

# IMPACT OF FINANCE ON INFORMAL SECTOR: A CASE STUDY OF AUTO-MECHANICS IN AKURE

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## **Abstract**

This paper examined the impact of finance on the informal sector, with auto-mechanics in Akure, Ondo State. Interview-questionnaire was administered on a sample of 52 out of a population of 103 auto-mechanics in Akure town. The instrument was validated and the reliability coefficient was 0.78. Recommendations were made on how to improve the financing of the informal sector so as to maximize contribution from the sector to national economic development.

## **Introduction**

The informal sector has continued to play a significant role in our economy in terms of employment generation, resource mobilization, the production and distribution of goods and services. The sector could be seen as the provider of jobs and training in entrepreneurship; therefore, the resistance to opportunities in such an important sub-sector is a major problem in any economy. According to Oyeneye (1980), one significant contribution which the informal sector makes to economic growth and development is in terms of the apprenticeship training and entrepreneurship which are developed within it. The training provided through apprenticeship equips the trainee with marketable skills that he or she can employ in his or her own trade later in life. On completion, master craftsmen are also able to create jobs for other people. The informal sector enterprises could be in the area of tailoring, automobile repair workshop, block-making etc. With the guarantee of employment for the people who are training in this sector, it has enhanced the growth and development of Nigerian economy.

The paper's emphasis is on informal sector financing using Auto mechanics as a case study. It, therefore, focuses on the artisan industry, that is, those craftsmen that work in workshop, singly or with a few apprentices. The paper attempts to show that if those in this sector are well financed, Nigeria's motor vehicle mechanics could be used as a strong base for technological and industrial advancement. The following questions are therefore raised.

- What are the sources of capital to auto-mechanics?
- What are the major problems facing auto-mechanics?

## **Sources of Financing Informal Sector**

A general feature of the literature on business finance is the consensus on the necessity of finance for informal sector and industrial development since capital is a pre-requisite for industrialization to succeed in any country. Financing informal sector takes various forms as explained below.

**Banks Loans and Overdraft Facility:** Bank loan and overdraft facility, the utilization of this facility has to be carefully examined in terms of benefits and cost of borrowing. An overdraft facility is an alternative source of financing business in cases where there are no available funds in the possession of the owners of the business.

**Specialized Financial Institutions:** Specialized financial institutions such as the Nigerian Bank for Commerce and Industry (NBCI), Nigerian Industrial Development Bank (NIDB), and the Nigerian Agricultural and Co-operative Bank (NACB) are sources of business finance.

**Personal Savings and Assistance from Others:** An individual could obtain capital for the commencement or expansion of business through manual jobs and personal savings. He could also get financial assistance from friends and relatives. Tin's may not be enough for establishing or expanding some businesses hence borrowing from any other method which are to be discussed may be the best alternative.

**Raising private loans:** There may be friends, relatives or colleagues who are in a position to lend you money (Record, 2000). Although it may seem like a good-idea at the time you can almost guarantee that they will demand their money back when you can least afford it. Therefore, it is important to get (the terms of the loan written down clearly and precisely in order to avoid any confusion at a later date. The points one should cover include details of the final date of repayment, the frequency and amount of interim repayments, any rate of interest, and the date when due whether the loan will entitle the lender to any control over the business.

According to Frost (1979), finance can in certain circumstances, be borrowed from private investors - people who are known to the borrower, or who may be introduced to him or her by a solicitor or accountant. This is not a recognized business source of finance. Such sources of money-may be regarded as possible necessity in a gap-bridging emergency. They should not be used for launching a new business.

**Retained Earnings:** According to scholars, the retained earnings sometimes referred to a ploughed back profits or undistributed profit representing the portion of the net profit which is set aside for the future expansion of business. A large proportion of new capital is generated through this method. According to Frost (1979), this fund is simply that part of the net profits put aside, not taken by the businessman for his own use, but earmarked as true business capital. Re-investment of profits is apparently the most popular source of finance for business expansion. Findings of studies conducted on some industries, for instance Teriba (1981), confirmed the importance of the re-investment of profits as overwhelming. It emerges as the most important in all industries followed by new loans. Retained profits are available for expansion, but may be inadequate if the business is growing rapidly.

**Depreciation Charges:** In theory, by the time such fixed assets are worn out, or have become technologically inadequate and are due to be replaced, the deduction funded over a period of years will provide for their replacement. When there are not yet any retained profits or where they are inadequate, the business may borrow from itself in an emergency, by using the accumulated depreciation charges sinking fund. Frost (1979), observed that such borrowing has to be replaced, and although the loan may seem to be advantageous in that it carries no interest, it has to be regarded as short-term. Caution must be exercised in its use because if the money is used on venture that is not paid off there will be no fund to replace the assets at the end of its lifespan.

**Trade Credit:** For certain type of businesses - specifically trading businesses, the conventions of trade credit may suffice to overcome a situation of what is, really, inadequate capital. Although business dealings between individual people are normally on a hard-cash basis, between businesses it is customary for there to be a settlement period, often a period of one month. This in effect may mean that traders can buy goods from their suppliers without having the money to pay for them, but knowing that in the normal way of business they would have sold at least enough of the goods to meet the debts by the time their payment has to be made.

**Rotating Savings Association:** This involves fixed contributions at fixed intervals by members. According to Dessing (1990), the sum of money collected from members is disbursed in rotating order to one member at a time. Its shortcoming is lack of a permanent loan fund available in times of need to all members.

