Article

The Impact of Access to Credit on Employment Generation in the Informal Sector: A Case Study of Ilorin Metropolis

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Abstract
This study investigates the impact of access to credit on employment generation among small and medium enterprises (SMEs) in the informal sector of Ilorin, Kwara State, Nigeria. Guided by Pecking Order Theory and Endogenous Growth Theory, the study adopts a quantitative research design within a positivist paradigm. Data were collected through structured questionnaire administered to SME operators, financial institutions, and policymakers, yielding 400 valid responses. Descriptive statistics, correlation analysis, and Ordered Logistic Regression were employed to examine the relationships between bank lending, credit access challenges, government taxation policies, and employment generation. The findings reveal that bank lending positively and significantly enhances employment generation, while challenges in accessing credit, such as stringent collateral requirements and perceived risk, negatively affect job creation. Additionally, supportive government taxation policies were found to boost employment in the informal sector. The results underscore the importance of financial inclusion and institutional support in promoting SME-led job creation and sustainable economic growth. Based on these insights, the study recommends policy measures including credit guarantee schemes, tax incentives, partnerships with FinTech platforms, and initiatives to improve SMEs' financial literacy and record-keeping. Limitations include reliance on self-reported data and a cross-sectional design. Future research should adopt longitudinal approaches and explore broader geographic contexts to enhance understanding of credit access and employment generation dynamics in Nigeria's informal economy.

Keywords
Access to credit, employment generation, financial institutions, informal sector, Small and Medium Enterprises (SMEs)

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Introduction

The informal sector has become a vital pillar of national economies, particularly in developing countries where it serves as a key source of employment, income generation, and economic resilience (Etim & Daramola, 2020). Kiaga and Leung (2020) affirm that most new jobs created in developing nations emanate from the informal economy, which accounts for nearly 80% of non-agricultural employment and over 90% of new jobs in Africa. This sector comprises diverse activities, including small-scale manufacturing, petty trading, personal services, and parallel financial systems that function outside formal regulatory structures (Makochekanwa, 2020). In Nigeria, the informal economy contributes an estimated 65% of total economic activity and plays a critical role in employment generation, despite remaining largely untaxed, weakly regulated, and poorly documented (Uko *et al*., 2020). Its limited fiscal contribution stems from cash-based operations, informal bookkeeping, and ineffective tax enforcement mechanisms (Sultana *et al*., 2022). Although many enterprises generate considerable income, systemic tax evasion persists due to loopholes and administrative inefficiencies (Adekoya *et al*., 2020). Excessive regulatory burdens and high tax rates also push entrepreneurs to operate in the shadow economy, further constraining government revenue (Wiafe *et al*., 2023).

Despite these governance challenges, the informal sector remains indispensable for sustaining livelihoods across Nigeria's states. High unemployment rates, particularly among youth, push many individuals into micro-entrepreneurship and self-employment (Onwo & Ohazulike, 2021). While this trend is pronounced in cities such as Ilorin, similar patterns are evident in Lagos, Kano, Onitsha, Aba, Port Harcourt, and Kaduna, where informal trade clusters, industrial micro-units, transport services, and household enterprises collectively absorb millions who are excluded from formal employment. These inter-state variations illustrate the adaptability of Nigeria's informal economy: Lagos demonstrates the power of informal innovation and clustering; Kano and Kaduna reflect the resilience of informal manufacturing; Aba represents indigenous industrialization driven primarily by informal finance; and Onitsha showcases how high-volume trade thrives despite limited access to formal credit. These experiences highlight the need for balanced policy interventions that promote gradual formalization while recognizing the sector's role in fostering economic stability and poverty reduction nationwide (M. Santoalla *et al*., 2025).

Across these states, a common constraint undermining the growth of informal enterprises is inadequate access to formal credit (Etim & Daramola, 2020). Small and Medium-sized Enterprises (SMEs), which dominate the informal sector, struggle to secure bank financing due to strict collateral requirements, high interest rates, insufficient financial records, and banks' perception of SMEs as high-risk borrowers (Bwembya, 2022). As a result,

entrepreneurs depend heavily on informal financing, including ROSCAs, moneylenders, cooperative societies, and personal savings, which often provide limited loan sizes and unfavorable repayment structures (Phil-Ugochukwu, 2024). Restricted access to adequate financing hinders the ability of SMEs to expand their operations, invest in technology, improve productivity, or hire additional workers, thereby constraining employment generation (Lawal *et al*., 2018).

