

Informal finance in Sierra Leone: *Why and how it fits into the financial system*

By

Ilara Mahdi

May 2018

Abstract:

This paper investigates why in Sierra Leone the informal financial sector continues to exist alongside the formal financial system, despite the implementation of financial sector reforms. One of the main policy objectives of the expansion of formal finance in developing countries is to curtail the use of informal finance because of the associated downsides of its use. However, a number of studies have found that large informal financial sectors still exist in sub-Saharan African economies. Cognisant of the existing theories of informal finance, this paper seeks to examine the context specific reasons for the continued relevance and use of informal finance in Sierra Leone. The paper finds a number of factors account for the prevalence of informal finance in Sierra Leone including; historical and social factors, external factors beyond policymakers' control, and problems with government and donor efforts to promote rural banking and the expansion of the microfinance sector. Perhaps most thought-provoking is that a degree of *interdependence* exists between formal and informal finance—they both feed off each other. A finding which has implications for policies aimed at curbing the use of informal finance.

Key words: informal finance, formal finance, financial system, financial sector reforms, Sierra Leone

JEL classification: O17, G21, G23, O55

Introduction

This paper examines why and how informal finance fits into the financial system of Sierra Leone. The subject matter of this paper follows on from a body of literature that emerged in the late 1990s relating to sub-Saharan African (SSA) economies specifically to Ghana, Nigeria, Malawi, and Tanzania on the impact of liberalisation reforms on the financial sectors of these economies. The main focus of these studies i.e. Aryeetey (1994, 1996), Aryeetey et al (1997), Soyibo (1996a, 1996b), Chipeta and Mkandawire (1996a, 1996b) and Bagachwa (1995, 1996) was to assess the impact of financial liberalisation on economic growth in SSA. A major part of their research however, was to prove or disprove the financial repression hypothesis- presented by Mckinnon (1973), Shaw (1973) and Fry (1988) - on the existence of informal financial sectors in relation to SSA economies.

According to the financial repression hypothesis, the existence of large informal financial sectors is due to repressive financial systems. That is, where interest rate ceilings are being set and credit allocated by the state, a large proportion of the populace are being excluded from utilising formal credit services-including the poor, micro and small businesses or generally sections of the populace who do not have ties to the political elites. As a result, this section of the population have no alternative but to turn to informal means of accessing credit such as family, friends or being part of informal savings and credit clubs such as Rotating Savings and Credit Associations (RoSCAs), Susu groups or Osusu groups (as they are, known in Sierra Leone) and Tontines. The solution according to Mckinnon (1973), Shaw (1973) and Fry (1988), is to liberalise the financial systems of these economies by letting interest rates be market determined, thus increasing competition amongst formal financial institutions. This will then promote financial deepening and efficiency and in the process, eliminate the use of informal finance. The ultimate gain from financial liberalisation will be economic growth.

Since the 1980s, efforts to liberalise financial sectors across developing countries were observed. Liberalisation policies were implemented as part of International Financial Institution's (IFI's) structural adjustment programmes (Nissanke 1999) as well as the push to expand access to formal financial services, especially credit. The rationale being, informal finance providers like local money lenders are deemed to have predatory lending techniques including charging high interest rates and harsh loan recovery methods such as land seizures and long labour hours in exchange for loan payments. Or like Adams and Von Pischke (1992) put it, informal finance was seen as *'an evil that should be eliminated'* through increased access to formal finance.

It is along these lines that there is hardly any poverty reduction strategy or financial sector reform plan to be found in SSA economies in the past two decades that does not include policy makers' efforts towards

ensuring sub-Saharan African countries increase access to formal credit, albeit in line with the 'financial liberalisation cause' i.e. market based provision rather than state provided directed credit.

Sierra Leone implemented several such economic and financial policy reforms during the 1980s and 90s. According to Fowowe (2008), Kargbo and Adamu (2009) and Kargbo (2010), financial liberalisation in Sierra Leone included bank denationalisation and restructuring, interest rate liberalisation and removal of directed credit. In addition, one of the country's largest post-war joint donor-government access to finance projects to date; Microfinance Investment and Technical Facility (MITAF) had as part of its core objectives '*to increase access to formal finance while transforming credit allocation to a market based system*' (MITAF 1, project document).

Following this wave of liberalisation reforms of financial sectors in SSA, empirical studies such as Aryeetey and Nissanke (1998) and Aryeetey et al (1997) focused on assessing the impact of financial liberalisation on growth in SSA. In the process, they also sought to find out the impact these reforms had on the financial sectors in these economies since this was to be the channel through which economic growth was to be achieved. The liberalisation reforms were meant to improve the efficiency of the formal financial systems making them more capable of serving all sections of the population. This was to result in the elimination of fragmented financial systems that exists; as the formal financial system became more efficient and deeper, the informal financial system will be eliminated.

To assess this claim, cross-country analyses were undertaken which included in-depth field surveys in Ghana, Nigeria, Malawi and Tanzania. Aryeetey and Nissanke (1998) is a comprehensive report of the individual country studies. Of relevance to this paper is the finding that in spite of financial sector reforms that had been implemented fragmented financial systems still existed in the case study countries.

The use of informal finance was prevalent, it was providing for the credit needs of large sections of the populace including farmers and microenterprises. For example, Aryeetey (1996) found that the two indicators which they employed to measure the deepening of the formal financial sector; the M2/GDP ratio and the share of private sector credit to GDP, did not show any upward trend despite financial sector reforms. Aryeetey and Nissanke (1998) further explain that in Nigeria these two indicators deteriorated. Banks were also found not to be extending the levels of credit that liberalisation reforms were expected to produce because they were still constrained by factors such as underdeveloped infrastructure to support markets and the lack of useful information base. As a result, banks had to be risk averse by not providing credit to sections of the populace that were not considered to be creditworthy.

A number of reasons were provided for the continued existence of large informal sectors. Aryeetey and Nissanke (1998) however emphasised the existence of high transaction costs and imperfect information as major contributing factors. Due to the personalised nature of doing business in the informal sector, this part of the financial system had developed more effective ways of dealing with the costs and risks

associated with extending loans to low income earners and or marginalised groups such as women and youths. Similar findings are reported by Aryeetey et al (1997).

While the studies mostly referred to were undertaken for countries such as Ghana and Nigeria more than two decades ago, no such study exists for Sierra Leone. Hence, this paper will contribute to the literature that seeks to find out the empirical evidence for the continued existence of informal finance. The more recent studies such as Nissanke and Aryeetey (2006, 2008) on the existence of informal finance in developing economies employ an institutional economics approach, however this paper does not utilise this approach and hence it draws more on the earliest studies.

This paper aims to investigate the status quo of the informal financial system in Sierra Leone by providing a historical overview of the formal financial system; including how it emerged and continues to develop. The analysis will cover the colonial period up until 2016. This is done in order to develop our understanding of why and how informal finance has always existed and still continues to thrive alongside a growing formal financial system.

This paper finds that a range of factors are responsible including historical, social and political reasons. The challenges associated with expansion of microfinance in Sierra Leone and the interdependence of formal and informal finance are amongst the predominant reasons in the current context that make the extinction of informal finance a policy objective that is yet to be achieved.

To allow for a robust investigation and analysis of the subject matter of this paper, it is organised as follows: Section 1 examines some existing theories of informal finance. Section 2 provides an overview of Sierra Leone's financial system, how it emerged and continues to develop while illustrating how and why informal finance fits into it. Finally, in Section 3, a summary of the analysis is provided and conclusions are drawn with regards to context specific factors that account for the reasons why informal finance continues to thrive as part of the financial system in Sierra Leone.

1. Why do informal financial systems exist?-The Theories.

In addition to the financial repression hypothesis discussed in the introduction above, the literature also provides some additional theories on the existence of informal finance.¹ In this section, these other theories are reviewed while assessing their applicability to African economies and implications for access to formal finance for the poor including micro and small businesses.

Chipeta and Mkandawire (1996a) and Soyibo (1997) summarise the main schools of thought and theories relating to the origins of informal finance. Broadly these include: (a) The Institutionalists theories

¹ The literature also includes attempts to model informal financial markets; they contribute to our understanding of how informal financial markets operate. See IMF (1993) and Soyibo (1997) for a detailed discussion of these models.

(Nissanke and Aryeetey, 2006, 2008), (b) The Imperfect Information Hypothesis (Hoff and Stiglitz, 1990) and (c) The Structuralist school of thought (Hugon, 1990).

