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# Informal Credit Systems in Pre-colonial Africa before Colonial Banking

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**Abstract** : *Prior to the coming of Europeans and establishment of colonial banking systems, Africans had sustained diverse informal credit systems rooted in their socio-economic and cultural practices. These systems were rotating savings and credit associations, kinship and lineage-based lending, merchant credit, pawnship, and cooperative arrangements organised through age grades, guilds, and religious institutions. Credit transactions were thus regulated by trust, reciprocity, and customary law, with social reputation functioning as the primary form of security rather than formal collateral. Informal credit played significant role in financing agriculture, long-distance trade, artisanal production, and household consumption. Despite their accessibility and adaptability, these systems also reflected social hierarchies and power imbalances that could lead to exploitative outcomes. The introduction of colonial banking and legal framework marginalised indigenous financial practices by privileging western institutions and written contracts. This study adopted a qualitative historical methodology based on primary and secondary sources to examine the structure, functions, and limitations of pre-colonial African credit systems. The findings, thereafter highlights the resilience of informal finance and its enduring relevance to contemporary discussion on inclusion in Africa.*

**Keywords**: Informal Credit Systems, Indigenous finance, Financial inclusion, Colonial Banking.

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## INTRODUCTION

Before the emergence of their colonial and banking system, Africans had a wide range of informal credit systems that were integral part of their economic organisation and social life. In the absence of centralised financial institutions, credit was embedded in social relations and regulated by customary norms rather than formal agreement. These indigenous systems assisted resource mobility, risk-sharing and economic continuity in all agrarian, pastoral, and trading communities. Recognising these practices challenges earlier historiography that underestimated the complexity of pre-colonial African economies.<sup>1</sup>

In the pre-colonial era, informal credit systems took different forms according regions and its social structures. Common features included rotating savings and credit associations, lineage and kinship-based lending, merchant and trade credit, pawnship and cooperative arrangements linked to age grades, religious institutions and craft guilds.<sup>2</sup> Access to credit was largely determined by reputation, social obligation, and communal trust rather than material collateral. These systems encouraged agricultural production, artisanal manufacture, and long-distance trade in both monetised and non-monetised contexts.<sup>3</sup>

Trust and reciprocity constituted the base of these credit relationships. Customary law and social sanctions also played a central role in enforcing repayment and resolving disputes, reducing transaction costs in environment characterised by limited state enforcement mechanisms. At the same time, informal credit systems were shaped by existing social hierarchies. Inequalities related to gender, age, and status could restrict access to credit or expose borrowers to exploitative practice, particularly in systems involving pawnship or labour obligations.<sup>4</sup>

The emergence and imposition of colonial landscapes on Africa, devalued its financial landscapes by introducing formal banking institutions aligned with imperial commercial and administrative priorities. The primary objective of colonial banks was to serve European enterprises and export-oriented sectors, while indigenous populations were excluded. Colonial legal systems gave impetus to written contracts and individualised property rights thereby undermining customary credit arrangements and delegitimising indigenous financial practices.<sup>5</sup>

Despite this marginalisation, informal credit systems persisted and adapted, continuing to serve as an important sources of finance to individuals and African communities. Examining informal credit system in Africa before colonial banking is imperative for understanding both historical economic processes and contemporary patterns of financial exclusion. These systems illustrate African agency in economic innovation and institutional development. Furthermore, their endurance into the post-colonial period underscores their relevance to current debates on financial inclusion and development policy. A historical analysis of pre-colonial informal finance therefore provides valuable insights into the long-term evolution of African economic institutions.<sup>6</sup>

### **Conceptual Clarification**

**Informal Credit System:** Informal credit systems describe lending and borrowing practices that take place outside officially regulated financial institutions. They operate without formal contract, standardised procedures, or direct government supervision. In many communities, especially where access to bank is limited, individuals rely on local arrangements to obtain funds for consumption, trade, agriculture, or emergencies. These systems are typically based on personal interaction and long-standing social relationships rather than written agreements. Hernando de Soto explains that the widespread use of informal financial practices is closely connected to the exclusion of large segments of the population from formal legal and financial structures.<sup>7</sup>

