

DEBT FINANCING AND PERFORMANCE OF SELECTED SMALL AND MEDIUM ENTERPRISES IN MAKURDI METROPOLIS, BENUE STATE, NIGERIA

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Abstract

Small and Medium Enterprises (SMEs) are indispensable in the growth of economies of nations globally and they need capital to boost their performance hence the need to finance their operations principally through debt. The purpose of this study is to examine the effect of debt financing on the performance of selected small and medium enterprises in Makurdi Metropolis, Benue State, Nigeria. The study specifically examined the effect of long-term debt, short-term debt on performance of SMEs in Makurdi Metropolis. A survey research design was adopted for the study. The study used primary data collected from 110 SMEs within Makurdi Metropolis. Data collected through self-administered questionnaire were analysed using descriptive statistics and multiple regression with the aid of the Statistical Package for Social Sciences (SPSS 23). The study found long-term debt, short-term debt has a significant effect on the performance of selected SMEs in Makurdi Metropolis, Benue State, Nigeria. The study therefore recommends amongst others that, policy support for financial institutions should emphasize the training of SMEs to enable them efficiently utilize debts provided to them to help improve their performance.

Keywords: Debt Financing, Long-term Debt, Short-term Debt, Firm Performance, Small and Medium Enterprises

1. Introduction

Small and medium enterprises (SMEs) make up a significant portion of the global business system in every nation and significantly contribute to economies by expanding employment opportunities, increasing production volumes, boosting exports, fostering innovation and entrepreneurship skills, and raising Gross Domestic Product (GDP). According to the World Bank (2020), small and medium enterprises, which are thought to include the estimated informal sector, account for more than 60% of all employment in industrialized nations, 80% in developing ones, and a major source of delivery of goods and services especially in lower income economies. SME operations and the

achievement of defined objectives are nevertheless hampered by a number of challenges in both developed and developing nations. One of the challenges preventing successful performance of SMEs has been recognized as limited access to finance and the high cost of borrowing that goes along with it (Asare & Angmor, 2015; Ikmal, Djeneba, Neil, Ragoussis, Aarti, & Timmis, 2020). As a result, SMEs need finance in order to carry their operations if they want to improve their performance.

Historically, debt finance for SMEs was scarce due to their small size and poor credit worthiness (Frasch, 2013). Large companies with sophisticated treasury operations, economies of scale in their

financing operations, and access to securitized lending and stock markets were the only ones with access to financial market tools. Today, the growth of microfinance organizations has given rise to greater debt financing for SMEs. Due to insufficient retained revenues, debt finance is a major source of cash for start-ups (Kyarikunda, 2018).

Debt financing refers to a type of funding when a company borrows money to operate its business from any other source, mostly financial intermediaries such commercial banks, microfinance organizations, and private money lenders. It is a strategy designed to increase the rate of return on owners' investments by generating returns on borrowed funds that outweigh their cost of use (Aziz & Abbas, 2019). Debt financing decision is a financial framework of debt levels maintained by an entity, and it is vital to managers since it constitutes the basis for making financing decisions in any firm (Harelimana, 2015). As businesses expand and reach a certain level of production, they look for external sources of debt funding in the form of long-term debt, short-term debt, and trade credit

Over time, SMEs in Nigeria have consistently performed worse. According to Onoja and Ovayioza (2015), the vast majority of SMEs have failed in recent years, and they continue to face a number of challenges in terms of increasing their performance due to inadequate management of short-term loans, trade credit, and long-term loans. Although debt is required for SMEs to operate with a free flow of cash, an excessive amount of debt in their capital structure may be problematic for their performance and financial health. Additionally, SMEs continue to experience financial hardship and business failure due to their failure to use optimum debts in their daily transactions.

Previous studies such as Taiwo and Olayinka (2012), Moranga and Omagwa (2017), Kyarikund (2018), Aniefor and Onatuyeh (2019) and Akaji, Nwadiolor and

Agubata (2021) document positive relationship between debt financing and corporate performance while studies such as Majumdar and Sen (2010), Iorpev and Kwanum (2012), Muchiri (2016) and Sohail and Ulfat (2019) reported negative relationship between debt financing and firm performance. Asare and Angmor (2015) however, reported no significant relationship between debt financing and firm performance. Few studies have been conducted in Nigeria on how the performance of SMEs is affected by debt financing especially in areas such as Makurdi Metropolis which the current study intends to fill. The current study is thus carried out to examine the effect of debt financing on the performance of selected SMEs in Makurdi Metropolis, Benue State, Nigeria

Objectives of the Study

- i. To determine the effect of long-term debt on the performance of selected SMEs in Makurdi Metropolis, Benue State, Nigeria.
- ii. To establish the extent to which short-term debt affect the performance of selected SMEs in Makurdi Metropolis, Benue State, Nigeria.

