ICT for Improving Financial Access in Informal Sector

Mwanaidi Shafii Msuya, College of Business Education (CBE), Dar es Salaam, Tanzania

ABSTRACT

Access to finance is an important factor for the sustainability and growth of business. Lack of finance means that, the business will operate under-optimal and cannot enjoy economies of scale. This article explores the difficulties of informal sector access to formal finance. The author offers means by which information and communication technology (ICT) can help bridge that gap. The study carried out asystematic literature review where several articles from Sub-Saharan Africa were reviewed. The findings show that access to finance is constrained by information asymmetry, lack of collateral, business informality, and bureaucratic procedures for accessing finance. ICT has potential to overcome these challenges by streamlining information flow, providing online collateral registration and reducing administrative processes for loan processing, disbursement and repayment. The findings suggest that, despite the big digital revolution in Africa, little has been done to align the digital world with the challenges of the informal sector.

KEYWORDS
Access to Finance, Digital Finance, Financial Inclusion, ICT4D, Informal Economy, Informal Sector
1. INTRODUCTION

Many firms in developing countries are either micro, small or medium enterprises operating in the informal economy. “Informal Economy” refers to unregistered, unregulated, and untaxed, but otherwise legal, businesses, including those in the service and production sectors (Spring, 2009). The informal economy is commonly viewed as a marginal and transitory phenomenon that inevitably will be absorbed by the modernizing urban industrial sector (Brown & McGranahan, 2016). Yet despite huge economic growth in the world, informal undertakings continue to mushroom in all developing countries (Schneider & Dominik, 2000). Most the world’s population lives and works in developing countries (Brown & McGranahan, 2016). In fact, the informal sector contributes about 55 per cent of Sub-Saharan Africa’s GDP and 80 per cent of the labor force. Nine in 10 rural and urban workers have informal jobs in Africa and most employees are youth (Williams, Shahid, & Martínez, 2016). The prominence of the informal sector in most African economies arises from the opportunities it offers to the most vulnerable populations such as the poorest, women and youth. Despite its importance, the informal sector is constrained by many challenges that limit business performance. One of the frequent problems facing the informal sector is difficult access formal finance (Mramba et al., 2015). Financial access may be defined as the possibility of those desiring financial services to access them without facing price and non-price impediments (Eryigit & Dulgeroglu, 2015). The topic of access to finance and financial inclusion has been of growing interest throughout the world, particularly in emerging and developing economies. Policymakers are increasingly concerned that the benefits produced by financial intermediation and markets are not being spread widely enough throughout the world’s population and economic sectors. This situation has potential negative impacts on growth, income distribution and poverty levels. Furthermore, there is concern over potential negative consequences for macro stability when financial assets are concentrated in relatively few individuals, firms, or sectors.

Limited access to finance is one of the major factors explaining the development of the informal sector. It is difficult for informal enterprises to access finance through formal financial houses (Ottoo, Fulton, Lowenberg-Deboer, & Ibro, 2012). Due to inaccessibility of formal finance, the informal sector focus on informal finance. These include individual money lenders, family, friends, and rotatingsavings and credit association (ROSCA), and informal credit agreements e.g. Mali Kauli (Lyons & Brown, 2009). Informal financiers emerge as alternative financing sources for informal firms when formalfinance is unavailable. However, there are negatives associated with informal financiers (Li & Kuang, 2010):

- they are more expensive
- they charge higher interest rates than banks
- repayment rates are low
- the loan amount is very limited
- There are many hidden expenses e.g. loan service charges, unlimited liabilities.
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