavior of financial practitioners and the subsequent effect on markets. Depending upon nature of financial behavior of individuals will determine their financial health (Hilgert et al, 2003). In other words if someone follows good financial practices they may depend on

Marcolin & and Abraham (2 006) has identified that financial literacy is a ares which needs focus for research with the latest developments in financial markets. According to Ibrahimi and Alqaydi (2013) on the relationship between financial literacy, personal financial attitude and the decision to carry personal debt, that there is no significant relationship between the average of financial literacy, as well as personal financial attitude and the decision to carry debt from bank loans or borrow from a friend/or a family member. However, they also revealed that there is a strong negative statistical relationship between personal financial attitude and borrowing through a credit card.

The need for financial skills has grown rapidly over the last decade because 'financial markets have been deregulated and credit has become easier to obtain as financial institutions compete strongly with each other for market share (Beal & Delpachitra, 2003). Typically, financial literacy and/or financial knowledge indicators are used as inputs to model the need for financial education and explain variation in financial outcomes such as savings, investing and debt behavior. Rooij et al. (2007) found that those with low financial literacy are more likely than others to base their behavior on financial advice from friends and are less likely to invest in stocks.

Morgan and Hunt (1994), Alrubaiee & Al-Nazer (2010) shows that relationships can be viewed as a series of transactions that foster an awareness of a shared relationship through trust and commitment. Higher levels of trust and commitment in turn are related to higher levels of customer retention, and this could result in higher organizational profitability. Thomas (2009) further defines trust as "an expectancy of positive outcomes, outcomes that one can receive based on the expected action of another party".

III. Data and Methodology

a) Sample Frame and Sampling Procedure

Population of the study was people living in Rathnapura district. When deciding the sample convenient sample was dictated due the absence of formal or informal sample frame which select all subjects related to the study. There are 52170 people living in Rathnapura District according to 2011 population data (Wikipedia). In order to determine the most suitable sample size Solvin's Formula was used and it suggested a sample of 276 as the sample at 95% confidence level.

The solving formula is shows as follows. (n = Sample size, N = Population, e = Error term)

$$\mathrm{n} = N/(1 + Ne^2)$$

$$\mathrm{n} = 52170/(1 + (52170 * 0.05^2))$$

n = 276

Even though 280 questionnaires were distributed only 250 responded to the questionnaire while maintaining a 89% respondent rate.

b) Development of the Questionnaire

This study used a comprehensive questionnaire to design and cover the major variables that hypnotized to be affecting on the reliance on informal finance. The survey respondents were ask to answer 53 questions which includes multiple choice questions on demographic data such as gender, educational level, , marital status and income level. Likert scale questions measuring tendency on informal financial methods, personal financial attitudes, financial behavior, financial literacy, trust and reliability. The quality and the consistency of the survey are further assessed using Cronbach's alpha.

c) Research Variables and Their Measurement

Tendency on informal financing methods - In the study we mainly considered reliance on cheetu system and borrowing from local credit groups, Pawning gold jewellery and loans from friends or family to measure this variable.

Income- Option to select different income classes was provided to determine the level of income of each respondent as highest level, middle level and lower level.

Educational Level **-** This variable measures the refers the level of education of each respondent as bachelor's degree, up to advanced level, up to ordinary level or below ordinary level. It also refers the parent's highest level of education of each respondent.

Occupation- This variable indicates which sector of occupation each respondent is employed in, namely public, privet or self employee sector. The measurement question in the questionnaire is question number 5.

Gender– It is the classification of respondents as male and female.

Financial Behavior - This variable represents how people act situations that require spending, savings and financial future planning.

Financial Literacy- This variable measures the knowledge to get an effective and correct decision regarding usage and management of money to fulfill of financial needs. It covers dimensions of knowledge on investment, interest, savings and borrowings.

Personal Financial attitudes - Personal financial attitudes refer personal deposition towards financial matters. It is measured by question number 14 – 20 in the questionnaire.

Trust and Reliability- This variable indicates people's trust on financial institutions and impression of each respondent regarding financial institutions.

d) Research Hypotheses

This paper tested the following hypotheses which are stated in the alternative form:

H_{1a}: There is a significant association between income level and reliance on informal finance.

H_{1b}- There is an association between educational level and reliance on informal finance

H_{1c}- There is an association between occupation and reliance on informal finance

H_{1d}- There is an association between gender and reliance on informal finance

H_{1e}- There is an association between marital status and reliance on informal finance

H_{1f}- There is an association between financial behavior and reliance on informal finance

Global Journal of Management and Business Research (C) Volume XV Issue XI Version I Year 2015
3

H_{1g}- There is an association between financial literacy and reliance on informal finance

H_{1h}- There is an association between financial attitudes and reliance on informal finance

H_{1i}- There is an association between trust & reliability and reliance on informal finance

IV. Results

Data was collected though distributing questionnaire to 250 respondents randomly selected from Rathnapura district of Sri Lanka. The Demographic Characteristics of the selected sample is illustrated in

Table 1 : Demographic Characteristics of the Sample (N= 250)

Variables	Characteristics	n	%
Gender	Male	120	48%
	Female	130	52%
Education Level	Below Ordinary Level	63	25%
	Up to Ordinary Level	88	35%
	Up to Advance Level	48	19%
	Degree	53	21%
Occupation	Public Sector	48	19%
	Private Sector	115	46%
	Self- Employed	63	25%
	Unemployed	25	10%
Income Level	< Rs. 15,000	38	15%
	Rs. 15,000- Rs. 24,999	78	31%
	Rs. 25,000 - Rs. 34,999	68	27%
	Rs. 35,000 -Rs. 44,999	58	23%
	<Rs. 45,000	10	4%

Source – Survey Data 2015

From the total sample, 52% represent females and 48% represent male respondents. Majority of the respondents have completed education up to GCE A/L which was 35% from the total sample. 46% of the sample was employed in the private sector and that is the sector which majority of the sample were employed. Rs. 15,000 – Rs. 24,999 was the income level which most of the respondents were earning, representing 31% from the sample.

a) *Level of Reliance on Informal Finance*

Descriptive statistics was used to measure the level of dependency on informal finance sources and to examine different informal financial sources which mostly people rely.