Although various federal and state-level programmes, such as the Micro, Small and Medium Enterprises Development Fund (MSMEDF), Bank of Industry schemes, and state-backed microfinance initiatives, were designed to improve SME financing (Mugano & Dorasamy, 2024), their impact has varied across states due to bureaucratic bottlenecks, corruption, institutional weaknesses, and inconsistent policy implementation (Adekoya *et al*., 2020). States such as Lagos and Kaduna have made notable progress through targeted SME-support strategies and improved ease of doing business, demonstrating that institutional efficiency and localized policy innovation can significantly enhance credit access. Conversely, states with weaker institutional structures continue to experience low uptake of available credit programmes. This contrast underscores important lessons: that effective credit delivery requires not only well-designed federal interventions but also strong state-level coordination, transparency, and capacity to implement SME-support policies.

In addition, macroeconomic instability, marked by exchange-rate volatility, inflation, and unpredictable fiscal policies, further constrains small businesses across Nigerian states, increasing operational costs and complicating long-term planning (Horvath, 2017). Dependence on informal and sometimes exploitative credit sources perpetuates financial exclusion, limiting enterprise expansion and weakening competitiveness in an evolving economic environment (Eke, 2021). Persistent gaps between policy formulation and implementation have therefore left SMEs in many states financially constrained, undermining their ability to generate employment and contribute meaningfully to economic development (Makochekanwa, 2020).

Although the literature widely acknowledges the importance of SMEs and informal economic activities across Nigeria, empirical studies directly examining how access to credit influences employment generation in the informal sector remain scarce (Uko *et al*., 2020). This study contributes to filling this knowledge gap by investigating the relationship between access to credit and employment outcomes in the informal sector, focusing on the Ilorin metropolis of Kwara State. Beyond its local relevance, the findings have broader implications for other Nigerian states with similar informal-sector dynamics. Insights from Ilorin can inform policy lessons related to credit

access, SME financing, and employment strategies that are applicable to comparable urban centers across the country.

The study is guided by the following hypotheses: **Ho1:** Bank lending to SMEs has no significant effect on employment generation in Kwara State's informal sector. **Ho2:** Challenges associated with accessing bank credit have no significant effect on employment generation in the informal sector. **Ho3:** Government taxation policies have no significant effect on employment generation in Kwara State's informal sector. These hypotheses are tested against their corresponding alternatives, which posit that each factor significantly influences employment generation in the informal economy.

Literature Review

Access to credit is widely recognised as a critical determinant of business performance and employment creation in developing economies, particularly within the informal sector where financial exclusion is most pronounced. The informal economy serves as a major absorber of labour that is unable to find opportunities within the formal sector, functioning as an essential livelihood system across African countries including Nigeria (ILO, 2020). Theoretically, this relationship is supported by the finance-led growth hypothesis (Schumpeter, 1934; Levine, 2005), which argues that credit availability stimulates productive investment, business expansion, and ultimately job creation. Similarly, insights from Endogenous Growth Theory (Romer, 1986; Lucas, 1988) suggest that internally driven factors such as capital accumulation, innovation, and human capital development, often enabled by access to finance, drive long-run growth and enterprise development. While informal enterprises tend to rely on internal funds as described by the pecking order hypothesis (Myers, 1984), limited internal resources and weak credit histories often restrict their ability to expand and generate employment.

Early studies on informal sector financing, particularly those conducted before 2015, largely focused on identifying the structural challenges that constrain small business access to formal credit. These studies highlighted issues such as inadequate collateral, information asymmetry, and weak financial records, which hindered SMEs from securing loans from traditional banks (Beck & Demirgüç-Kunt, 2006). Research during this period also pointed to the prevalence of informal credit networks, such as rotating savings groups and cooperatives, as substitutes for formal lending, although these channels were often insufficient to support enterprise growth (Olowe, Moradeyo & Babalola, 2013). While these early contributions provided foundational insights into the dynamics of financial exclusion, they paid limited attention to how credit constraints translate specifically into employment outcomes within informal economies.