1.1 The Institutional Economists' school of thought

The pioneers of the institutionalists' school of thought argue that informal finance or fragmented financial sectors exists due to institutional constraints faced by formal institutions that operate in African financial systems.² The constraints include the lack of appropriate mechanisms to deal with the management of financial risks, enforcement of contracts and screening and monitoring of loans. This then results to a fragmentation of the financial system, because formal institutions are likely to only serve clients that pose minimum risk and costs to them. The other clients will have to look to informal sources to satisfy their financial services needs.

The proposed means of addressing these institutional constraints according to Institutional economists includes integrating or linking the formal and informal sector. They argue that this will result in improving the effectiveness of informal finance and also increase financing to small and medium-sized enterprises and the low income populace.

The hypothesis as is presented applies to most underdeveloped financial sectors across sub-Saharan Africa and therefore contributes to our understanding of the continued existence of informal finance. This paper acknowledges that the financial transactions executed by the formal financial sectors found in underdeveloped economies often involve high transaction costs-both on the part of the customers and of financial institutions such as commercial banks. The institutions face challenges with enforcement of contracts on account of factors such as the absence of well-functioning local courts to handle commercial cases and limited tools available to screen and monitor loan clients.

This hypothesis also suggests that in the presence of institutional constraints, there is an extreme selection of clientele between the formal and informal sector. However, it is important to point out that in the context of SSA economies; there are players in the financial system that interacts with both the formal and informal sectors. Studies such as Baydas et al. (1995) Conning (2001) and Gine (2011) have found evidence of agents that interact with both sectors. Thus, a generalised assumption of extreme fragmentation is not always applicable to all groups that participate in the financial sector.

To address the current institutional constraints faced by financial sectors, institutional economists' propose that linkages between the formal and informal financial sector must be formed as already stated. Linkages can be formed by the formal sector designing products similar to those offered by the informal

² This paper notes that the theories offered by this school of thought have direct links to the findings of the studies (including Bagachwa 1995, 1996) that were discussed in the introduction.

sector or using informal sector agents (such as local money lenders) to provide services on the formal sectors' behalf. For example, wholesale loans are made available to informal money-lenders and they will then on-lend to their customers. It suggests that this will allow for the financial system to leverage on the positive features of both sectors and will lead to improved savings mobilization and access to credit. Jones et al (2000) demonstrates how this has been done in Ghana.

This paper suggests that the proposal to link formal and informal finance is one that needs to be thought through more carefully. Consideration must be given to the practicality of implementing such policies and the most effective mechanisms for linking the formal and the informal sector especially after taking into consideration context specific factors. The reason for this caution proffered is that studies such as Pagaru and Kirsten (2005) have found that linkages in some cases can be difficult to set up and manage. Such factors mitigate the benefits to be derived from improved access to finance through forming linkages between the formal and informal financial sector.

1.2 The Imperfect Information Hypothesis

Hoff and Stiglitz (1990) put forward a hypothesis for the existence of informal financial markets which considers the type of financial sector that will exist in environments characterized by imperfect information and imperfect enforcement of contracts. They argue that under such circumstances, differences in costs and characteristics of different types of financial transactions are created which leads to different sections of the system specializing in certain types of transactions. This gives rise to an informal financial sector that exists alongside the formal sector. The hypothesis goes further to note that due to imperfect information and enforcement of contracts, the economy is faced with the challenges of moral hazard, asymmetric information, adverse selection and adverse incentive.

This paper notes that this school of thought offers similar reasoning to the institutional economists for the existence of informal financial activities within an economy given that it also emphasises on the role of factors imperfect information and enforcement of contracts in promoting financial transactions taking place outside the formal financial system. However, it goes further to acknowledge that the problems such as moral hazard and adverse incentive are faced by both the formal and informal sector. Ang (2008) provides an overview of the financial deepening and growth literature. This paper tries to summarise the debate and claims that financial institutions exist due to asymmetric information. Thus, formal and informal financial institutions exist because they face differing asymmetric information problems. Hoff and Stiglitz (1990) explain that the informal sector deal with these challenges through informal relationships that exist between informal agents and their clients.

This hypothesis is relevant to the current financial system that exists in most Sub-Saharan Africa economies. The formal financial system face challenges associated with imperfect information and enforcement of contracts such as moral hazard and information asymmetry because they are

underdeveloped. They lack mechanisms and tools such as well-functioning credit reference bureaus to screen potential customers. Financial institutions in underdeveloped financial systems have to rely on qualitative methods to screen potential clients. Thus, they have to charge high interest rates as a way of excluding clients that are usually regarded as not creditworthy and also to make up for the high transaction costs they incur. It has resulted to the exclusion of marginalised groups such as micro and small businesses from interacting with the formal sector. In such a situation, businesses that cannot afford to pay for the services of the formal financial system are limited to the amount of finance that can be satisfied by the informal sector. To a large extent, this limits the scale of investment that these businesses can undertake.

1.3 The Structuralists' school of thought

The explanations or hypotheses reviewed so far in sections 1.1 and 1.2 for the existence of informal finance are economic in nature. According to the structuralists' school of thought outlined by Soyibo (1997), the existence of informal finance does not need to be attributed solely to economic reasons. The structuralists believe that the informal sector is a subordinate to the formal sector. The informal financial sector exists for example, not because of excessive government regulation-claimed by the financial repression school- but to serve a social purpose. Through the informal financial sector, incomes are being redistributed from the 'haves' to the 'have nots' in communities. It serves a purpose of meeting short term liquidity needs of those who need it in society. The social purpose of informal finance is also reiterated by Von Pischke (1991) in defence of the usefulness of informal finance.

This paper welcomes the notion of 'going beyond the economics'. The reason being, in some cases it is a useful way of analysing certain phenomena, especially with regards to African economies where data is scarce and experiences with policy implementation are not properly documented.

This hypothesis is also relevant to Sierra Leone and to most countries in Africa, because contrary to the previous hypotheses reviewed, it acknowledges that finance is usually accessed to satisfy short-term liquidity needs rather than for investment purposes. This is a point that was missed by the promoters of access to formal finance as a means of promoting expansion of micro and small businesses. In consideration of the debt crises associated with the contemporary microfinance movement (see for example Bateman 2010), it has now been widely documented that most microcredit for example are being used for consumption purposes rather than for productive investment (Rosenberg and Schicks 2011, Bateman et al 2014).

2. Informal finance: The case of Sierra Leone

This paper posits that informal finance in Sierra Leone cannot be fully understood without having an insight into the formal financial sector including its institutions, markets, services, transactions and practices. In addition to the theoretical explanations for the emergence of informal finance that have been discussed above in Section 1, the analysis that follows would reveal the country specific factors that have led to the continued existence of the informal financial sector alongside the formal system in Sierra Leone. An overview of the formal financial system in Sierra Leone and its development over the years will be provided in this section.

The evolution of the formal financial system will be discussed in relation to four distinct eras; that is (a) Pre-independence, (b) Post-independence, (c) mid to late 1990s i.e. the war period and (d) the 2000s- i.e. the post-war period up until 2016. The analysis will highlight the implications for the use and existence of informal finance during these different periods.

2.1 Pre-independence; 1800 to early 1960s: *A foreign dominated financial system*

Similar to other African nations, Sierra Leone went through a period of colonial rule by the British, from 1800 to April 1961 when she gained independence.

Sierra Leone's formal financial system emerged from the setting up of a banking system that existed during the colonial era. In 1898, The Bank of British West Africa Limited was the first commercial bank to be established in Sierra Leone. Leigh (2004) and Rogers (2006) explain that, it was set up mainly 'to provide banking facilities for British trading companies and the colonial administration'. This was followed by the setting up of the West African Currency Board (WACB) in 1912 which mainly served the purposes of a central bank. The WACB operated from London, with the Accountant General in the respective colonies acting as the main counterpart to the British headquarter. As a currency board, its basic function was to buy and sell currencies required by the colonial administration and British businesses respectively.

In 1917, another commercial bank Barclays Bank, Dominion, Colonial and Overseas (Barclays Bank, D C O) was established. Similarly, this bank was set up to provide banking services to British entities in Sierra Leone.

Leigh (2004) points out some limitations of the aforementioned commercial banks and this paper argues that these limitations had some implications for the use of informal finance during this era. According to Leigh (2004), the banks that existed at that time did not provide credit to Africans (referring to Sierra Leoneans) because: (a) they did not keep accounts of their commercial activities, (b) they did not have the appropriate collateral required for loans, and (c) also Africans were allegedly unreliable when it came to financial matters.