2. Literature Review and Hypotheses Development

Debt Financing

Debt financing has roots that go back to the dawn of civilisation, and it has undergone many definitions. Debt financing is the practice of obtaining finances from lenders outside of an organization, including commercial banks, payday loan companies, and microfinance organizations. It consists of both short-term loans (repayable in less than a year) and long-term debt (repayable in more than a year) (Frasch, 2013). Horne (2013) defines debt financing as the procurement of funds from a specific lender to operate a firm and repay it back within a predetermined time frame with interest.

According to Torre (2016), debt financing is a method of funding in which a business

accepts credit—including long-term debt and short-term loans—and makes a commitment to repay it, so ensuring both their competitiveness and the competitiveness of the entire country. The goal of debt financing is to increase firm profits in order to recoup costs, benefit the owners, and keep any surplus (Damodaran, 2013). Trade credit, also known as spontaneous credit from suppliers, SME loans, loans from individuals, financial institutions, and governments are common forms of debt financing that are used by both new and established businesses to expand and weather difficult economic times (Hussain, 2016). Debt financing in this study takes the form of long-term debts, and short-term debts.

Small and Medium Enterprises Performance

Small and Medium Enterprises are defined as legally established companies with fewer than 250 employees that make a significant contribution to employment and GDP, frequently struggle to access financial services in many developing markets, and expand in ways related to the formalization of an economy (Akaji, Nwadiolor & Agubata, 2021). The benefits from shares as well as those from a firm's functioning and daily operations are referred to as the concept of "firm performance." Financial ratios, which express relationships between variables reported in companies' financial statements, can be used to analyze a firm's performance (Latridis, 2010). Omaliko, Okeke and Obiora (2021) cite that many financial ratios, including total asset growth, loan growth rate, and earnings growth rate, are typically used to gauge performance. Profitability and asset growth are used in this study as performance indicators.

Long-Term Debt Financing and Firm Performance

The percentage of assets that are financed with debt that is due after more than a year is represented by long-term obligations.

Long-term loans and bonds are included. These bonds and loans typically have higher interest rates since lenders expect a bigger return in exchange for taking on the higher risk of making long-term loans. Long-term debt actually restricts managerial choice by making it more difficult to get new cash and make excessive investments (Aniefor & Onatuyeh, 2019). Ubesie (2016) defines long-term debt financing as debt with a maturity date greater than one year. It occurs when a business sells corporate bonds, trade bills, or notes to retail, institutional, or both, investors in order to raise funds for working capital or capital expenditures. In return for lending the money, the individuals or institutions become creditors and receive a promise the principal and interest on the debt will be repaid.

A study by Hernandez-Canovas and Koeter-Kant (2008) suggests that the most significant variables in determining a firm's performance are the long-term debts. Previous studies such as Onoja and Ovayioza, (2015), Yan (2013); and Zeitun and Tian (2007) established a positive relationship between long-term debt and firms' performance variants of return on assets (ROA) and return on equity (ROE). On the other hand, Onaolapo & Kajola (2010) found negative relationship between long-term debt and profitability, while Makanga (2015) found a negative correlation between long-term debt and firm performance. Based on the review above, we therefore proposed the following hypothesis:

***H₀₁:** Long-term debts have no significant effect on the performance of selected SMEs in Makurdi Metropolis, Benue State.*

Short-Term Debt Financing and Firm Performance

Any debt that a company incurs that is due within a year is referred to as short-term debt, and it is an account that is displayed in the current liabilities section of a

company's statement of financial status (Olaniyi, Elulu & Abdusalam, 2015). Among other debts, short-term bank loans are typically what make up a company's liabilities account of debt. Accounts receivable and inventories are two examples of current assets that can be financed with short-term debt and swiftly converted back into cash. Long-term assets, including buying land and building a building or ship, are financed by non-current obligations in the form of long-term debt. (Julius & Lucky, 2020). In fact, a key indicator of a company's financial health is the amount of outstanding short-term obligations. Given that it is thought to be more affordable or less expensive for businesses, short-term debt is the greatest financing option (Nwude, Itiri, & Agbadua, 2016).