**Co-operative Societies:** Co-operative societies are in between the informal financial sector and the formal financial sector. Every member contributes to the co-operative and can borrow from it. As Buden (2002), puts it, the members borrowing from members have the advantage that the co-operative pay comparatively low rates of interest, without having to provide securities for the capital. Some co-operatives have been able to obtain loans on almost equally good terms from private/commercial banks that are interested in business and are ready to lend to co-operatives just as to any other business concern. The co-operative only stands as a guarantor to individual member.

From the above points of view, the poor can be bankable as long as innovative and flexible lending methods are employed. In this respect, informal financial institutions can be used to reach low-income client, and existing social institutions can provide a mean for guaranteeing loans

repayment and for screening applicants.'

The raising of finance should be adequate at the right time, from a proper source and at the right price or cost. According Charantimath (2007), financial in adequate is reported to be one of the most important causes leading to sickness of small-scale units. Money should not be used for any purpose other than purely business activity. Many business units become sick because of lack of proper use of finance.

### Methodology

This is a descriptive research of the survey type. The data for this study were collected through the administration of an interview- questionnaire on respondents (Auto-mechanics) in Akure. The researcher had to visit their workshops in various areas of the town since there was no mechanic village in the town. A sample of 52 auto-mechanics were randomly chosen from the population of 103. A total number of 52 interview-questionnaires were administered on the respondents and the same number was used for analysis. The use of personal interview produced a high response rate of about 90 percent.

In order to validate the instrument, a pre-test was undertaken on a sample of 20 motor auto-mechanics in Ado-Ekiti after which some modifications were made. The test was repealed after an interval of two weeks and the first and second scores were correlated to obtain a reliability coefficient of 0.78, which considered high enough for study of this nature. The data for this research was analyzed with percentage.

### Findings and Discussion

Fifty-two auto-mechanics were interviewed with the aid of the questionnaire. The questionnaire covered source of capital and problems faced by the mechanics.

**Table I: Source of Capital of the Respondents**

Sources	Number	Percentage
Personal	22	43.31%
Relatives	30	57.69%
Co-operatives	-	-
Contributions	-	-
Private loans	-	-
Other Sources	-	-
Total	52	100%

Table 1, shows the sources of capital of 52 respondents interviewed, of which 22 persons (42.31%) said that they personally provided the capital for the business through savings whereas 30 persons (57.69%) had their own financed by their relatives. Apart from these two sources of finance, there was no financial assistance to the respondents from-other sources of finance. The study revealed that mechanics had no co-operative society to assist members.

**Table 2: Major Problems Facing the Respondents**

Problem	Number	Percentage
Lack of capita]	43	82.69%
Workshop	5	9.61%
Lack of electricity	2	3.855
Spare parts	2	3.85%
Others	-	-
Total	52	100%

Table 2, shows the major problems facing motor vehicle mechanics. Out of the total of 52 respondents interviewed, 43 persons (82.69%) agreed that their problem is lack of capital, 5 persons

(9.61%) is lack of workshop, lack of electricity is 3.85% and spare parts is also 3.85%.

The study revealed that the main source of initial capital to the respondents were through their relatives which accounted for 57.69% of the total of 52 persons interviewed, and this was closely followed by the capital sourced through personal savings of the respondents which accounted for the remaining 42.31%. There was no any other source of capital or financial assistance to them after the establishment of their businesses except retained earnings. It was observed that most of the respondents were not aware of some of these sources of finance.

Lack of capital and high cost of machine and tools were the major problems of those in this sector and this accounted for 82.69% of the total respondents. It was revealed that the problems of workshop, electricity and spare parts are not serious compared to capital. Most of the respondents cannot afford latest machines and tools due to the problem of capital. In addition, apprentices on completion can hardly afford complete sets of machine and tools to start their own businesses according to the study. Many of them expressed their readiness to get a loan, if made available, as it will enhance their operations. They have been waiting for government loans which is not forthcoming as expected. Despite financial limitations, it was observed that the informal sector could now forge the link between the cottage and small scale industry on the one hand, and the transnational corporations on the other, in the supply of components and spare parts.

### **Recommendations**

Based on the findings, the following recommendations are made to improve the capital available to auto-mechanics in particular and the informal sector in general.

1. For ease of acquiring fund, there should be a public enlightenment campaign on the various sources of finance for the people in the informal sector. This can be handled by government agency like National Orientation Agency.
2. Since finance is the major problem of the informal sector, the government agencies like National Directorate of Employment (NDE) should increase its financial assistance to this sector.
3. The people in the informal sector should try to raise some amount of capital for business through either daily, weekly or monthly contribution. They can as well form co-operatives to help their members raise capital.
4. Those in the informal sector should be enlightened on the efficient utilization of borrowed fund to ensure maximum performance, and the need for prompt payment of such loans. In addition, there should be a government body to monitor the utilization and repayment of these loans, and severe penalties for loan defaulters.
5. Those in the informal sector should form co-operative societies to assist members.
6. Government should form a National Committee on the mobilization of skilled and talented Auto-Mechanics, and use them as a team in starting Nigerian motor vehicle plant.

### **Conclusion**

Since the informal sector has been shown to have great potentials in generating employment, utilization of local raw materials, manpower development through apprenticeship, mitigation of rural urban migration and increase in Gross Domestic Product (G.D.P), investments in this sector will facilitate economy. Hence, the crux of this paper is that government should pose a short of challenge to those in the informal sector in a bid to identify their skills and capabilities. This will expose the various types of indigenous skills they have.

Auto-mechanics are sound bases on which to build the nation's vehicle plant because the group can give the nation the opportunity to develop technologically through learning-by-doing-process. With the provision of adequate capital to those in this informal sector, future hope for the development of a motor vehicle plant with local components could be realized if there is proper monitoring and co-ordination.

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