In consideration of this narration provided by Leigh (2004), this paper concludes that from the onset, major sections of the indigenous population were excluded from what formed the majority of the formal financial system. In such a financial system, the financial needs of the local populace would have to be met by informal forms of finance. This includes likely being part of community loan and saving groups or borrowing from friends and family.

The only formal banking service available to Sierra Leoneans at that time was The Post Office Savings Bank which was established in 1896 and later became the Salpost Savings Bank in 1990. As the name implies, the services it offered were mainly for savings deposits and payment transactions for middle and low-income earners.

In addition, the operations of The Post Office Bank were governed by a set of rules and regulations outlined by Leigh (2004). This paper would like to point out that these rules and regulations could have discouraged the indigenous populace (especially the rural populace) from using this formal institution to cater for their financial services needs. They included; a limit on the amount that could be withdrawn by those in the rural areas, and also withdrawals could only be made once a week, otherwise an excess withdrawals commission was levied. With such restrictions on the savings services offered and since the Post Office Savings Bank did not provide any credit facilities, the use of informal finance would have been widespread amongst Sierra Leoneans during the colonial period.

2.2 Post-independence; 1960s to early 1990s: *The rise of domestic banks' participation in the formal financial system*

Upon gaining independence in April 1961, Sierra Leone's formal financial system was reformed accordingly. To this end, domestic participation was encouraged. This period also saw the establishment of a variety of institutions and accompanying services and instruments in the financial system. Other financial activities in addition to banking began to emerge such as insurance and also financial instruments such as treasury bills and mortgage loans were introduced.

2.2.1 The banking sector

Continued membership of the West African Currency Board (WACB) managed from London, was certainly not consistent with Sierra Leone's new-found independence at that time. Thus, plans to set up a central bank started in 1962. The Bank of Sierra Leone was established to assume all central banking responsibilities with the enactment of the Bank of Sierra Leone Act 1963.

2.2.1.1 Commercial banking

The operations of commercial banks during this period were governed by the Banking Act 1964 that was later replaced by the amended Banking Act 1970. These Acts were used to regulate banking activities and also to provide for licensing of banks. The main purpose of the amended Banking Act 1970 was to reduce the dependency of foreign banks on their headquarters in London.

This led to the 'nationalization' of the two commercial banks that already existed (Leigh (2004)). The British Bank of West Africa became Standard Bank Sierra Leone Ltd and Barclays Bank, D C O became Barclays Bank Sierra Leone Limited. In line with the drive towards domestic participation in Sierra Leone, the first indigenous bank owned by the State known as the Sierra Leone Commercial Bank (SLCB) started operations in 1973.

A wave of new commercial banks then emerged, including Bank of Credit and Commerce International, BCCI (in 1976), International Bank for Trade and Industry (IBTI) (in 1983), Meridian Biao Bank (in 1990), Union Trust Bank another indigenous bank majority privately owned (in 1995), The First Merchant Bank now known as Guaranty Trust Bank Ltd (in 1999) and the First International Bank Ltd (also in 1999).

There are some features of commercial banking during this period that has consequences for the use of informal finance. According to Leigh (2004), one such feature was the banks' objective of making profits for its shareholders in relation to its required liquidity ratio. The amount of liquid assets held by banks during this period was high owing to the liquidity ratio stipulated by the central bank. This paper argues that the amount of liquid assets held had a bearing on the amount of loans that could have been made available to the general public. In addition, in order to make profits on the small amount of loans that were being offered, the interest rates charged on these loans were very high. Under such circumstances, the use of informal credit in particular was inevitable.

In terms of existing literature, there is not much written specifically on informal finance in Sierra Leone. However, a leading Sierra Leonean historian Alusine Jalloh has some work on this subject. His work specifically relates to the role of informal credit in the politics of Sierra Leone. During the period prior to financial liberalisation, those who missed out on acquiring credit from the formal sector (since credit was

directed) including small and medium-sized enterprises would have had to seek finance from informal sources such as family, friends and the political elites. Jalloh (1999, 2003) documents how informal credit was used by politician ‘business men’ (an entrepreneur in the local lingua) to gain popularity with voters. Sierra Leone’s financial system was repressed during this period and large sections of the populace could not access formal finance as deduced from the discussions above. It is evident that the politician business men must have served as an informal source of credit for the poor and small businesses. According to Jalloh (2003), informal credit included both trade credits (for rice) and cash. Thus, this paper can infer that the role of informal finance in politics represented both a demand for and a supply of informal credit in Sierra Leone, hence contributing towards the use and relevance of informal finance during this period. It should be stated that the use of informal loan provision to gain political support was not unique to Sierra Leone. It was also common in West African politics including in Nigeria and Senegal according to Jalloh (2003).

It was during this era also that development banks and mortgage institutions became part of the formal financial system. Two indigenous development banks were set up: the National Development Bank (in 1968) a public limited company and the National Cooperation Development Bank (in 1971). Sierra Leone Housing Corporation Savings and Loans (SLHCSL) now known as Sierra Leone Housing Corporation (SALHOC) was set up in 1986. Due to a number of reasons such as poor loan recovery and undercapitalisation, development banks historically are not regarded to have contributed significantly towards solving Sierra Leone’s access to finance problem (Kangaju 2006).

The domestic insurance sector started to develop in 1971 with the incorporation of the National Insurance Company (NIC) after the Insurance Act in 1970 was enacted.

2.2.1.2 Late 1980s to mid-1990s: The rise of rural banks

Another development aimed at improving access to formal finance during the late 1980s to mid-1990s, was the setting up of eight rural banks from 1985 to 1993. Fraser (2012) further explains that this was done in order to provide financial services (more so credit) for those rural businesses that commercial banks did not extend credit services to. The Yoni Rural Bank was the first of the five rural banks to be established in 1985 and the other four banks started operations two years later (Jabati and Heidhues 1995). However, the rural banks operated under difficult circumstances and did not ‘deliver the goods’ as intended by the Bank of Sierra Leone who ploughed a significant amount of resources to establish these banks.

For example, an examination of the performance of the Yoni Rural bank by Jabati and Heidhues (1995) finds that it did not perform well in terms of reaching its target group and loan operations. On the whole, a very small proportion of the target group were being served with a loan portfolio which was dominated

by agricultural businesses. As a result, the loan demands of the commerce sector for example were not being met. Loan portfolio performance was affected by a number of factors at the macro, credit institution and client levels respectively. It included high inflation rates which affected real incomes of customers, lack of tools and mechanisms to assess credit worthiness of customers, delays in disbursements by the banks and low product prices which affected clients' sales. Fofana (2004) also summarises the challenges faced by the eight rural banks and it included among others; undercapitalisation, political influence in the banks' operations and lack of expertise by staff to undertake rural banking operations. Likewise Conteh (1995) comes to similar conclusions after assessing the performance of four rural banks namely Yoni Rural Bank, Marampa/Masimera Rural Bank, Kunike Rural Bank and Mattru Rural Bank.

The failed rural banks count amongst the state interventions that did not gain traction, and hence did not achieve its objective of expanding formal finance to the rural populace. Hence, the use of informal finance would have been reverted to, in order to meet the financial services (credit) needs of the residents in these rural communities.

2.3 The collapse of the formal financial system; mid to late 1990s; *Dollarization*

Civil war broke out in Sierra Leone in 1992, starting with the eastern region, and then gradually spreading to the rest of the country, reaching the capital city-Freetown in 1999. While the war was contained in the rural areas, it severely affected commercial banking in that part of the country and banks lost their physical assets. The Sierra Leone Commercial Bank (SLBC) had the highest rural penetration in the country during this period. It closed its branch in Koidu (Kono district) when the war reached Kono (a diamond rich area) in 1992. This was immediately followed by the closure of its other branches in Koindu and Kailahun respectively and subsequently other branches in the provinces as the war spread to other regions leaving only its branches in capital city Freetown in full operations. The operations of the financial system came to a more or less complete halt when Freetown was invaded by rebels (Revolutionary United Front, RUF) in 1999. This invasion led to the withdrawal from the country of one of the leading commercial banks during that period i.e. Barclays Bank.

Other institutions of the financial system were also affected once the war got to Freetown, because their operations were mainly based in the capital. In such circumstances, the use of informal finance became the main mode of meeting the populace's financial services needs including savings and remittances (domestic and international). In relation to remittances, Toporowski et al (2009) found that, this is an aspect of financial services that became increasingly executed through informal channels during the war years (and beyond) due to the closure of most of the formal facilities for remitting money within the country and internationally.

