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Informal financial savings practices to facilitate formal financial inclusion

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Abstract

This review continues the exploration of the role of informal savings mechanisms, such as the group-based savings system called Ajo or Esusu in the south-west of Nigeria, in promoting financial inclusion in Nigeria, and particularly among women. Ajo/Esusu, which is a traditional form of cooperative savings and lending, is deeply rooted in many African communities and has proven effective in providing a sense of belonging and financial access to individuals excluded from the formal banking sector [31]. According to [1], these informal savings mechanisms have the potential to bridge the financial inclusion gap by offering an accessible, tested, trusted, and community-based platform for saving and borrowing. Despite significant efforts to enhance financial access, a substantial gender gap persists, with approximately 30% of adult women excluded from formal financial systems [36]. This study highlights the importance of informal savings as a viable alternative for fostering economic empowerment within communities of trust amongst marginalized groups, even in developed economies. Thus, the discourse on integrating traditional group-based savings practices with formal financial services can create a transformative pathway for increased participation in formal financial services systems. The study also assesses the impact of Ajo/ Esusu on women's financial behavior, access to formal banking services, and their economic livelihood based on their adopting a group-based micro savings culture. It provides insights into how informal savings systems drive financial inclusion and seeks to inform policy recommendations that harness the potential of informal financial practices for the benefit of low-income women and broader economic development objectives.

Keywords: Digital Transformation; Financial Inclusion; Informal; MSME; Micro-savings; Savings-groups

1. Introduction

Financial Inclusion continues to emerge as a critical global issue, particularly in developing economies like Nigeria, where a significant proportion of the population remains un(der)banked or underserved. The World Bank defines financial inclusion as the access to useful and affordable formal financial services, which includes savings accounts, credit, insurance, and payment systems [40]. Financial inclusion refers to the deliberate efforts to remove barriers that prevent individuals and businesses from accessing formal financial services, financing and safely participating in the financial services sector. It involves providing affordable and accessible financial products and services to all individuals and companies, regardless of their net worth or business value [25]. This concept encompasses access to a range of financial services—including payments, savings, credits, investments, pensions, and insurance—delivered responsibly, safely, and sustainably within a well-regulated environment [2]. Financial inclusion ensures that vulnerable groups, such as the elderly, physically challenged, and low-income individuals, can effectively use these services to manage financial risks and seize opportunities for economic advancement [43],[49].

In Nigeria, recent surveys indicate that approximately 30% of adult women are excluded from formal financial services, compared to 21% of men, highlighting a considerable gender gap in financial access [40]. This exclusion is particularly detrimental to women, who often bear the brunt of economic hardships and face systemic barriers to accessing credit

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and other financial services. According to EFInA 2023[40], Access -To -Finance research, 63% (133m) of Nigerians are now multidimensionally poor because of the sluggish economic growth with high inflation in 2022. As more people fall into poverty because of crippling economic factors outside of their control, the exclusion gap widens, triggering a continued focus on the deployment of efforts to find mechanisms to increase the rate of adoption of formal financial services.

Informal savings cultures, which are mainly traditional savings methods like Ajo/Esusu, represent the power of the communal systems to self-regulate by providing governance, compliance, insurance, arbitration services and the likes for members who have agreed to participate. Members of Ajo/Esusu groups enter into agreements to save an agreed fixed amount at predetermined regular intervals, with the total sum distributed to each member of a group on a rotational basis [37]. This system fosters a culture of savings and provides participants access to lump sums of money, which can be critical for meeting emergency needs or financing future investments such as starting small businesses [34]. Despite the advancement of the financial services ecosystem in Nigeria, and the expansion of its service footprint regionally and internationally, informal financial systems play an integral part in the economic framework, linking them to rural, low-income and marginalized communities [29].

Informal savings groups can serve as a safe passage for the excluded to move forward confidently to request for and access formal financial services[30,. The trust-based nature of informal savings groups and similar systems can facilitate the adoption of formal financial services by reducing barriers such as lack of trust in formal institutions; financial illiteracy; awareness; culture and gender restrictions for women, and documentation requirements for identity management [29],[47]. The potentials of the informal systems notwithstanding, promoting the adoption and integration of these systems into the formal financial sector poses significant challenges, including regulatory hurdles, research funding for product /program system design, customer identification limitations, and the need for financial literacy programs [49]. The cost of developmental research for exploring the financial returns on this type of financial service at a scale large enough to cause a significant change in the numbers of those excluded is significant. The design of the complex application system that would be agile enough to scale quickly as it links banks, non-banks and with national payments systems will also be a challenge.