At a conceptual level, informal credit systems at times are built on trust and social obligation. Instead of pledging material collateral, borrowers depend on their reputation, kinship ties, or standing with the community. Repayment is often secured through social pressure and mutual accountability rather than legal enforcement. Terms of repayment may be flexible, reflecting seasonal incomes or irregular earning. Rotating Savings and Credit Association (ROSCAs) is a typical example of this structure: members contribute regularly to a common pool, and each member receives the pooled sum in turn. The Yoruba referred this as Esusu which were organised by kinsmen or by group of friends and devoted mainly to socio-economic purposes.<sup>8</sup>

Informal credit systems include various arrangements such as local money lenders, cooperative saving groups, trade credit among merchants, and loans among relatives or friends. Although these systems can involve higher interest rates and limited borrower protection, they remain important because of their accessibility and speed. Abhijit V. Banerjee and Esther Duflo note that informal finance continues to function not because formal banking services are unavailable to many poor households, but also because informal mechanisms are more adaptable to everyday realities.<sup>9</sup> Thus, informal credit systems can be understood as community-based and socially regulated methods of mobilising and distributing financial resources outside the formal banking framework.

### **Theoretical Framework**

The embeddedness theory as articulated by Karl Polanyi, posits that economic activities are not autonomous but are deeply enmeshed within social, political and cultural institutions. This is in contrast to the neoclassical notion of self-regulating market. In these cases, economic activities such as provisioning are embedded in non-economic kinship, religious and political institutions. In market societies, in contrast economic activities have been rationalised and economic action is disembedded from society and able to follow its own distinctive logic, captured in economic modelling. Polanyi's ideas were widely adopted and discussed in anthropology in what has been called the formalist-substantivist debate.<sup>10</sup>

In application to African historical context, embeddedness theory illuminates why informal credit systems, including pawnship, kinship based lending, and merchant credit, were effective over long periods. These systems were not merely provisional substitutes for formal finance; they represented coherent, socially regulated economic institutions designed to maintain both financial and social equilibrium.<sup>11</sup>

Therefore, Polanyi's embeddedness theory provides a theoretical lens for analysing pre-colonial African informal finance. It highlights the interconnection between economic practices and social institutions and underscore that informal credit systems were deeply structured, socially legitimate, and adaptive rather than chaotic or underdevelopment.<sup>12</sup>

### **Rotating Saving in Pre-colonial Africa**

Before the introduction of colonial banking systems, many African societies relied on locally organised financial arrangements to meet economic needs.

### **Informal Credit System in Precolonial Africa: Kinship Lending and Rotating Savings in Pre-colonial Africa and its Mechanisms**

In pre-colonial African societies, access to credit was rarely mediated by informal institutions. Instead, financial support was embedded in social relationships and collective practices. Two of the most significant mechanisms were kinship lending and rotating savings associations. Although distinct in structure, both operated within networks of trust, obligation and communal oversight, and together they formed the backbone of indigenous financial systems.<sup>13</sup>

Kinship lending emerged from the obligations that bound families, lineages and clans. Assistance to relatives—whether in the form of grain, livestock, or currency—was understood as part of maintaining social continuity. A farmer might borrow seeds during the planting season, a trader might seek goods to begin a journey, or a household might request support for marriage or funeral expenses. Repayment expectations were shaped by reputation and moral duty rather than written contracts.<sup>14</sup> Because credit relationships were inseparable from family standing, default risk was controlled through social pressure and the desire to preserve honour within the kin group.<sup>15</sup>

Rotating Savings and Credit Association by contrast were organised around periodic collective contributions. Members agreed to contribute fixed sum at regular intervals, and the pooled funds were allocated to one participant in rotation. Overtime, each member received the full pot once.<sup>16</sup> While kinship lending relied on bilateral obligations within families, rotating savings association created structured cycles of mutual assistance that could extend beyond close relatives to neighbours, occupational groups, or age grades. Yet they operated according to similar principles of trust and communal accountability.

Both systems demonstrated a high degree of flexibility. In kin-based lending repayment schedules were often adjusted after poor harvests or unforeseen hardship. Interest, when present, was typically modest or implicit in future reciprocity.<sup>17</sup> In rotating savings groups, contribution amounts and meeting intervals could be modified to reflect seasonal income flows or changing needs. This adaptability allowed communities to manage economic uncertainty without recourse to external lenders or formal banks.