Garcia- Terul and Martinez-Solano (2007) argued that short-term debt is positively correlated with firm's growth opportunities. A study by Onoja and Ovayioza (2015) revealed that short-term debts are superior for limiting managerial discretion and reducing moral hazard on the firm's side. Similarly, Yan (2013); Weill (2008); and Zeitun & Tian (2007) found evidence in support of a positive

association between short-term debt and firms' profitability. A study by Makanga (2015), however found a negative but insignificant relationship between short-term debt and corporate performance. Based on the literature, we propose that:

HO₂: Short-term debts have no significant effect on the performance of selected SMEs in Makurdi Metropolis, Benue State.

3. Methodology

The study's cross-sectional survey research methodology allowed it to offer a thorough grasp of how debt financing affects the performance of SMEs. Due to the abundance of SMEs in the city, a cross-sectional survey approach was employed. 110 participants from several SME sectors, including the hotel, education, transportation, general commerce (supply fuel & gas, provision beverages & alcohol, and others), consultancy, and agro-allied, made up the study's population. Specifically, the top management representatives in these groups made up this population. The study employed a census sampling methodology. The details of the study population are shown in table 1 below:

Table 1: Population of Selected SMEs in Makurdi Metropolis

S/N	SME Category	Number of Participants
1	Hotels	15
2	Education	28
3	Transport	6
4	General Merchandize	25
5	Consulting	10
6	Agro-allied	26
	Total	110

Source: Field Data, 2022

The researchers employed a self-administered questionnaire as a tool of data collection to collect quantitative data from respondents. The instrument contained questions relating to debt financing and firm performance. The researchers used a

closed ended five-point Likert scale ranging from strongly agree to strongly disagree. The researchers used Cronbach Alpha Coefficient to check for the reliability.

Table 2: Reliability Test Result

Variable	Cronbach Alpha Value
Long-term Debt	.875
Short-term Debt	.893
SMEs Performance	.849

Source: Researchers' Computation from SPSS Output, 2022.

Cronbach coefficient alpha value of 0.7 and above is considered adequate (Pallant, 2016). From the results all the Cronbach alpha coefficients ranged from 0.849 to 0.893, therefore meeting the acceptable threshold, hence considered acceptable and reliable for this study.

Data collected were analysed using the Statistical Package for Social Sciences (SPSS 23) Software. Multiple Linear Regression model is employed as an econometric model to assess the association between two or more independent variables and single or multiple dependent variables. The econometric model representing the dependent and independent variables is thus;

$$Y_i = \alpha + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$

Where; Y_i represents SMEs performance.

X_1 represents Short Term Debt

X_2 represents Long Term Debt

α = Constant of the equation

β_1 and β_2 = Coefficients of the variables used in the model

ε represents Error Term

4. Results and Discussion

To achieve objectives of the study respondents were asked to show their degree of agreement to the questions on a five-point Likert scale from strongly agree to strongly disagree. The minimum and maximum values on which levels of agreements were addressed as well as means and standard deviations according to the agreements on the statements.

For the questions relating to long-term loan, respondents agreed with the statements as represented by the means and standard deviations values. The means and standard deviations were as follows: Mean=3.398, Std. Dev. =1.235; Mean=3.45, Std. Dev. =1.206; Mean=3.48, Std. Dev. =1.041;

Mean=3.19, Std. Dev. =1.302 and Mean=3.51, Std. Dev. =1.293. The responses indicate that the enterprises acquire long-term debt to finance their operations and this affect performance accordingly.

For the questions relating to short-term debt, respondents' level of agreement with the statements as indicated by the means and standard deviations values. The means and standard deviations were as follows: Mean=3.53, Std. Dev. =1.073; Mean=3.52, Std. Dev. =1.021; Mean=3.29, Std. Dev. =.987; Mean=3.47, Std. Dev. =1.035 and Mean=3.39, Std. Dev. =1.108. The responses clearly demonstrate that enterprises use short-term debt to finance their operations and this ultimately affects performance.

For the questions relating to firm performance, respondents' level of agreement with the statements on performance of SMEs as indicated by the means and standard deviations values as follows: Mean=3.26, Std. Dev. =1.407; Mean=3.6, Std. Dev. =1.126; Mean=3.46, Std. Dev. =1.186; Mean=3.30, Std. Dev. =1.159 and Mean=3.49, Std. Dev. =1.024. The responses clearly demonstrate that there is improvement in the performance of SMEs necessitated by debt financing practices.