2. The AJO/ESUSU savings method as an informal financial system

Ajo/Esusu are used interchangeable to describe a traditional group savings method practiced widely among various communities in Nigeria and other parts of West Africa. Esusu involves a group of individuals coming together to save a (usually small) predetermined amount of money, which is then collected by a designated person (often referred to as a collector) at specified time periods, who then keeps the money for a small fee, and returns the money to the members at agreed intervals and payment schedule [37]. The collector takes a small fee for custodial, record-keeping, logistics and customer service. Ajo is like Esusu in that it is group based. However, Ajo does not need a collector/agent if members of the group know each other well and agree to forward the agreed sum, on an agreed date to the member who has drawn the lot to take up the fund's contribution first. The funds collected by the first member are used as they deem fit. The next month, all members contribute the same amount for the next person assigned to take the collections, and so forth and so on. These systems allow participants to save collectively, while creating future access to lump sums of money when needed, thus serving as a crucial financial savings and lending mechanism for those lacking access to credit from formal banking systems [34].

Informal financial agents('collectors') that operate mostly within the traditional open markets, play a significant role by providing retail-based lending services to individuals and micro-enterprises who typically lack access to formal banking mainly due to distance, cost, illiteracy, their inability to meet collateral requirements from banks and other formal lending institutions, amongst other barriers. The operation of agents/ collectors in the informal sector highlights the inadequacy of formal financial systems in meeting the needs of all segments of society, particularly the low income, mass market, rural populations and urban poor, who often rely on simpler and cheaper informal mechanisms for their financial needs.

The activities of the collectors and agents notwithstanding, the financial gap persists for small businesses, which require larger sized loans at lower rates than what informal agents can provide; owing to the lack of the necessary financial history, track record with loan repayments and appropriate collateral to access formal loans. However, the emergence of new non-bank financial intermediaries in Nigeria, indicates a growing response to the unmet demand for credit not satisfied by either the formal or informal sectors. A linking of these informal institutions with the formal financial system and payment network may be essential for increasing savings mobilization and making more funds available for high-return investments of small businesses [32], [31].

Many informal financial intermediaries, operating as self-help organizations, have sought to establish linkages with formal institutions to help small entrepreneurs access bank loans. Formal banking institutions have struggled to engage with informal groups that lack legal status to formalize them into registered entities that can facilitate direct connections to banks. This formalization can allow for more structured access to financial services and credit, ultimately enhancing the economic inclusion of underserved populations [24] as well as the expansion of the formal service industry.

The ongoing development of the formal economy notwithstanding, informal financial markets remain integral to the domestic economic framework of most African countries [29] serving as mechanisms for accumulating and redistributing savings within rural communal society for ages [35].

3. Women as drivers of informal savings systems

Women's exclusion from financial systems is a global issue, with Enhancing Financial Innovation and Access [36] survey showing that 30% of adult women in Nigeria were excluded from formal financial services compared to 21% of men and is significantly larger than the World Bank's global average of four percent [5]. According to the World Bank [5], women from lower-income segments are the most likely to be financially underserved, with inadequate access to credit being a primary barrier for women entrepreneurs. In many developing countries, especially in rural areas, the formal banking system often fails to meet the financial needs of a significant portion of the population [27]. Barriers such as limited access to banking infrastructure, high transaction costs, and lack of financial literacy persist. In Sub-Saharan Africa, where only 43% of adults have formal bank accounts [40], low levels of education also contribute to financial exclusion. According to a World Bank report, unbanked adults are more likely to have low levels of education; in developing economies, about half of all adults have no more than a primary school education [40].