Beyond their economic functions, these institutions reinforced social cohesion. Kinship lending redistributed resources within extended families, ensuring that temporary misfortune did not permanently marginalise vulnerable members. Rotating savings groups meanwhile, created regular spaces for interaction, deliberation, and collective decision-making.

Financial cooperation hence, strengthened communal bonds as much as it facilitated access to liquidity. In this sense, both arrangements reflect Karl Polanyi's argument that economic activity in pre-industrial societies was embedded with social institutions rather than governed solely by impersonal market forces.<sup>18</sup>

Taken together, kinship lending and rotating savings associations reveal the sophistication of pre-colonial African financial practices. They mobilised capital, distributed risk, and supported agricultural and commercial activity long before the introduction of colonial banking systems.<sup>19</sup> Rather than viewing them as informal or rudimentary, it is more accurate to understand them as socially regulated credit systems tailored to local conditions and sustained by deeply rooted norms of reciprocity and collective responsibility.

### **Bridewealth as a Mechanism of Capital Formation in Pre-colonial Africa**

In many pre-colonial African societies, bridewealth—sometimes referred to as lobola, ishi-aku, dowry or bride price was a culturally sanctioned transfer of wealth from the groom or his family to the bride's family as part of marriage negotiations. While primarily social and symbolic in function, bridewealth also served as a mechanism for capital formation by redistributing resources and facilitating economic transactions within and between the lineages.<sup>20</sup> Bridewealth payments were typically made in livestock, agricultural produce, or other tangible assets which could be then reinvested in productive activities such as farming, trade, or artisanal production. Later in some parts of West Africa, such as Nigeria, Ghana, and Benin, Cowrie shells were used in brideprice and other ceremonial payments. Cowrie shells were also used for saving and wealth storage. By channeling resources through marriage exchanges, communities effectively mobilised savings, redistributed wealth, and created forms of financial liquidity that could support household and communal economic projects.<sup>21</sup>

In this sense, bridewealth functioned as an informal economic institution that complemented other pre-colonial credit and savings mechanisms.<sup>22</sup>

The system of bridewealth was socially regulated and embedded within communal norms. Obligations to pay or receive bridewealth were enforced through social sanctions, kinship accountability, and ritual obligations. These mechanisms ensured the reliability of capital transfers and reduced the risk associated with economic exchanges. The redistributive nature of bridewealth also reinforced social cohesion by binding families and clans into reciprocal economic networks.<sup>23</sup> Bridewealth contributed to human and physical capital formation in multiple ways. Economically, the assets exchanged could be converted into productive resources, supporting farming, trade or artisanal activities. Socially, bridewealth strengthened kinship ties, facilitated labour-sharing arrangements and enhanced access to communal resources, thereby indirectly contributing to the accumulation of social and human capital.<sup>24</sup>

### **Relationship Between Informal Credit Systems and Formal Banking**

Informal credit systems and formal banking institutions are important mechanisms through which individuals and businesses obtain financial assistance for economic activities. In many African societies, especially in Nigeria, informal credit systems existed long before the establishment of modern banking institutions during colonial rule. These indigenous systems played vital roles in trade, agriculture, social welfare, and community development. Over time, the emergence of formal banking institutions did not completely replace informal credit arrangements; instead, both

systems developed a close relationship that continues to influence economic activities in modern African societies.<sup>25</sup>

Informal credit systems refer to traditional methods of savings, borrowing, and lending that operate outside government regulation and formal financial structures. Such systems include rotating savings and credit associations, cooperative societies, family lending, age-grade contributions, and local money lenders. Different ethnic groups in Nigeria had various names for these systems. Among the Yoruba, it was called ajo; among the Igbo, isusu; and among the Hausa, adashi.<sup>26</sup> These systems were based largely on trust, communal solidarity, kinship ties, and mutual assistance rather than written agreements or collateral.

Formal banking, on the other hand, refers to organized financial institutions regulated by government laws and monetary authorities. These include commercial banks, central banks, mortgage institutions, insurance companies, and microfinance banks. Formal banks provide services such as savings accounts, loans, money transfers, and investment opportunities through documented procedures and legal frameworks.<sup>27</sup> Colonial governments introduced formal banking institutions primarily to support international trade, revenue collection, and commercial expansion. One important relationship between informal credit systems and formal banking is that informal systems provided the foundation for modern banking operations in Africa. Before colonialism, Africans already understood the principles of savings, credit allocation, and loan repayment through indigenous financial institutions.<sup>28</sup> When colonial banks were established, they formalized many of these practices into structured and regulated systems. Thus, modern banking inherited several operational ideas from traditional African financial arrangements.