Another category of financial transactions that became more informal as a result of the war, was the buying and selling of foreign currencies especially the United States (US) dollars. With the closure of the commercial banks, combined with a rapid depreciation of the local currency i.e. the Leone, Sierra Leone became a dollarized economy. The United States dollars (US dollars) became the preferred medium of exchange and store of value.

During this period, the influx of peace keepers' i.e. Economic Community of West African States Monitoring Group (ECOMOG), United Nations Mission in Sierra Leone (UNAMSL) and donor agencies (providing emergency aid) also meant that there was abundant supply of dollars in the economy. With no formal system for executing foreign exchange transactions, the informal foreign currency traders became the prime source for buying and selling foreign currencies. The use of informal 'foreign exchange changers' still remains the preferred option for buying and selling foreign currencies in Sierra Leone mainly because they are deemed to give better rates than the commercial banks. Their use might also be on account of ease of accessibility compared to bank branches in certain parts of the country.

2.4 The Post-war financial system: the 2000s

Peace was finally restored to Sierra Leone in 2002 after a series of peace talks and a process of disarmament of all the armed factions involved in the war. Immediately after this, the financial system had to assist with post-war reconstruction. According to Rodgers (2006), a significant proportion of commercial banks' credit portfolio at that time was towards 'post-war reconstruction activities and revitalizing the real sector' (pg14).

From 2005-2006 onwards, the Government was keen to rebrand Sierra Leone from its war-torn image to a country that is ready for investment. The Trade and Investment Forum held in the United Kingdom during November 2009 and the Trade and Investment Partnership Forum (November 2011) in Sierra Leone were integral to the rebranding drive.

Not only was the Government keen to attract foreign investments, it was also seeking to stimulate domestic investment and entrepreneurship as a way of raising income levels and creating jobs. As a result, the financial system was being tasked with assisting the government in achieving its domestic private sector development agenda. It was however recognized that given its state the financial system had some limitations that had to be addressed in order for it to effectively promote private sector development and the Government of Sierra Leone's (GOSL) other poverty reduction priorities. Consequently, a Financial Sector Development Plan (FSDP, October 2009) was developed, based on the recommendations of a joint International Monetary Fund (IMF)-World Bank review of the financial sector in May 2007, as part of the IMF's Financial Sector Assessment Program (FSAP).

The discussions that follow will give an overview of the financial system in the 2000s but only up to 2016, highlighting major areas of development of the system during these years. Majority of the developments observed during this era are consistent with the objectives set out in the FSDP 2009. As per the objective of this paper, the analysis will draw implications for the persistence of informal finance alongside the present formal financial system.

2.4.1 The banking sector

The Bank of Sierra Leone in its capacity as the 'head of the financial system' continued to evolve in order to capitalise on opportunities and at the same time face the challenges being presented by developments in the financial sector. The Bank of Sierra Leone Act was amended in 2000 and most recently in 2011, in order to reflect the Bank's evolving role which includes promoting financial inclusion.

In line with the objectives set out in the FSDP, to help increase access to finance, the central bank embarked on certain reforms including establishing a Credit Reference Bureau (CRB) by the enactment of a Credit Reference Act in 2011. The Bureau which is currently part of the central banks' infrastructure is responsible for generating credit information reports that are being used by the commercial banks when making loan allocation decisions. The vision is that this will help address the problem of high non-performing loans, affecting the banking system. It is also expected to contribute towards a reduction in interest rates, for formal finance to become more accessible in future.

Specific to promoting the expansion of formal finance, the Bank revived rural banking by facilitating the establishment of community banks, microfinance institutions (MFIs) and financial services associations (FSAs). These developments will be discussed in section 2.4.2.

2.4.1.1 Commercial banking

There has been continued expansion of the commercial banking sector in Sierra Leone. Total banking assets stood at 20% of GDP in 2007 (IMF 2007) and it increased to Le 2.8 trillion (\$650 million) or 24% of GDP in 2012 (Sesay 2012). As at end December 2016 total assets of the banking sector stood at Le 6.33 trillion or 26% of GDP (Bank of Sierra Leone, March 2017).

Since the restoration of peace, the most noticeable development in the commercial banking sector is the influx of foreign owned banks. A development that represents further steps to liberalise the banking sector in addition to those noted earlier in the introduction. Table 1 shows that the number of banks has grown steadily from four in 2000 (Sesay 2012), seven in 2006 (Kangaju 2006), to ten in 2007 (Sesay 2011) and as at 2016 stood at thirteen (Bank of Sierra Leone). Ecobank (2013) referred to Sierra Leone's banking sector as 'a magnet for foreign banks' (pg 1) on account of the rapid entrance of foreign banks into Sierra Leone's financial sector.

Table 1: Number of commercial banks in Sierra Leone

Year	Number of Commercial banks
2000	4
2006	7
2007	10
2013 to 2016	13

Source: Author

The table below shows a list of the thirteen Commercial banks in Sierra Leone during 2016:

Table 2: List of Commercial Banks in Sierra Leone as at 2016

COMMERCIAL BANKS	
1.	Sierra Leone Commercial Bank Ltd
2.	Standard Chartered Bank Ltd
3.	Rokel Commercial Bank Ltd
4.	Guaranty Trust Bank Ltd
5.	Union Trust Bank Ltd
6.	First International Bank (SL) Ltd
7.	International Commercial Bank (SL) Ltd
8.	Access Bank (SL) Ltd
9.	EcoBank (SL) Ltd
10.	Skye Bank (SL) Ltd
11.	United Bank For Africa (SL) Ltd
12.	Keystone Bank (SL) Ltd
13.	Zenith Bank (SL) Ltd

Source: Bank of Sierra Leone (http://www.bsl.gov.sl/financial_institutions.html)

In Table 3 below it can be seen that the number of commercial bank branches also continued to increase from 38 in 2007, 57 as at 2011 (Sesay 2011), 81 as at 2012 (Decker 2012) and 90 as at January 2014 (Bank of Sierra Leone).³ However, as at 2016 not all the banks had branches outside of Freetown. The geographical distributions of those banks that do have branches outside of the capital also vary from bank to bank.

³ This figure does not include the head offices of all thirteen banks which brings the total branches to 103

Table 3: Number of Commercial Bank branches in Sierra Leone

Year	Number of Commercial Bank branches
2007	38
2011	57
2012	81
2014	90

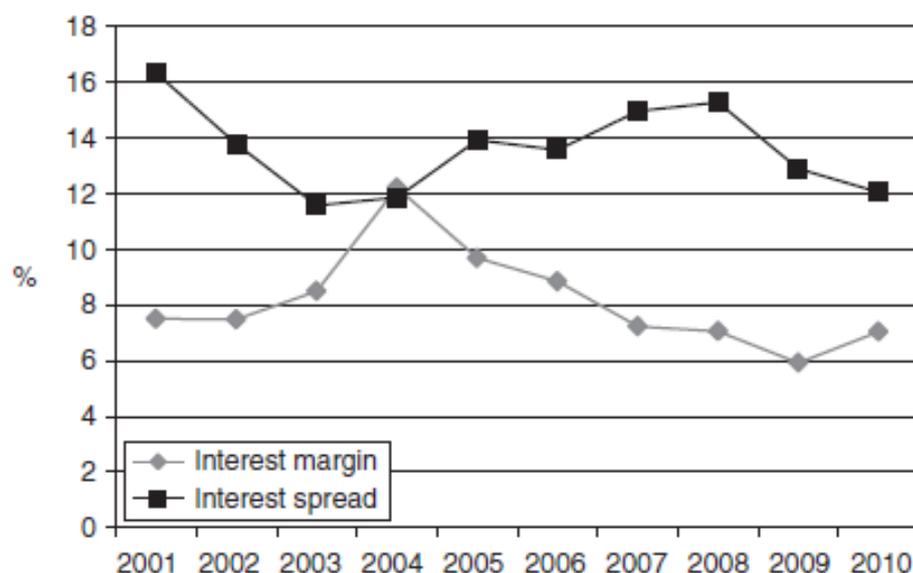
Source: Author

Deposit taking and providing credit facilities form the main business of commercial banks to date. In terms of deposit taking, with the influx of the new banks, innovative forms of deposit taking emerged. It includes branchless banking or cash centres; i.e. some banks now have a team of staff located at some institutions or large businesses that handle large sums of money daily such as Sierra Leone Road Transport Authority (SLRTA) and LEOCEM Sierra Leone.

Though on an increasing trend, the number of bank accounts and bank penetration were still below the average sub-Saharan Africa level. According to Decker 2012, there were only 160,000 accounts for a population of more than five million in 2007. As at end 2011, the number of bank accounts stood at 966,256 accounts out of a population of nearly six million and the Bank penetration was amongst the lowest in Africa, with one branch per 70,000 people (Sesay 2012).