Despite their contributions in generating sustenance income and fostering economic resilience, women in general, and women-led businesses in particular, face greater and persistent barriers to accessing financial resources. The location of their business at home relative to urban centers where more customers and better financial services are more easily available is a challenge. Other barriers to financial inclusion for women is the lack of income, poverty, income inequality and the dearth of infrastructure for supporting the build-up of formal services closer to home where they usually operate from. In many rural areas, low-income households headed by women face crippling financial difficulty because of societal gender-biased roles, harsh cultural and religious beliefs that place a cap on a woman's ability to create economic benefit for herself. Further, poverty and unemployment continue to force other family members to become more dependent on their micro business for sustenance. This, in turn, limits their ability to save and invest in economic opportunities such as education, entrepreneurship, or asset accumulation, perpetuating the cycle of poverty [52],[33].

Women-led micro, small, and medium enterprises (MSMEs) account for a substantial share of employment. Women typically engage in micro businesses that they can operate closer to home, where they depend on the communal system to advocate, trade and help one another to survive. These businesses frequently face man-made obstacles in accessing credit and financial services, exacerbating the challenges posed by financial exclusion [38]. Quicker access to financial education and basic but crucial financial products and services, such as micro loans, savings, and insurance, become essential for sustained business growth [52].

The adoption of mobile money by the un(der)banked has demonstrated the potential of leveraging the wide network of informal systems to drive financial inclusion by providing more accessible financial services to underserved populations using technology. Mobile money has driven financial inclusion in Sub-Saharan Africa, with 43% of adults now holding accounts and significant growth in mobile transactions. In Nigeria, with over 205 million mobile connections, which was about 91% of the country's population in 2024, there has been a 3.9% increase from the start of 2023 [39]. This rise offers opportunities to reduce gender and income gaps in accessing financial services.

As these informal systems are already embedded in local communities, making them more accessible and trusted than formal institutions, the integration of savings and lending system like Ajo/Esusu into the strategies of non-bank financial institutions can be transformational. Through partnerships with fintech's and online financial platforms, the landscape for the excluded can change by driving a new level of awareness and engagement of the un(der)served with alternative banking solutions.

4. Digital transformation of informal savings practices to foster financial service adoption

By creating a bridge between informal savings practices rooted in communal trust, and formal financial services backed by technology, policymakers, financial service providers, and civil society organizations can carve out a pathway for individuals and businesses in underserved communities to more confidently access the financial services they need to thrive. Through a combination of digital financial services, tailored financial education, and supportive regulatory frameworks, rural excluded communities can be empowered to participate fully in the formal financial system to drive economic growth.

Over the past decade, there has been substantial growth in financial services and access points driven by mobile money, digitalization, and innovations within the financial services sector, notably in payments [28]. This shift from traditional banking models to more cost-effective, branchless channels has allowed community and online banks to play a more impactful role in reaching underserved populations. Commercial banks have taken the lead with the strategy, introducing self-service electronic channels to decongest branches and lower transaction costs for small-scale consumers outside urban centers. They are however constrained by the costs of deploying infrastructure into the suburbs and rural areas in the absence of a profitable return on investment.

The recent introduction of Payment Service Banks (PSBs), a regulation spearheaded by the Central Bank of Nigeria (CBN) in 2020 to enhance financial service accessibility for low-income earners and unbanked segments has caused a shift in the formal services landscape with a potential to impact the informal system. These PSB's, operating through mobile and digital platforms, provide a new framework for financial inclusion initiatives targeting rural and economically marginalized areas. Mobile phone penetration in Nigeria which has vastly improved, with 3G coverage reaching 78% and 4G coverage at 45% by 2019 [45], has been responsible for the positive shift. However, significant gaps remain, particularly in rural areas where 20% of the population is still uncovered, and there is a 30% gender gap in mobile internet usage, more significant than the average gap in low- and middle-income countries [44].

Fintech companies have created alternative financial ecosystems using mobile payments technology in Nigeria offering a broader array of services, including payments, lending, and financial management, often targeting internet users. Mobile network operators have successfully made their foray into payment services through the licensing of PSB's allowing users to operate mobile money accounts without necessarily being linked to traditional bank accounts. Government has launched initiatives that distribute hardship allowances, grants and pensions through government payment platforms allowing individuals in remote areas to access their funds securely, while microloan programs provide critical seed capital for underserved entrepreneurs [14]. These programs, often paired with financial literacy and mentorship training, help individuals effectively manage their finances and grow their businesses [10].