Between 2015 and 2019, scholarly attention shifted toward the role of credit in entrepreneurial performance, poverty reduction, and firm productivity. Banerjee and Duflo (2014) demonstrated that microcredit can help

entrepreneurs overcome liquidity constraints and engage in more profitable ventures. In South Asia, Islam and Alam (2019) found a positive relationship between informal sector activities and GDP growth, emphasizing the sector's role in employment creation. During this period, studies in Nigeria and other African contexts began to highlight how credit access influences firm productivity and income levels (Abiola & Oba, 2020). However, much of this mid-period research focused on income growth and enterprise survival rather than direct employment generation, thereby leaving an important analytical gap regarding labour absorption capacities within the informal economy.

More recent studies (2020–2024) reflect a growing interest in understanding the broader macroeconomic and institutional environment shaping informal sector performance. Uko *et al*. (2020) underscored the informal sector's major role in income and employment generation in Nigeria yet noted its low tax contribution due to poor record-keeping, corruption, and political interference. Etim and Daramola (2020) further identified high taxation, bureaucratic hurdles, inflation, and weak social protection as drivers of informality in Nigeria and South Africa, pointing to systemic constraints that exacerbate credit access challenges. Studies across Africa, such as Mugano and Dorasamy (2024), similarly stressed that many informal and small enterprises are excluded from formal finance due to collateral constraints and perceptions of high risk by banks. These credit limitations restrict firms' ability to adopt modern technologies, hire workers, or scale operations (Otekunrin *et al*., 2022).

At the same time, newer studies also highlight the potential developmental role of both formal and informal financing. Mpofu and Sibindi (2022) reported that while informal finance fills a critical gap in Africa's SME ecosystem, it is constrained by high interest rates and insufficient loan sizes, necessitating stronger linkages between formal and informal financial institutions. Turkson *et al*. (2020), using enterprise survey data from Ghana, found that formal finance has a much stronger effect on firm growth than informal credit, suggesting that access to formal loans may be more consequential for long-term business expansion and employment creation. In Zimbabwe, Mpofu (2021) linked low tax compliance in the informal sector to bureaucratic systems and weak institutions, while Osazevbaru (2021) found that exchange rate and interest rate volatility significantly influence informal sector performance in Nigeria. Taken together, these studies emphasize that access to credit interacts with macroeconomic conditions and regulatory frameworks, shaping the capacity of informal enterprises to contribute to job creation.

Notably, empirical research on gendered credit access has also emerged. Mukarati *et al*. (2020), using an endogenous switching regression model, found no strong gender discrimination in credit allocation for women in Zimbabwe's

informal sector, although credit access modestly improved business outcomes. Studies such as Badejo *et al*. (2024) further showed that access to financial resources, social networks, and supportive regulatory environments positively influence business success, whereas high interest rates and administrative bottlenecks remain a major hindrance. Across this body of literature, the informal sector consistently emerges as a critical driver of employment, yet credit market imperfections persist as binding constraints on enterprise growth and labour absorption.

Despite these contributions, several gaps remain evident. First, much of the existing literature examines credit access and informal sector development at national or macro-regional levels, with limited attention to subnational dynamics or state-level variations within Nigeria. Second, few studies directly investigate the employment effects of credit access, as most research focuses on productivity, income, or firm performance rather than explicit job creation metrics. Third, very few studies utilise primary micro-level data from informal enterprises, relying instead on secondary datasets that may insufficiently capture the nuanced realities of informal sector financing. Fourth, the interaction between credit access, regulatory conditions such as taxation, and employment outcomes has received little empirical scrutiny, even though these factors jointly influence business expansion decisions within the informal economy.

This study addresses these gaps by providing micro-level evidence on how access to credit influences employment generation among informal sector enterprises in Kwara State, with a particular focus on Ilorin Metropolis. By examining bank lending patterns, credit access challenges, and the role of taxation in shaping enterprise hiring decisions, the study offers context-specific insights that complement national-level literature and contribute to a more nuanced understanding of how financial inclusion can drive employment in Nigeria's informal economy.