With the influx of the new banks, it was expected that this would introduce some competition into the banking system thus lowering interest rates and subsequently more sections of the populace could gain access to the formal financial system. However, interest rates are still in excess of 20%, similar to 2006 levels. Commercial bank lending rates as at December 2011 were between 21-29% (Sesay 2012). The spread between lending and deposit rates are above 10% seen in Figure 1 for the period of 2001 to 2010. Interest rates did not decrease despite the increased competition and banks still preferred to invest in treasury bills rather than making loans available to customers that are perceived to be highly risky. Even though commercial banks increased their lending to the private sector by 8.38% from December 2010 to December 2011 (Sesay 2012), treasury bills formed a significant proportion of commercial bank's assets.

Figure 1: Interest rate spreads and interest rate margins 2001-10



Source: Decker 2012

Despite the expansion of the commercial banking sector, large sections of the population were still not being served by the formal financial system, taking into consideration the data on the number of bank accounts and bank branches or the fact that interest rates still remained high.

This outlook has still not improved since only 12.6% of the economically active population is currently being served by the formal financial system according to the National Strategy for Financial Inclusion (NSFI, 2017-2020). It is therefore not surprising that the government and donors continued to focus their efforts on developing rural banking and the microfinance sector more generally, in order to provide formal financial services for those large sections of the populace that are still reliant on informal finance.

2.4.2 Rural banking: Community Banks and Financial Services Associations (FSAs)

2.4.2.1 Community Banks

Along with the rest of the financial sector, rural banking also collapsed as a result of the war. The Bank of Sierra Leone however restarted rural banking mainly through the setting up of community banks across the provinces. Two community banks were established in 2002 and by 2012 there were nine such banks in the country and this increased to seventeen as at end of 2014 (Bank of Sierra Leone). The table below is a list of Community Banks in Sierra Leone as at 2016:

Table 4: List of Community Banks in Sierra Leone as at 2016

COMMUNITY BANKS IN SIERRA LEONE
1. Marampa-Masimera Community Bank
2. Yoni Community Bank
3. Segbwema Community Bank
4. Mattru Community Bank
5. Zimmi Community Bank
6. Kabala Community Bank
7. Nimiyama Community Bank
8. Sandor Community Bank
9. Pendembu Community Bank
10. Nimikoro Community Bank
11. Tongo Field Community Bank
12. Koindu Community Bank
13. Simbaru Community Bank
14. Taiama Community Bank
15. Sumbuya Community Bank
16. Madina Community Bank
17. Kamakwie Community Bank

Source: Bank of Sierra Leone (http://www.bsl.gov.sl/financial_institutions.html)

Community banks offer standard banking services to the rural populace, and Kangaju (2006) explains that their deposit services include demand, savings, and fixed deposits and other accounts such as school fees savings accounts. The loans offered are mainly short-term for the duration of four to eight months. The interest rate charged on loans are similar to those of commercial banks (and in some cases higher), however the loan requirements are simpler and procedures less time consuming. Initially community banks' lending was mainly limited to individuals but they eventually moved towards the group lending format utilised by microfinance institutions. Their outreach stood at 3,000-4,000 customers in 2006 (Kangaju 2006) by 2012 they were serving 18,803 customers (Sesay 2012). The current client base of community banks stands at 16,000 clients (NSFI 2017-2020).

Some of the community banks did not perform well (Sesay 2012) because they experienced a number of technical and administrative challenges. The central bank and International Fund for Agricultural Development (IFAD) had to reform the community banks in order to make them more effective (Sierra

Leone National Budget 2012). According to Mahdi (2015), the reform process has also been met with some challenges. The original mandate of IFAD was to revive distressed banks; however, Mahdi (2015) found that those banks that were not distressed at the start of the IFAD support and therefore were not given priority to receive IFAD's support later became distressed. In 2013, additional support to community banks came in the form of the setting up of an Apex Bank for the community banks. The Apex bank's mandate is to serve as a central bank for the community banks offering a central clearing service and performing first level regulatory and supervisory duties in addition to the overall oversight provided by the central bank.

2.4.2.2 Financial Services Associations (FSAs)

One of the most recent features of the financial system in terms of institutional composition is Financial Services Associations (FSAs) or village banks as they are commonly known. They were set up to expand financial services in the rural areas and to complement the services being offered by community banks while they undergo reform. FSAs are membership based, that is the members own shares of the FSAs, and loans are made available from a pooled fund.

There were 26 FSAs, with a membership of 21,082 as at 2011 (Sesay 2012). AYANI (2013) notes 42 FSAs and explains that there are plans to establish a further 150 as part of the Global Agriculture and Food Security Program. However, to date there are 59 FSAs operational which serve 70,000 clients (National Strategy for Financial Inclusion 2017-2020).

Neel (2010), in an earlier independent evaluation of the FSA program in Sierra Leone, acknowledges that there is potential for FSAs in Sierra Leone. It also found that there was a general acceptance of FSAs by communities. However, the study recommended that there was a need to examine the challenges associated with the funding gaps faced by FSAs and also consideration must be given to the provision of more training and support (logistics and supplies) for managers of the FSAs.

Despite the potential of FSAs to assist in addressing the access to credit challenge, Mahdi (2015) explains that there was a sense that the FSA format will be limited in its objective of serving the poor due to its lack of flexibility. For example, only shareholders can access loans and members must have been shareholders for a certain period before they can access loans. Thus, this limits FSAs potential to fully capture the portion of the populace that usually relies on informal finance.

2.4.3 Microfinance

The expansion of Microfinance- mainly microcredit has been a key policy agenda in the post-war years as a mechanism through which the much-needed jobs and incomes could be provided. It was a policy

objective of the government’s Interim Poverty Reduction Strategy (2001) and the National Recovery Strategy (2002-2003) noted by Turay (2008). The National Commission for Social Action (NaCSA) a government agency had the provision of subsidised microfinance as part of its mandate towards immediate post war relief efforts. Social Action for Poverty Alleviation (SAPA), the microcredit window of NaCSA implemented two microcredit programs; the NGO programme and the Chiefdom programme.

Kooi and Tucker (2003) provides a detailed discussion of SAPA’s NGO and Chiefdom projects, and the paper finds that similar to the community banks, these programs also experienced administrative and technical problems. For example, a number of the NGOs that were utilised to channel funds as part of the NGO programme did not have the expertise to implement microfinance projects.

With support from the World Bank and the African Development Bank (AfDB), a National Microfinance Policy was developed and launched in 2003. Following the SAPA project, one of the largest post-war support towards developing the microfinance sector was a joint-government-donor project- Microfinance and Technical Assistance Facility (MITAF 1) that was launched in 2004. It is important to note that the implementation of MITAF was also a further attempt by donors to transform the provision of microcredit from state-provided targeted credit to a more market based and commercialised form.

The main players involved in providing microfinance in Sierra Leone over the years include community banks, development banks, non-governmental organizations (NGOs) and donors. As at 2016, there was a mix of deposit taking (two) and credit only (eight) microfinance institutions (MFIs) operating in the sector and are registered with the Bank of Sierra Leone (seen in Tables 5 & 6 below). Additional MFIs operate in the sector but they are registered with the Non-Governmental Organisation (NGO) department of the Ministry of Planning and and Economic Development (MoPED) formally Ministry of Finance and Economic Development (MoFED).

Table 5 DEPOSIT – TAKING MICROFINANCE INSTITUTIONS

NO	NAME
1	Ecobank Microfinance(SL) Limited
2	Bank for Innovation and Partnership Microfinance

Source: Bank of Sierra Leone (http://www.bsl.gov.sl/financial_institutions.html)

Table 6: CREDIT-ONLY MICROFINANCE INSTITUTIONS

NO	NAME
1	BRAC Microfinance (SL) Limited
2	A Call to Business Trading (SL) Limited

3	Finance Salone (SL) Limited
4	Salone Microfinance Trust (SMT)
5	Counterpart in Community Development and Microfinance Company Limited
6	Grassroots Gender Empowerment Movement (GGEM) Microfinance Limited
7	Capitol Finance Company Limited
8	SAFE Microfinance

Source: Bank of Sierra Leone (http://www.bsl.gov.sl/financial_institutions.html)

On the one hand, the microfinance sector has served sections of the populace that were in the past not served by the formal financial sector. Table 7 obtained from AYANI (2013) shows that the outreach of the major MFIs as at December 2012 was 78,200 clients. Other data provided by Duval and Bendu (2009) and SLAMFI (2015) indicates that the total outreach of the main players in the microfinance sector did not exceed 100,000 customers.