As of 2020, Nigeria had over 99 million internet users, representing 46.6% of the population [51]. As mobile phones have become a critical tool for informal businesses, facilitating communication with suppliers and customers, enhancing business efficiency, and providing access to market information [21], online banks have capitalized on this technology to offer digital financial services through mobile apps, reducing the need for physical infrastructure. This model is particularly suited for urban populations with internet access but is gradually expanding to rural areas through partnerships with mobile network operators and fintech companies in Nigeria [19].

Notwithstanding the progress of fintech's, the informal nature of many businesses in Africa has created challenges for many modern banks in offering services profitably. Information asymmetry, the lack of transaction histories, and the absence of collateral make it difficult for banks to assess loan applications from informal businesses [18].

In contrast, community banks with their proximity to local populations, that have historically focused on providing basic financial services to those excluded from mainstream banking [35],[34] can help extend the reach of banks by offering products based on digital transaction data, reduced cost to serve, and greater outreach. The digital transformation of these institutions may likely expand their ability to integrate with collectors and agents for group-based savings to serve remote and underserved areas. The main challenges a partnership between community banks and traditional savings groups may face include limited access to national technology infrastructure, dearth of investment funding for rural community banks to shore up capital, unfavorable policies for regulating the traditional savings groups, illiteracy amongst those in the rural community, and other socio-economic factors.

5. MSMES and financial inclusion

Nigeria is home to over 41 million micro, small, and medium enterprises (MSMEs), which account for 60% of the country's jobs [38]. However, despite their significant economic contribution, many MSMEs still struggle to access credit for business growth and expansion [41].

MSMEs in Nigeria, like their counter parts in many parts of the world, particularly in developing regions, face significant barriers to accessing financial services and inclusion in the formal economy. The informal economy, which includes unregistered firms and informal employment arrangements, makes up a substantial part of economic activity [17]. Informal MSME's, often run by women, lack formal registration, formal management structures, access to formal financial services, hindering their ability to grow into structured businesses that would be more attractive to banks. In Sub-Saharan Africa, for example, 66% of employment in non-agricultural sectors is within the informal economy, while in Southern Asia, the figure reaches 82%. The prevalence of this informality in densely populated low-income countries highlights the extent of financial exclusion, with informal enterprises employing a significant portion of the labor force [50].

Banks, designed to maximize profit, tend to focus on customers who can generate short- or medium-term returns, often excluding those in rural or low-income areas. Retail banks in Africa, for instance, impose high fees for basic banking services, making it cost ineffective for informal businesses to use their services [20]. As a result, many women and MSMEs in the informal economy rely on cash transactions that guarantee receipt of the full-face value when transacting. This is particularly pronounced in African countries where only a small percentage of informal businesses maintain dedicated bank accounts [3].

Women typically rely on their own savings or support from family and friends to finance their operations. Banks often deem these businesses too risky for lending due to a lack of formalization, collateral, and credit history, which limits their ability to secure loans or formal financial services. Banks' high interest rates further exacerbate this challenge, making it difficult for informal enterprises to grow and contribute to economic development [23] when they are granted credit.

Microfinance institutions and community-based savings groups have emerged as alternatives to large banks, offering micro-credit and savings opportunities to MSME's that may not benefit from the limited services of traditional financial systems [48]. Despite the success of some initiatives by microfinance institutions, their reach remains limited, and they also struggle to bridge the huge gap in service delivery that exists between informal and formal financial systems. MSME's access to credit from these systems can be limited and expensive, with high interest rates and short maturities making them unattractive for long-term business investments. Nevertheless, they provide an entry point for more inclusive financial services that can help formalize and strengthen the financial health of marginalized communities [18].

In Nigeria's informal sector, of the 70% of businesses that have received loans, 12.2% obtained them from banks, while 70.7% reported borrowing from friends and family, and 2% secured loans from cooperatives [38]. These statistics show the need for stronger linkages between formal and informal lenders to enhance the flow of credit to MSMEs. The lack of integration between formal and informal financial sectors hampers economic growth and limits opportunities for women and MSMEs to scale their businesses [22].