Table 2 : Selection of Financial method

Sources of Personal Finance	Frequency	Percent	Valid Percent	Cumulative %
Loan from Bank	9	3.6	3.6	3.6
Pawning in Bank	40	15.9	16.0	19.6
Pawning in Informal	35	13.9	14.0	33.6
Loan from Family/Friends	133	53.0	53.2	86.8
Personal Borrowing	33	13.1	13.2	100.0
Total	250	99.6	100.	

Table 2 it shows percentage of financial sources that people use. The most preferable financing source is loan from family/friends. People prefer this source of finance more than formal financing sources such as loan from bank and pawning from bank.

Table 3 : Level of dependency on informal financing sources

Level	Frequency	Percent	Valid Percent	Cumulative %
Low	31	12.4	12.4	12.4
Moderate	82	32.7	32.8	45.2
High	137	54.6	54.8	100.0
Total	250	99.6	100.0	

Table 3 illustrates the level of dependency on informal financial sources. The results shows that 54.6% people dependency is in higher level, 32.7% depend on moderate level and 12.4% depend on lower level. It means most of people rely on informal financial sources.

b) Factors affecting for Tendency towards Informal Finance

Chi – Square method was the statistical tool employed to test the relationship between independent variables and dependent variables. It also used to test the hypotheses of factors associated with tendency towards reliance on informal financial services in Ratnapura district. Gender, educational level, marital status, occupation, income level, financial behavior, personal financial attitudes, financial literacy, trust and reliability are consider as the independent variables and reliance on informal finance methods, reliance on Cheetu system, reliance on personal borrowing from local credit groups are consider as the dependent variables.

Table 4 illustrates the results of Chi-square test. When using Chi – Square test if Pearson Chi- Square P value is less than 0.05 it signifies that variables are dependent with each other.(P<0.05).

Table 4 : Factors associated with Relience on Informal Finance

Variable	Pearson Chi – Square (P< 0.05)		
	Relies on Informal Finance	Relies on Cheetu System	Relies on Borrowing from local credit groups
Income Level	0.000	0.000	0.000
Educational Level	0.000	0.000	0.000
Occupation	0.000	0.000	0.000
Gender	0.041	0.541	0.118
Marital Status	0.196	0.334	0.522
Financial Behavior	0.000	0.000	0.000
Financial Literacy	0.000	0.000	0.000
Personal Financial Attitudes	0.000	0.000	0.000
Trust and Reliability	0.000	0.000	0.000

The results of Chi – Square test show P value is less than 0.05 for all three independent variables and income level. Therefore it can be concluded that, there is a significant association between income level and tendency of informal finance, tendency of Cheetu system and personal borrowing from local credit groups while accepting the alternative hypothesis. Results also shows that there is a significant association between educational level and reliance on informal finance, reliance on Cheetu system and reliance on personal borrowing from local credit groups because P value shows less than 0.05. This allows accepting second alternative hypothesis. There is a significant association between occupation and reliance on informal finance, reliance on Cheetu system and personal borrowing from local credit groups because P value shows 0.000. Results proves to accept fourth alternative hypothesis confirming association between gender and reliance on informal finance but no relationship with reliance on Cheetu system and personal borrowing from local credit groups. Those P values are higher than 0.05. Not only that marital status also has no significant association with reliance on informal finance, tendency of Cheetu system and personal borrowing from local credit groups because of P value is higher than 0.05 thus for marital status null hypothesis was accepted.

According to the analysis there is a significant relationship between financial behavior and reliance on informal finance, reliance on Cheetu system and personal borrowing from local credit groups because of P value is less than 0.05. Rest of the three independent variables, namely financial literacy, personal financial attitudes, and trust and reliability also shows significant relationships with tendency of informal finance, tendency of Cheetu system and personal borrowing from local credit groups with a P values of less than 0.05. As a result for last four variables alternative hypothesis was accepted.

According to the Chi –Square test income level, educational level, occupation, gender, financial behavior, financial literacy, personal financial attitudes and trust and reliability are affecting for reliance on informal finance by rural community in Rathnapura district.

V. Conclusion

The main objectives of this study were to investigate the factors which are associated with reliance of informal finance by rural community of Sri Lanka. Rathnapura District was the main geographical area selected for the study and 250 respondents were conveniently selected to distribute questionnaires. Data collected through questionnaires were statistically analyzed to derive at the conclusion.

According to the descriptive statistics, it was found that loan from family/friends is the most preferable informal financing method of rural community this findings is also consistent with the findings of Stynwand (2007). And it was also revealed that the majority of the

Global Journal of Management and Business Research (C) Volume XV Issue XI Version I Year 2015

respondents have a high tendency to rely on informal finance sources.

The results of Chi – Square test shows, gender, educational level, occupation, income level, financial behavior, personal financial attitudes, financial literacy, trust and reliability on formal finance are the factors which have associations towards reliance on informal finance. But marital status fails to prove an association with reliance on informal finance. Further when tendency towards informal finance and personal borrowing from local credit groups were analyzed separately shows that reliance on these two informal methods is independent from both gender and marital status.

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