Table 7: MFI Outreach, December 2012

MFI	Borrowers
Association for Rural Development (ARD)	7,000
BRAC Microfinance	22,000
Bank for Innovation and Partnership (BIP)	1,600
Call to Business Microfinance	10,000
Community Empowerment and Development Agency (CEDA)	1,500
Ecobank Microfinance Sierra Leone (EMSL)	2,200
Finance Salone (FS)	13,000
Grassroots Gender Empowerment Movement (GGEM)	3,200
Lift Above Poverty Organization (LAPO)	10,300
SEND SL	800
Salone Microfinance Trust	6,600
TOTAL	78,200

Source: AYANI (2013)

On the other hand however, similar to past access to credit efforts, the sector is characterised by problems which are limiting its outreach to the ‘target group’. The challenges include: the concentration of MFIs only in certain localities while other areas are underserved. Poor infrastructure such as bad roads contributes to this problem, thus it is more convenient and cost effective for MFIs to operate in areas such as Freetown and the other district head-quarter towns where the infrastructure is better.

Other reasons for the limited expansion of the credit services of microfinance institutions to their intended beneficiaries include limited funding to make loans; locally there are no ways of accessing wholesale loans, MFIs therefore need to access loans externally (from donors and other foreign investors) at high costs, this limits the amount they could access and thus on-lend (Mahdi 2015). Another reason is that limited tools and mechanisms exist for MFIs to undertake screening of potential clients. The Credit Reference Bureau mentioned earlier does not serve MFIs; therefore MFIs mainly rely on qualitative screening methods when assessing their clients. This means that MFIs need to take certain precautions such as having credit policies which stipulates that they do not fund start-ups. There is a maximum loan amount above which Mahdi (2015) found that MFIs do not give to a first time client regardless if the client needs more than that amount or if the client can handle more capital. Table 8 below is an example of a typical loan product offered by MFIs in Sierra Leone. Taking this example into consideration, even if a new client has been deemed worthy of handling Le600,000 (£91.89) based on the MFI's assessment at their first loan round, the policy of the MFI is to start new clients at Le 400,000 (£61.27).

Table 8: Loan amounts provided at each loan round:

Loan round	Loan amount	£ Equivalent in current prices (£1=Le 6,529.89 as at February 2016)
1	Le400,000	£61.26
2	Le500,000	£76.57
3	Le600,000	£91.89
4	Le800,000	£122.51
5	Le1,000,000	£153.14

Source: Mahdi (2015)

These policies have consequences for the continued use of informal finance. That is, start-ups that cannot get finance from MFIs (and certainly most of these businesses will never be able to obtain funds from the commercial banks for reasons already discussed), the only option is starting their business from personal savings or accessing an informal loan. Also, in the event where businesses are unable to obtain the full amount they require from MFIs to undertake their intended investment, they will likely look to informal sources to make up for the remainder of the capital required.

These factors discussed are amongst some of the challenges faced and limitations of MFIs which has impacted on MFIs' outreach to marginalised groups in Sierra Leone. Therefore, informal finance still remains relevant and continues to provide for the financial services needs of the millions of Sierra Leoneans who are still yet to be served by the formal financial system.

In the introduction to this paper, it was mentioned that one of the most interesting contributing factors to the continued use of informal finance is the interdependence between informal and formal finance. Mahdi (2015) includes research on how microfinance loans are financed and it was found that formal and informal finance in a way feed off each other. Most clients served by the microfinance sector were found to rely on savings/loans from osusu groups to finance their loans from MFIs. From the preliminary and main interviews conducted for the study (Mahdi 2015), the response of 80% of the respondents when asked how they ensured that they had money to pay for their microcredit; was *'I am a member of an osusu group'*.

A number of factors were found to account for this finding. Firstly, majority of MFIs that exist in Sierra Leone do not meet the regulatory body's requirements for accepting deposits, hence they are credit-only MFIs (recall from Tables 5 & 6). Secondly, the culture of saving with commercial banks is yet to be cultivated amongst low income earners. There's a perception amongst this section of the populace that their monies are too small to be saved in a bank. Thirdly, this paper will like to highlight that one cannot underestimate the role of low literacy levels and specifically low financial literacy levels amongst most Sierra Leoneans and more so the target group of MFIs. It contributes to the limited understanding of the use and need for formal financial services hence the continued reliance on informal finance.

Similarly, the wealthier players in the informal sector such as money lenders and Osusu Masters utilise the commercial banks for safe keeping of monies they have collected.⁴ However, this contributes towards funds that are available to commercial banks which they then utilise to make loans to their customers.

These findings point towards a degree of interdependence between formal and informal finance that currently exists in the financial system. The implication is that for as long as these types of interactions continue to occur, informal finance will continue to exist into the near future.

2.4.3.1 Mobile money

Another development in recent years that has accompanied the entrance of new commercial banks in the sector (discussed in section 2.4.1) is the provision of mobile money transfer facilities. Mobile money transfer facilitated the provision of microcredit to a minimal extent and there is potential for it to contribute further to promoting access to credit as suggested by Fraser (2012). Most commercial banks provide this service while Airtel Money and Splash have partnered with some MFIs such as Salone Microfinance Trust (SMT) and Ecobank Microfinance. Hope Micro (before it collapsed), in early 2011, in partnership with Splash and Kopo Kopo a software company, were the first to make loans available via mobile money transfer. The then managing director gave the following rationale for utilisation of this innovative method of providing loans: *"Making payments at our office takes the client away from their business. We*

⁴ Osusu Master is the group member that is responsible for managing the funds of the Osusu group. He/she is usually responsible mostly for collecting monies from other members and also to make payments to members.

partnered with Splash and Kopo Kopo in order to make our services as convenient as possible and put more money into the pockets of our customers.” (www.sierraexpressmedia.com/archives/20112. Accessed in May 2012). The most recent effort by policy makers towards developing the mobile money sector is the development of ‘Guidelines for Mobile Money Services in 2015 by the Bank of Sierra Leone.

Providing credit through mobile money is still at its rudimentary stage and it will take time for this form of credit provision to take off at the rate it has done in countries like Kenya (see The Economist 2013).

3: Main Findings & Conclusions

Taking into consideration the existing theoretical explanations for the existence of informal finance, this paper set out to unearth the context specific reasons for the continued existence of informal finance in Sierra Leone over the years.

The discussion of the other theories for informal finance offers us a broader understanding of why developing countries continue to observe the use of informal finance be it due to the social purpose it serves (the structuralist school of thought) or because of the existence of imperfect information and imperfect enforcement of contracts (imperfect information hypothesis).

The analysis of the developments in the formal financial system in Sierra Leone has provided some relevant implications and reasons for the existence of informal finance in the past and presently, despite efforts and steps to liberalise the financial sector and other financial sector reforms aimed at increasing access to formal finance.

This paper’s main findings and conclusions are as follows:

In the current financial system that exists in Sierra Leone, one of the most intriguing finding is the interdependence of formal and informal finance. The existence of such a relationship between the two will continue to facilitate the continued need and use of informal finance. The formal system does not adequately cater for savings needs of microfinance clients since 80% of the microfinance institutions in Sierra Leone are Credit-only institutions. Another related point is that most Sierra Leoneans especially the target group of access to credit programmes do not see the need to save money with a formal institution. This paper draws on the finding by Mahdi (2015) which finds that 80% of microenterprises surveyed were reliant on savings or credit as part of their Osusu groups in order to make payments towards their MFI loans. This is a particularly useful finding because of its policy implications; firstly, it shows that the policy objective of eliminating the informal financial system is not being achieved. Secondly, authors such

as Roodman (2012) and Schicks and Rosenberg (2011) have suggested that savings will be a better way of banking the unbanked due to the debt problems observed with microcredit. However, in contexts where sections of the populace are not socialised to save with a formal institution, policy makers will have to develop innovative mechanisms and products to get people to see banks and MFIs as the preferred option for saving.

In Sierra Leone, microfinance mainly through Microfinance Institutions (MFIs) has been the main mechanisms through which access to formal finance has been expanded. This paper finds that a number of challenges face MFIs which thus limits their capacity to expand their outreach. External challenges include poor infrastructure in the rural areas which makes it difficult for MFIs to set-up shop in certain parts of the country. Internal challenges include: MFIs' restrictive lending policies and the problems MFIs face with accessing funds also limits the number of clients that can access loans from formal institutions.