To address these challenges in Nigeria, national policy frameworks must prioritize financial inclusion by incentivizing formal financial institutions to engage with informal savings groups. Integrating informal and formal financial systems would promote equitable access to credit and allow different financial agents to specialize in serving various market segments, thereby improving overall efficiency.

6. Opportunities and challenges in expanding financial inclusion through informal savings mechanisms

The journey towards achieving widespread financial inclusion has been marked by both progress and persistent challenges. Informal savings mechanisms, such as Ajo/Esusu which bear similarity to rotating savings and credit associations (ROSCAs) in other climes, present unique opportunities to bridge the financial divide, especially in remote communities. However, their integration into formal financial systems also faces significant challenges that must be addressed for sustainable financial inclusion.

6.1. Opportunities

6.1.1. Bridging the Gap for the Unbanked

Informal savings groups like Ajo/ Esusu play a critical role in reaching unbanked populations, particularly in areas where formal financial institutions are scarce. As these systems are deeply embedded in local communities and serve individuals who may lack formal identification or adequate income to participate in the formal financial sector, they can act as entry points for financially excluded individuals to adopt formal financial services, fostering gradual trust in the banking system [13].

6.1.2. Cultural and Social Acceptance

Informal savings mechanisms thrive on social trust and community accountability, which formal financial institutions often lack. Their community-based structure encourages participation and ensures adherence to saving routines. This trust-based relationship is difficult for formal institutions to replicate, but it provides a reference point for integrating similar mechanisms into formal financial services, to reach marginalized populations [10].

6.1.3. Promoting Financial Literacy

Informal savings groups often serve as de-facto financial literacy programs, educating participants on savings habits, interest accumulation, and financial discipline. Integrating these groups into the formal financial system offers an opportunity to leverage their role in promoting financial education, enhancing participants' financial capabilities, and reducing their vulnerability to predatory lending [16].

6.1.4. Low entry barrier and Flexibility

Informal savings mechanisms often come with low entry barriers and flexible participation terms, which are ideal for low-income earners and micro-entrepreneurs. Formal financial institutions can design tailored products that incorporate these flexible characteristics, making formal services more appealing and accessible to previously excluded individuals [12].

6.1.5. Digital Financial Inclusion

The rise of mobile banking and FinTech offers an unprecedented opportunity to digitize informal savings mechanisms. With increasing mobile phone penetration, particularly in developing regions, digital platforms can formalize and scale these savings groups, offering enhanced security, transparency, and efficiency. Mobile platforms also allow for greater financial inclusion by providing essential services, such as savings, payments, and loans, to populations that previously lacked access to formal banking services [15].

6.2. Challenges

6.2.1. Lack of Formal Identity Documentation

Participants' lack of formal identification documentation is a significant barrier to integrating informal savings mechanisms into the formal financial system. Many individuals who rely on these systems lack the required identification documents to open bank accounts or access other formal financial services [14]. This exclusion perpetuates a cycle of financial vulnerability, as these individuals remain reliant on informal and sometimes predatory financial systems.

6.2.2. Geographical Barriers and Infrastructure Gaps

Rural and underserved areas often suffer from inadequate IT infrastructure, that limits the expansion of bank branches or agent networks, which in turn limits access to formal financial services. The geographical divide between rural and urban centers also creates logistical challenges in extending formal banking services to areas where informal savings mechanisms are most prevalent [20]. While mobile banking offers potential, the digital divide, particularly limited internet connectivity, remains a barrier to financial inclusion for these communities [8].

6.2.3. Financial Literacy Gaps

Although informal savings groups can promote basic financial literacy, many participants still lack the knowledge to engage fully with formal financial products and services. This lack of financial illiteracy can make individuals vulnerable to scams, predatory lending, and high-cost financial products that may further entrench their financial exclusion [10]. Developing comprehensive financial education initiatives that complement and extend the informal savings systems is crucial for fostering meaningful financial inclusion.

6.2.4. Legal and Regulatory Hurdles

Informal savings groups operate outside formal regulatory frameworks, which can pose risks for participants and potential formal integration efforts. Overly stringent regulations designed to mitigate financial risks can stifle the growth of small financial institutions and agents, limiting their ability to offer services tailored to the needs of low-income communities [20]. A balanced regulatory approach with a view of business agility is needed to ensure that informal savings mechanisms are safely integrated into the formal financial sector without undermining their flexibility and accessibility.