Regression Analysis and Test of Hypotheses

Regression analysis was used to ascertain the causal effect of independent variables (short term loan ratio, long term loan ratio and trade credit) on dependent variables (profit margin ratio and return on asset). To explore such issues, the study assembles data on the underlying variables of interest and employs regression to estimate the

quantitative effect of the causal variables upon the variables that they influence (dependent variables).

Table 7: Regression Results

Variables	Coefficient	Std. Error	t-Statistics	P-values
Constant	0.794	0.268	4.317	0.002
Long-term Debt	0.542	0.245	3.402	0.016**
Short-term Debt	0.519	0.283	3.648	0.027**
F-Value	85.253			
P-Value	0.000			
R-Square	0.747			
Adj. R-Square	0.705			

Dependent Variable: SMEs Performance

Source: Authors Computation from SPSS Output, 2022

In order to test the power of the relationships above, the overall model was analysed for correlation. The relationship between the predictors and the model shows R-squared = 0.747 with an adjusted R-square value of 0.705. This indicates that 74.7% variation of the performance of SMEs is explained by the predictors (long-term debt and short-term debt). The analysis of variance (ANOVA) indicates F-value of 85.253 which is significant at one percent ($p = 0.000 < 0.01$). The result in Table 7 shows a value of ($\beta_1 = 0.245$; $t=3.402$; $p = 0.016 < 0.05$), indicating that long-term debt has a significant positive relationship and effect on SMEs performance. The result also indicates that the value of ($\beta_2 = 0.283$; $t=3.646$; $p = 0.027 < 0.05$), which indicates that short-term debt has a positive and significant effect on SMEs performance. The two hypotheses earlier formulated in null form were therefore rejected, which implies that long-term debt, and short-term debt has positive and significant effect on the performance of selected SMEs in Makurdi Metropolis, Nigeria.

Discussion of Findings

Findings of the study indicated that there is positive and significant relationship between the predictor variables (long-term debt, short-term debt and trade credit) and the dependent variable (SMEs

performance). The result of hypothesis one tested indicates that long-term debt has a significant positive effect on the performance of selected SMEs in Makurdi Metropolis, Benue State. The result confirms Pelham's (2001) findings that long-term loans was positively and significantly related to market share, sales effectiveness, and profit in small and medium size firms. Similarly, previous studies by Onoja and Ovayioza, (2015), Yan (2013); and Zeitun and Tian (2007) established a positive relationship between long-term debt and firm performance. Contrarily, Onaolapo and Kajola (2010) and Makanga (2015) found a negative correlation between long-term debt and firm performance. This research reaffirms the position of the researchers that concluded long-term debts positively and significantly affect SMEs performance. This implies that activities of SMEs have significantly improved because of their accessibility to long term debts.

The result of hypothesis two revealed that there is a significant positive effect of short-term debt on the performance of selected SMEs in Makurdi Metropolis, Benue State. The result is in agreement with Garcia-Terul and Martinez-Solano (2007) who established that short-term debt is positively correlated with firm's growth opportunities. Onoja and Ovayioza (2015) in their study also reported that that short-

term debts significantly improve the performance of business enterprises. Correspondingly, Yan (2013) found a positive association between short-term debt and firms' profitability. On the contrary, Makanga (2015) found a negative but insignificant relationship between short-term debt and corporate performance. However, this reaffirms the position that, a significant positive effect exists between short-term debt and performance of selected SMEs in Makurdi Metropolis, Benue State. This implies that SMEs can not do effectively without short-term debts.

5. Conclusions and Recommendations

The outcomes of the study showed that debt financing practices (long-term debt, short-term debt and trade credit) have significant positive effect on the performance of SMEs in Makurdi Metropolis, Benue State. The study concluded that long-term debts are mostly used by firms that are well established and they are usually considered by those enterprises that are looking towards the expansion of their businesses. The study also concluded that short-term debt is a debt finance option mostly accessible by the enterprises from the various finance institutions and it positively affects their performance.

The study therefore recommends that policy support for financial institutions should emphasize the training of SMEs so as to prepare them comprehensively to use the available of long-term debts provided to them to help improve their performance. Finally, financial institutions should incorporate in their programmes a pronounced aspect of training about how best their clients could utilize the available services to enhance entrepreneurs in the area of short-term debt. This will help improve their growth potentials.

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