Another relationship is that both systems provide credit facilities for economic development. Informal credit associations assisted traders, farmers, artisans, and local entrepreneurs with loans needed for business activities and agricultural production.<sup>29</sup> Formal banks also provide loans and financial support to businesses, industries, and individuals for investment and commercial activities. Although formal banking institutions require collateral and documentation, their overall purpose of providing financial assistance is similar to that of informal credit systems.

Both informal credit systems and formal banking institutions also promote savings culture among members of society. Traditional contribution systems encouraged people to save money regularly for future use or emergencies. Modern banks continue this practice through savings accounts, fixed deposits, and cooperative financing schemes.<sup>30</sup> Microfinance banks especially reflect many principles of indigenous financial systems because they target low-income earners and small-scale entrepreneurs who may not easily access commercial banks.

Another significant relationship is that both systems contribute to financial inclusion and economic growth. Informal credit systems made financial services accessible to rural dwellers and poor members of society who lacked access to colonial banks.<sup>31</sup> In many developing countries today, informal associations still complement formal banking by serving people excluded from

mainstream financial institutions. This cooperation between the two systems helps stimulate trade, employment, production, and local development.

Despite these similarities, there are important differences between informal credit systems and formal banking institutions. Informal systems rely mainly on trust, oral agreements, and social relationships, whereas formal banking depends on written documentation, legal contracts, and government regulations.<sup>32</sup> Informal credit associations generally operate within local communities on a small scale, while formal banks operate nationally and internationally with larger financial resources. In addition, formal banks charge regulated interest rates and maintain official financial records, unlike many indigenous systems where repayment conditions may be flexible.

Furthermore, formal banking institutions are more secure and organized because they are supervised by central monetary authorities. Informal credit systems, although flexible and accessible, may face challenges such as limited capital, lack of legal protection, and risks of fraud or default.<sup>33</sup> Nevertheless, many people continue to rely on informal financial systems because they are easier to access and involve fewer bureaucratic procedures than commercial banks.

In conclusion, informal credit systems constituted an essential component of economic organisation in pre-colonial African societies prior to the introduction of colonial banking institutions. In many regions of Africa where formal financial institutions did not yet exist, communities relied on indigenous mechanisms of credit based on trust, kinship relations, communal responsibility, and customary law. These systems included practices such as pawnship, merchant credit, rotating saving associations and family-based lending which enabled individuals to secure resources for trade, agriculture, craft production and other economic activities.<sup>34</sup>

These arrangements demonstrate that pre-colonial African economies were not primitive or economically stagnant but were supported by structured financial practices adapted to local social and economic realities. Collateral could take several forms, including labour, personal property, or social guarantee, while mediums of exchange such as cowrie shells facilitated transactions and repayment.<sup>35</sup> The effectiveness of these systems lay in their usually, credit facilities were arranged in the presence of witnesses, and were guaranteed either by depositing bonds supplied by third parties, or by offering property such as livestock, house, land etc as security. Poorer members of society often resorted to pawnship as a means of guaranteeing the repayment of a debt. Pawnship was a system by which the debtor or a nominee (usually a kinsman) worked for his creditor without payment until the debt was cleared.<sup>36</sup> Legal sanctions were also employed, and most societies had rules which defined various types of loan and laid down regulations for recovering debts.<sup>37</sup>

Integration with social institutions, where community and social obligations ensured compliance and accountability.<sup>38</sup>

Although the establishment of colonial rule and the introduction of modern banking gradually transformed financial systems across the continent, many indigenous credit practices persisted and

later evolved into modern informal financial institutions such as cooperative savings groups and rotating credit associations.<sup>39</sup> Consequently, informal credit systems in pre-colonial Africa should be understood as important foundations of African economic life, illustrating the ingenuity, adaptability, and resilience of African societies in managing credit and financial exchange long before the emergence of formal banking structures.<sup>40</sup>

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