6.2.5. Security and Trust Issues

While informal savings systems rely heavily on trust, integrating them into formal financial systems can create new security and data privacy challenges. Participants may be hesitant to share personal financial information with formal institutions, especially considering potential data breaches or misuse of personal data [11]. Addressing these concerns requires building robust regulatory frameworks that protect participants' data while promoting transparency and trust in formal financial services.

7. Policy implications for integrating informal savings systems into formal financial systems

Integrating informal savings systems into formal financial systems holds significant promise for advancing financial inclusion even in developed systems such as the US. Informal savings systems, like the rotational savings groups and community-based savings associations like Ajo/Esusu which have long been essential financial mechanisms for underserved populations like African women owned MSME's needs to be unpacked, and repackaged for purpose. Incorporating these informal savings mechanisms into formal financial systems can provide more security and structure and service benefits to a larger number.

7.1. Policy recommendations

7.1.1. Regulatory Adaptation

Governments should develop supportive frameworks that integrate informal savings systems into formal financial structures while preserving their benefits. This can be achieved by legally recognizing informal savings groups, allowing them to open accounts with formal institutions, and ensuring member protection through insurance. Simplifying the registration process for these groups can build trust and encourage wider adoption, especially among those lacking formal documentation.

7.1.2. Incentives for Formal Institutions

Financial institutions should be encouraged to offer standardized services for informal savings groups within a scalable ecosystem. This could include providing low-cost accounts, simplified processes, mobile banking solutions, payment switching services at costs that would allow them to operate competitively with other formal service providers.

7.1.3. Technological Design and Integration

FinTech companies can lead efforts to integrate informal systems into formal financial services by utilizing mobile technology and agent networks to reach unbanked populations. Digital platforms that connect informal savings groups to formal banks can help users retain communal benefits while gaining security and financial growth. Additionally, blockchain and distributed ledger technologies can lower transaction costs and enhance trust within these systems.

7.1.4. Consumer Protection and Financial Literacy

Protecting consumers as informal systems integrate with formal finance is crucial. Clear guidelines should be established to prevent exploitation and fraud, alongside financial literacy programs that equip users to navigate the formal system confidently. Educating participants on the benefits of formal financial services, such as credit and insurance access, will encourage adoption.

7.1.5. Collaboration and Partnership

Multi-stakeholder collaboration is vital to integrating informal savings systems. Governments, financial institutions, FinTech companies, and civil society organizations should work together to co-develop financial products tailored to the needs of informal savings users. Developing group-based savings products that align with communal, trust-based practices can smooth the transition for users. Partnership with NGOs and community groups can support targeted financial literacy and inclusion programs for specific groups, such as rural women.

7.1.6. Cross-Sector Knowledge Sharing

Policymakers and financial institutions should learn from successful integration models across countries and sectors. Sharing best practices from community-based savings groups in different contexts can help craft policies that promote formal financial inclusion while maintaining the strengths of informal systems.

8. Conclusion

Integrating informal group-based savings systems, into formal financial institutions represents a significant opportunity to promote financial inclusion for women, and women-led MSME's. These traditional savings practices have provided an agelong platform for many women hesitant to engage with formal financial systems but require the financial boost that can only come from engaging with formal financial service providers.

Despite the challenges of integrating informal savings systems into formal financial frameworks, the potential benefits of such integration are substantial. Policymakers must recognize and leverage the strengths of these informal savings practices, implementing targeted interventions including legal recognition of informal savings groups, standardized financial products, financing for supporting the build of critical technology infrastructure of the ecosystem to cover vast rural areas, and incentivized financial literacy programs. Collaborative partnerships among government, financial institutions, and community organizations are vital for developing strategies that enhance access and promote sustainable financial behaviors. While barriers to integration seem insurmountable it is a potentially transformative pathway to economically empower women and contribute to broader societal development goals and ensuring that more individuals have the resources they need to build secure financial futures in Nigeria.

Compliance with ethical standards

Disclosure of conflict of interest

No conflict of interest to be disclosed.

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