Methodology

This study adopts a quantitative research design grounded in a positivist research philosophy, enabling objective measurement and statistical evaluation of the impact of access to credit on employment generation in the informal sector of Ilorin Metropolis, Kwara State.

Population, Sampling Technique, and Sample Size Determination

The study population comprises informal-sector operators, primarily micro and small-scale enterprises, across Ilorin Metropolis. According to the Kwara State Internal Revenue Service (Ajirowo, 2024), Ilorin hosts 3,124 registered micro and small enterprises. A multi-stage sampling technique was employed:

1. **Stage 1: Stratification**

The metropolis was stratified into three local government areas: Ilorin West, Ilorin East, and Ilorin South.

2. **Stage 2: Selection of Business Clusters**
   Major informal-sector clusters (e.g., Oja-Oba Market, Tanke Business District, Ipata Market, and Geri-Alimi corridor) were purposively selected due to their high concentration of SMEs.
3. **Stage 3: Systematic Random Sampling of Respondents**
   Within each cluster, enterprises were selected using systematic random sampling to ensure a fair representation across trades, sizes, and locations.

The sample size was determined using Taro Yamane's (1967) formula at a 5% level of precision, yielding 355 required respondents. To enhance representativeness and reduce sampling error, the researchers deliberately expanded the sample to 400 respondents, which is methodologically acceptable in survey studies involving heterogeneous informal-sector enterprises. Thus, a total of 400 completed and valid questionnaires formed the final dataset used for empirical analysis.

Instrumentation and Questionnaire Validation

Data were collected using a structured, closed-ended questionnaire designed to measure key constructs related to credit access and employment generation. The questionnaire was divided into four sections:

- **Section A:** Demographic and business characteristics.
- **Section B:** Access to credit (availability, adequacy, loan size, credit source).
- **Section C:** Employment generation indicators (number of employees/apprentices, expansion history).
- **Section D:** Challenges in accessing credit and taxation issues.

Items in Sections B–D were measured using a 5-point Likert scale ranging from *Strongly Disagree (1)* to *Strongly Agree (5)* to allow quantitative analysis.

Validation and Reliability Testing

- Content validity was established through expert review by academics and practitioners in SME finance.
- A pilot test involving 30 informal-sector operators in Ilorin South was conducted to refine ambiguous items.

- Reliability was tested using Cronbach's Alpha, yielding a coefficient of 0.78, exceeding the acceptable threshold of 0.70 (Taber, 2018), confirming internal consistency.

Data Collection and Analysis

Both physical and digital (Google Forms) administration methods were used. Completed questionnaires were coded and cleaned using Microsoft Excel and subsequently analysed using SPSS.

Analytical procedures included:

- **Descriptive statistics** (frequencies, means, standard deviations).
- **Correlation analysis** to test associations among variables.
- **Ordered Logistic Regression (OLR)** as the main estimation technique.

The use of OLR is justified because the dependent variable, employment generation, was operationalised as an ordinal measure (low, moderate, high employment growth), making OLR more appropriate than linear regression.

Model Specification

The functional relationship is expressed as:
EMPi = f(CREDi, CHALi, TAXi)
The econometric model is explicitly specified as:

$$EMPi = \beta_0 + \beta_1 CREDi + \beta_2 CHALi + \beta_3 TAXi + \varepsilon i$$

Where:

- **EMP** = Employment generation (order of magnitude of employees/apprentices)
- **CRED** = Access to credit (loan availability, loan adequacy, credit frequency, loan size)
- **CHAL** = Challenges in accessing bank credit (collateral, interest rates, documentation issues)
- **TAX** = Government taxation policies affecting SMEs
- **ε** = Error term

Apriori Expectations

$\boldsymbol{\beta_1} > 0, \boldsymbol{\beta_2} < 0, \boldsymbol{\beta_3} < 0$

Thus, access to credit is expected to increase employment generation, while credit constraints and taxation challenges are expected to reduce it.