The rapid expansion of the commercial banking sector (financial liberalisation) and the reigniting of rural banking through community banks and financial services associations have not led to a wipe out of informal finance. Majority of the commercial banks in Sierra Leone still do not want to incur the high administrative costs involved with dealing with microbusinesses for example. Another reason might be simply due to lack of the expertise by the commercial banks to do so. This paper also found that administrative and technical draw backs met by community banks have limited their potential to serve marginalised groups. FSAs are relatively new and are yet to make gains in terms of outreach.

The paper also finds that in the past 'from the word go' i.e. during the colonial era, the local populace had to utilise informal finance to carry out their financial transactions since they were excluded from the formal financial system. The only formal service available to Sierra Leoneans during the colonial era was the Post office Savings bank which did not offer credit services and had restrictive savings policies. Post-Independence saw domestic participation in the formal financial system notably the setting up of the state-owned bank Sierra Leone Commercial Bank. Even though more Sierra Leoneans were now being served by the formal financial system, however, the rules and regulation that commercial banks needed to adhere to meant that they could not make loans to the poor, or micro and small businesses. Thus, the use of informal finance continued. Evidence of informal finance's continued reign is also seen in the role informal finance played in the politics of Sierra Leone as documented by Jalloh (1999, 2003). This paper concludes that the use informal loans and trade credits by politician business men discussed in section 2.4.1 represented a demand and supply of informal finance.

The war (1991-2002) did not do any favours in terms of curtailing the use of informal finance. The war progressively affected the functioning of the formal financial system, which meant that its services slowly became unavailable starting off with the provinces then making its way to the capital, Freetown. With

very limited financial services being offered by the formal financial system, this definitely meant an increased reliance on informal finance including credit, remittances, money transfer and foreign exchange services.

The Ebola Virus Disease (EVD) outbreak (2014/2015), this paper infers would have amplified some of the limitations of the formal financial system to increase its outreach. For example, the deterioration in the business climate as result of the outbreak indicates that commercial banks and microfinance institutions will be less willing to give credit to businesses. Operations of financial institutions in the worst affected areas by the Ebola Virus Disease (EVD) were disrupted and consequently the services they offer as found by initial analysis undertaken by SLAMFI (2015). The SLAMFI study also shows that MFIs' customers also died from the disease. The impact of the EVD on the financial sector is certainly an avenue for further research.

To sum up, the discussions of the various theories shed some light on the existence of informal finance in general. In particular, all the theories to some extent apply to the context of Sierra Leone because this paper found that informal finance plays a social role in the society (Structuralists' school of thought), while also institutional constraints such as high administrative costs on the part of formal financial institutions have contributed to the use of informal finance (Institutional Economists school of thought and the Imperfect Information Hypothesis). However, this paper's analysis has offered additional empirical reasons for why informal finance has coexisted with formal finance and continues to exist in Sierra Leone. The reasons have ranged from historical and social factors, to the inadequacies of institutions such as commercial banks, community banks and microfinance institutions within the formal financial system. Taking a context specific approach has certainly added value to this paper and has assisted in uncovering the insightful findings with regards the existence of informal finance both in the past and present.

Bibliography:

Adams, D.W., Von Pischke, J.D. 1992. Microenterprise Credit Programs: Déjà vu. *World Development* 10, 1463-1470

Ang, J. B. 2008. A Survey of Recent Developments in the Literature of Finance and Growth. *Journal of Economic Surveys*, 22(3), 536-576.

Aryeetey, E., 1994. Financial Integration and Development in Sub-Saharan Africa: A Study of Informal Finance in Ghana, Working paper, Overseas Development Institute. Overseas Development Institute, London.

Aryeetey, E. (1996). The Formal Financial Sector in Ghana after the Reforms. Working Paper 86, London.

Aryeetey, E., Hettige, H., Nissanke, M., & Steel, W. (1997). Financial Market Fragmentation and Reforms in Ghana, Malawi, Nigeria, and Tanzania. *The World Development Review*, 11(2), 195-218.

AYANI, 2013. An Overview of the Microfinance Sector in Sierra Leone. AYANI, Inclusive Financial Sector Consultants. May 2013.

Bagachwa, M.S.D., 1995. Financial Integration and Development in Sub-Saharan Africa: A Study of Informal Finance in Tanzania, Working paper 79, Overseas Development Institute. Overseas Development Institute, London.

Bagachwa, M.S.D., 1996. Financial Linkage and Development in Sub-Saharan Africa: The Role of Formal Financial Institutions in Tanzania, Working paper, Overseas Development Institute. Overseas Development Institute, London.

Bank of Sierra Leone, n.d. The Republic of Sierra Leone, Data and Information from Bank of Sierra Leone submitted for the negotiation of the new Extended Credit Facility (ECF) program. March 14-28, 2017.

Bank of Sierra Leone, n.d. The Republic of Sierra Leone, Financial Sector Development Plan, October 2009.

Bank of Sierra Leone. (2015). Guidelines for the Mobile Money Services. Bank of Sierra Leone.

Bank of Sierra Leone. (2015). List of Community Banks and their addresses. Retrieved from Bank of Sierra Leone Website: http://www.bsl.gov.sl/financial_institutions.html

Bank of Sierra Leone. (2015). List of Credit-Only Microfinance Institutions. Retrieved from Bank of Sierra Leone Website: http://www.bsl.gov.sl/financial_institutions.html

- Bank of Sierra Leone. (2015). List of Deposit-taking Microfinance Institutions. Retrieved from Bank of Sierra Leone Website: http://www.bsl.gov.sl/financial_institutions.html
- Bank of Sierra Leone, n.d. The Republic of Sierra Leone. National Strategy for Financial Inclusion 2017-2020
- Bateman, M. (2010). *Why Doesn't Microfinance Work? The destructive rise of local neoliberalism*. New York: Zed Books.
- Bateman, M., Sinkovic, D., & Skare, M. (2014). How to destroy an economy and community without really trying: The Rise and fall of microcredit in post conflict Bosnia. *Post-Crisis Recovery in South Eastern Europe: Policy Challenges for Social and Economic Inclusion*. London: Europe Institute, London School of Economics.
- Baydas, M.M., Bahloul, Z., Adams, D.W., 1995. Informal finance in Egypt: “Banks” within banks. *World Development* 23, 651–661.
- Chipeta, C., Mkandawire, M.L.C, 1996a. Financial Integration and Development in Sub-Saharan Africa: Informal Finance Sector in Malawi, Working paper, Overseas Development Institute. Overseas Development Institute, London.
- Chipeta, C., Mkandawire, M.L.C, 1996b. Financial Integration and Development in Sub-Saharan Africa: The Formal and Semi-Formal Sectors in Malawi, Working paper 89, Overseas Development Institute. Overseas Development Institute, London
- Conning, J., 2001. *Mixing and Matching Loans: Credit Rationing and Spill over in a Rural Credit Market in Chile*. Mimeo, City University of New York.
- Conteh, B. K. (1995, December). *Institutions in Rural Development: The Case of Rural Banks in Sierra Leone*. *PbD Thesis*. Leeds: School of Business and Economic Studies, The University of Leeds.
- Decker, O.S., 2012. Structural Change and Competition in the Sierra Leone Banking Sector: An empirical Investigation. Chapter 4, *Economic Challenges and Policy Issues in Early 21st Century Sierra Leone*. Edited by Omotunde Johnson. International Growth Centre.
- Duval, A., & Bendu, F. (2009). *Development of a Sustainable Pro-Poor Financial Sector in Sierra Leone Project SIL/03/C01: Final Report*. Freetown: United Nations Capital Development Fund, Sierra Leone.
- Ecobank. (2013). *Sierra Leone’s Banking Sector: A Magnet for Foreign Banks*. Ecobank.
- Fofana, M.S., 2004. Deputy Governor’s Statement at The Official Opening of International Commercial Bank.
- Fofana, M.S., 2005. *Mainstreaming Micro and Rural Financial Services in Sierra Leone: Progress, Challenges and Prospects*. Paper presented at the African Rural and Agricultural Credit Association (AFRACA) sub regional workshop. Abuja, Nigeria. 13-15 September 2005.
- Fowowe, B., (2008) Financial liberalization policies and economic growth: panel data evidence from Sub-Saharan Africa. *African Development Review*, 549-574.