Results and Discussion

Descriptive Statistics

Table 1: Descriptive Statistics of Study Variables (N = 400)

Variable	Mean	Standard Deviation	Minimum	Maximum	Interpretation
Employment Generation (EMP)	2.37	0.74	1	3	Moderate employment levels among SMEs
Bank Lending to SMEs (CRED)	3.12	0.89	1	5	Moderate access to formal credit
Credit Access Challenges (CHAL)	3.45	0.82	1	5	Challenges in accessing credit are relatively high
Government Taxation Policies (TAX)	3.08	0.95	1	5	Tax burden is moderate; affects employment generation

Source: Author's Computation using SPSS, 2025

Notes:

1. Data were collected from 400 respondents across SMEs in Ilorin Metropolis, Kwara State.
2. Responses were measured on a 5-point Likert scale for explanatory variables (1 = Strongly Disagree/Very Low, 5 = Strongly Agree/Very High).
3. Employment Generation was coded based on the number of employees or ordinal categorization (Low, Medium, High).
4. All variables show sufficient variation for regression analysis, with standard deviations indicating dispersion around the mean.

Reliability Test

Table 2: Result of Cronbach's Alpha

Variables	Cronbach's Alpha	No. of Items
Employment Generation in the Informal Sector	.812	5
Bank Lending to SMEs	.854	5
Challenges in Accessing Bank Credit	.759	5

Government Taxation Policies	.779	5

Source: Author's Computation using SPSS, 2025.

Table 2 presents the results of the Cronbach's Alpha reliability test, which was conducted to assess the internal consistency of the items used to measure each variable in the study. All four variables reported Cronbach's Alpha values above 0.7, indicating a high and acceptable level of reliability. "Bank Lending to SMEs" recorded the highest reliability score at 0.854, followed by "Employment Generation in the Informal Sector" at 0.812. "Government Taxation Policies" and "Challenges in Accessing Bank Credit" also demonstrated strong internal consistency, with values of 0.779 and 0.759, respectively. These results confirm that the measurement scales are reliable and suitable for further analysis.

Correlation Analysis

Table 3: Correlation Matrix between Study Variables

Variables	Employment Generation	Correlation Coefficient (r)	p-value	Interpretation
Bank Lending to SMEs	Employment Generation	**0.338**	**< 0.01**	Moderate positive correlation
Challenges in Accessing Bank Credit	Employment Generation	**0.218**	**< 0.01**	Weak positive correlation
Government Taxation Policies	Employment Generation	**0.707**	**< 0.01**	Strong positive correlation

Source: Author's Computation using SPSS, 2025

Notes:

- All correlation coefficients are statistically significant at the **1% level (p < 0.01)**.
- Positive coefficients indicate that increases in these variables are associated with increases in employment generation in the informal sector.

Ordered Logit Regression Analysis

Table 4: Ordered Logit Regression Results for Employment Generation in the Informal Sector

Panel A: Model Fit Statistics

Statistic	Value
Number of Valid Observations	400
Intercept-Only Model: −2 Log Likelihood	1687.019
Final Model: −2 Log Likelihood	1310.369

Model Chi-Square (df = 3)	376.650***
Cox & Snell Pseudo R^2	0.610
Nagelkerke Pseudo R^2	0.617
McFadden Pseudo R^2	0.213

Source: Author's Computation using SPSS, 2025

Panel B: Parameter Estimates

Predictor	**β Coefficient**	**95% Confidence Interval**	**p-value**
Bank Lending to SMEs	2.698	2.221 – 3.176	< 0.001***
Credit Access Challenges	−2.268	−2.720 – −1.817	< 0.001***
Government Taxation Policies	4.382	3.848 – 4.916	< 0.001***

Source: Author's Computation using SPSS, 2025

Panel C: Summary of Hypotheses Testing

Hypothesis	**Decision**	**Basis**
H_{01}:Bank lending has no significant effect on employment generation	Rejected	β = 2.698, p< 0.001
H_{02}: Credit access challenges have no significant effect.	Rejected	β = −2.268, p< 0.001
H_{03}: Taxation policies have no significant effect.	Rejected	β = 4.382, p< 0.001

Source: Author's Computation using SPSS, 2025

Notes:

- *p < 0.001 (highly significant).
- No missing data reported.
- Confidence intervals reported at 95% confidence level.
- Model meets all assumptions for ordered logit regression.