- Fraser, H.K., 2012 *Access to Finance: the Role of Microfinance*. Chapter 5, *Economic Challenges and Policy Issues in Early 21st Century Sierra Leone*. Edited by Omotunde Johnson. International Growth Centre.
- Fry, M.J., 1988. *Money, Interest, and Banking in Economic Development*, 1st ed. Ed, The Johns Hopkins studies in development. Johns Hopkins University Press, Baltimore ; London.
- Giné, X., 2011. Access to capital in rural Thailand: an estimated model of formal vs. informal credit. *Journal of Development Economics*. 96 (1), 16–29.
- Government of Sierra Leone, 2001. *Interim poverty reduction strategy paper*. Republic of Sierra Leone.
- Government of Sierra Leone, 2002. *National Recovery Strategy: Sierra Leone 2002-2003*.
- Government of Sierra Leone, 2003. *National Microfinance Policy: Sierra Leone*.
- Government of Sierra Leone, Ministry of Trade and Industry. n.d. *Private Sector Development Strategy for Sierra Leone, 2009-2014*.
- Government of Sierra Leone, 2012. *Government Budget and Statement of Economic and Financial Policies for the Financial Year 2012*.
- Hoff, K., Stiglitz, J.E., 1990. Introduction: Imperfect Information and Rural Credit Markets: Puzzles and Policy Perspectives. *The World Bank Economic Review* 4, 235–250.
- Hugon, P., in White, L.H., 1990. *African Finance: Research and Reform*. Sequoia Inst.
- International Monetary Fund, 1993. *Informal Financial Markets in Developing Countries: A Macroeconomic Analysis*. Blackwell, Oxford UK & Cambridge USA.
- International Monetary Fund, 2007. *Sierra Leone: Financial Sector Strategy Note (Strategy Note)*. International Monetary Fund.
- Jabati, S., Heidhues, F., 1995. Rural Financial Markets in Sierra Leone: The Operational Performance and Problems of the Yoni Rural Bank. *Savings and Development* 4, 377-392
- Jalloh, A., 1999. *African Entrepreneurship: Muslim Fula Merchants in Sierra Leone*, Monographs in international studies. Ohio University Centre for International Studies, Athens.
- Jalloh, A., 2003. Informal Credit and Politics in Sierra Leone. *African Economic History* 91–110.
- Jones, H., Sakyi-Dawson, O., Harford, N., & Sey, A. (2000). *Linking Formal and Informal Financial Intermediaries in Ghana: Conditions for success and implications for RNR development*. National Resource Perspectives.
- Kangaju, E.O., 2006. *Integrating Financial Services into Poverty Reduction Strategies: The Case of Sierra Leone*.

- Kargbo, S. 2010. Financial liberalisation and savings mobilisation in Sierra Leone: a test of McKinnon's complementarity hypothesis. *West African Journal of Monetary and Economic Integration* 10(1):131–170.
- Kargbo, S. M., and P. Adamu. 2009. Financial development and economic growth in Sierra Leone. *West African Journal of Monetary and Economic Integration* 9(2):30–67.
- Kooi, P., Tucker, J., 2003. *Microfinance Sector Development in Sierra Leone: An Assessment*. United Nations Capital Development Fund (UNCDF).
- Leigh, E.S.E., 2004. *The Sierra Leone Financial System*. Author House.
- Mahdi, I. (2015, September). Access to Credit, Indebtedness and Debt-refinancing amongst microenterprises in Freetown, Sierra Leone. An Institutional Approach. School of Oriental and African Studies (SOAS), University of London. PhD Thesis (Unpublished). London.
- McKinnon, R.I., 1973. *Money and Capital in Economic Development*. Brookings Institution, Washington.
- Neel, D. C. (2010, September). Rural Finance Development in Sierra Leone: A Case Study of the Financial Services Associations. *Masters Thesis*. University of Stellenbosch.
- Nissanke, M. (1999). Structural Adjustment and The African Crisis. *Eastern Economic Journal*, 25, 4, 399-420.
- Nissanke, M., Aryeetey, E., 1998. *Financial Integration and Development: Liberalization and Reform in Sub-Saharan Africa*. Routledge.
- Nissanke, M., Aryeetey, E., 2006. Institutional Analysis of Financial Market Fragmentation in Sub-Saharan Africa; A Risk-Cost Configuration Approach (Research Paper No. 2006/87). World Institute for Development Economics Research.
- Pagura, M., Kirsten, M., 2005. *Formal-Informal Financial Linkages: Lessons from Developing Countries*. Food and Agriculture Organisation (FAO), Development Bank of Southern Africa
- Rogers, J.D., 2006. *Financial Services and Business Lending: Products and Services Currently Available to Business*.
- Roodman, D. (2012). *Due Diligence: An Impertinent Inquiry into Microfinance*. Washington, DC: Centre for Global Development.
- Schicks, J., & Rosenberg, R. (2011). *Too much microcredit? A survey of evidence on over-indebtedness*. Washington, DC: The Consultative Group to Assist the Poor (CGAP).
- Sesay, S., 2011. *Sierra Leone: Experiences, Practices and Challenges in Devising Financial Sector Policies*.
- Sesay, S., 2012. *Governor's Annual Dinner Speech, 2012*. Bank of Sierra Leone.

- Shaw, E., 1973. *Financial Deepening in Economic Development*. New York: Oxford University Press.
- Sierra Leone Association of Microfinance Institutions. (2015). *Sierra Leone: The Impact of the Ebola Crisis on the Microfinance Sector and stories of microentrepreneurs's resilience*. Freetown: SLAMFI.
- Soyibo, A., 1996a. *Financial Linkage and Development in Sub-Saharan Africa: The Informal Financial Sector in Nigeria*, Working paper. Overseas Development Institute, London.
- Soyibo, A., 1996b. *The Role of Formal Financial Institutions in Nigeria*, Working paper. Overseas Development Institute, London.
- Soyibo, A., 1997. *The Informal Financial Sector in Nigeria: Characteristics and Relationship with the Formal Sector*. *Development Policy Review* 15, 5–22.
- The Anti-Money Laundering Act, 2012. Supplement to the Sierra Leone Gazette Vol. CXLIII, No.9. Dated 23rd February, 2012.
- The Banking Act, 2011. Supplement to the Sierra Leone Gazette Vol. Vol. CXLIII, No.4. Dated 26th January, 2012.
- The Credit Reference Bill, 2011. Supplement to the Sierra Leone Gazette Vol. CXLII, No.22. Dated 5th May, 2011.
- The Economist. (2013, May 27th). *The Economist explains-Why does Kenya lead the world in mobile money?* Retrieved January 2014, from The Economist Website:
<http://www.economist.com/blogs/economist-explains/2013/05/economist-explains-18>
- Toporowski, J., Krishnan, S., Paschoa, J.P., Weeks, J., 2009. *Remittances Strategy Framework for Sustainable Development in Sierra Leone*.
- Turay, R., 2008. *Comparative analysis of forms of credit: identifying and analysing other forms of credits in Sierra Leone: a case study on the position of PASACOFAS microfinance scheme*
- Von Pischke, J.D., 1991. *Finance at the Frontier. Debt Capacity and the Role of Credit in the Private Economy*. Economic Development Institute of The World Bank. Washington, D.C.

Biography:

Dr. Ilara Mahdi is an international development professional with over ten years of experience of working in both public sector and for bilateral donors with specific experience relating to budget support programmes, public financial management, public sector payroll reforms, financial sector development and private sector development. She is also a researcher with interests in financial inclusion, micro and small enterprise development and microfinance debt issues.

She attained a PhD in Economics in 2016 from the School of Oriental and African Studies (SOAS) University of London (London, United Kingdom), a Master's degree (with Merit) in Finance and Economic Development from the University of Glasgow (Scotland, United Kingdom), a Post-graduate Diploma in Economics from the University of Edinburgh (Edinburgh, United Kingdom), and a Bachelor's degree in Economics from London Metropolitan University (London, United Kingdom).

She currently works as a consultant Payroll Reform Adviser for Adam Smith International and Linpico in Sierra Leone at the Ministry of Finance (MoF).

Dr.Mahdi worked as Key Result Area Facilitator (KRA) during 2016 at the Ministry of Trade and Industry (MTI) in Sierra Leone as part of the country's Post Ebola Recovery programme. The role involved providing support to the MTI to implement the ministry's Post Ebola recovery initiatives aimed at achieving an increase in the growth and competitiveness of micro small and medium enterprises (MSMEs) across key value chains.

Dr.Mahdi also worked for the Department for International Development (DFID, Sierra Leone) as an Economist from 2007 to 2011. She led on the implementation of DFID's Budget Support programme and also supported the implementation of DFID's projects aimed at improving public financial management and private sector development.