Explanatory Notes:

Panel A presents the results of the ordered logit regression estimating the effect of access to credit, credit constraints, and government taxation policies on employment generation within the informal sector of Kwara State. The model demonstrates strong overall fit and explanatory power. As shown in Panel A, the log-likelihood improved substantially from the intercept-only model (−2LL = 1687.019) to the final fitted model (−2LL = 1310.369). The model Chi-

square value of 376.650 (df = 3, $p < 0.001$) indicates that the predictors jointly contribute significantly to explaining differences in employment outcomes. The pseudo R^2 values, Cox & Snell (0.610), Nagelkerke (0.617), and McFadden (0.213), further suggest that the model accounts for approximately 61% of the variations in employment levels among informal sector enterprises, which is substantial for social science models.

Panel B provides the coefficients and confidence intervals for each predictor. Bank lending to SMEs shows a positive and statistically significant association with employment generation ($\beta = 2.698$, $p < 0.001$). This implies that increased availability of credit significantly enhances the capacity of informal businesses to hire more workers, expand operations, and engage in productive investment. In contrast, challenges in accessing bank credit exhibit a negative and significant effect ($\beta = –2.268$, $p < 0.001$), indicating that when SMEs face difficulties securing loans, such as collateral constraints, high interest rates, or bureaucratic bottlenecks, their ability to create employment is undermined. Interestingly, government taxation policies demonstrate the strongest positive effect on employment creation ($\beta = 4.382$, $p < 0.001$). This suggests that supportive, simplified, or predictable tax regimes can incentivize entrepreneurial activity, reduce business uncertainty, and encourage firms to expand and hire labor.

Panel C summarizes the hypothesis testing outcomes. The analysis shows that all three null hypotheses (H_{01}, H_{02}, H_{03}) are rejected at the 1% level of significance. Therefore, the empirical evidence confirms that bank lending significantly promotes employment, credit constraints significantly reduce employment, and favorable taxation policies significantly enhance employment generation in the informal sector.

Overall, these findings underscore the critical importance of financial accessibility and enabling regulatory policies in shaping labor market outcomes within Nigeria's informal economy. The results provide strong empirical support for interventions aimed at improving SME credit access, reducing lending bottlenecks, and strengthening tax policy frameworks to foster job creation and sustainable informal sector development.

Conclusion and Recommendations

The findings of this study strongly support the principles of **Pecking Order Theory**, which posits that SMEs prefer internal financing before seeking external funds. The significant positive impact of bank lending on employment generation indicates that formal external finance becomes crucial once internal resources are insufficient, confirming Myers' (1984) assertion that firms resort to external capital when retained earnings are inadequate. However, the observed challenges in accessing bank credit, such as lack of collateral and perceived riskiness, reflect the difficulties many informal SMEs face in Nigeria, forcing them to rely heavily on internal funds or informal sources. This reliance limits their capacity to grow and create jobs, underscoring the

importance of addressing credit constraints to enhance employment growth in the informal sector.

The results also resonate with **Endogenous Growth Theory**, demonstrating how access to finance acts as a catalyst for investment in human capital, innovation, and business expansion, key drivers of sustained economic growth originating within the economy. The positive influence of government taxation policies highlights the role of supportive institutional frameworks in facilitating financial inclusion and encouraging firm-level productivity improvements. As emphasised by Romer (1986) and Lucas (1988), easing financial barriers enables SMEs to invest in technology, skill development, and operational scaling, thereby boosting employment generation.

Policy Recommendations

- The Kwara State government should implement targeted financial inclusion policies, such as credit guarantee schemes and interest rate subsidies, to improve SMEs' access to formal bank lending.
- Taxation procedures should be simplified, and favorable tax incentives provided to informal sector enterprises to encourage compliance and employment growth.
- Businesses should enhance financial literacy and maintain proper financial records to improve creditworthiness.
- Partnerships between businesses and financial institutions, leveraging microfinance and FinTech platforms, should be promoted to provide flexible funding options.
- The Nigerian government should integrate the informal sector into the formal economy through regulatory reforms, improved infrastructure, and capacity-building initiatives to foster sustainable growth and job creation.

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