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ACCESS TO DEBT FINANCE ON THE PERFORMANCE OF SMALL AND MEDIUM SCALE ENTERPRISES (SMEs) IN NIGERIA

[1]Abubakar Bala PhD, [2]Nuruddeen Abubakar & [3]Esther Yusuf Enoch

[1&2]Department of Business Administration
Faculty of Arts and Social Sciences
Gombe State University, Nigeria
abubakarbalakawu@gmail.com
08088489371
[3]Department of Banking and Finance
Faculty of Arts and Social Sciences
Federal Polytechnic Mubi, Adamawa State

Abstract

This paper examines the relationship between access to debt finance (affordability, timeliness and adequate capital) and the performance of small and medium scale enterprises (SMEs) in Nigeria. The objective of the study is to determine the relationship between affordability, timeliness, adequacy and performance of small-scale enterprises in Nigeria. The study utilized different related literatures sourced from current journal articles, textbooks, and previous research of scholars that are related to the study. Some of the preliminary findings showed that all the factors in affordability and adequacy have a positive relationship with the performance of SMEs. However, timeliness has a negative relationship with the performance of SMEs in Nigeria. Therefore, the study recommended that the Government should give loans and other financial assistance to small business owners at lower interest charges so that they can boost their business. Additionally, the technicalities involved in the issuance of facilities by the banks should be addressed. Because the loans are not issued on a short-term basis mostly, the loans are given on a long-term basis, thereby, the technicalities involved take longer periods. Moreover, proper adequate funding of business can boost the performance of that business; therefore, authorities concern should provide proper capital debt finance to the SMEs in the country. Thus, their performance will increase and thereby create employment, and job opportunities and pay taxes to the government.

Keywords: *Affordability, Adequacy, Debt finance ,SMEs Performance and Timeliness*

Introduction

Due to the restriction and inability to obtain debt financing from financial institutions, most SMEs finance their operations internally. That is the use of personal savings, loans from friends, family, relatives, money lenders, and business profits. These funding sources are typically insufficient, and others—like moneylenders—are riskier; as a result, SMEs' expansion expectations to meet their goals aren't heightened (Lin & Xu, 2024). However, for the success of SMEs also engage in seeking external financing from financial institutions, in addition to internal finance. The structure and functioning of SMEs present a barrier to their ability to get loan financing from conventional financial institutions. This is because; they do not store and preserve records of the business transactions in the operations (Musah, 2017). Consequently, making the process of assembling, trustworthy financial statements that could gauge their success challenging. Furthermore, financial institutions are discouraged from lending to SMEs because they perceive such SMEs as unhealthy or dangerous due to the absence of collateral that may be used as security for their loans (Fu'ad, 2020). As a result of these, most financial institutions find it very difficult to accept loan application from SMEs, since they are less creditworthy and more hazardous. Perhaps, research suggests that the most important components that encourage the performance of SMEs are the availability of debt financing. Moris and Ng'urah, (2020) emphasized that, one of the primary factors responsible for influencing the survival and expansion of SMEs in both developed and developing nations is their ability to obtain debt financing.

It is assumed that, SMEs that have access to debt financing make profitable investments and make significant contributions to both economic growth and the reduction of poverty. These were designed to make sure SMEs could get debt financing that met their requirements and sped up their operations, which would support the country's economic growth and job creation. As an intermediary between banks and SMEs, both government and Business Development Services Providers (BDSP) share risk if SMEs are unable to repay the loans that have been provided. With the help of this facilitation, SMEs can now obtain debt financing that satisfies the three requirements of affordability, attractive terms, and adequacy—all of which are designed to boost

SMEs' performance.

Conversely, Motta (2020) suggest lack of access to suitable financial services as serious challenge directly affecting the performance of SMEs. The difficulty that small businesses have in obtaining debt financing is, in some ways, more severe in Sub-Saharan Africa than it is globally. Research shows that over 25% of SMEs consider one of the major obstacles that negatively impact their company's performance to be obtaining debt financing (Asikhia et al., 2020). However, according to a UK study of SMEs, the biggest obstacle they encounter is getting debt financing, and this accounts for 19% of SMEs. Perhaps, it is widely believed having accessibility to debt financing satisfies these three requirements, which boost SMEs' performance and increase their ability to contribute to job creation and economic growth and development. One factor contributing to increased growth throughout the size range is easier access to debt finance. However, its benefits at the same level of financing are not as great in Africa (Lin & Xu, 2024).

On the other hand, accessible debt financing makes it possible for SMEs that have been passed over for formal financing to obtain funding at a reasonable cost, at a convenient time, and in a quantity sufficient to satisfy their requirements. Additionally, OECD defines debt finance as the promotion of an adequately, timely, and reasonably priced range of regulated financial goods and services, along with financial literacy and awareness campaign aimed at extending its use to all societal sectors. Studies reveal that on average 60% of jobs created in the manufacturing sector in both developed and developing nations were done by SMEs. Particularly in Nigeria, SMEs account for 27% of jobs and 35% of GDP. One of the most critical factors responsible for these SMEs' development is their ability to obtain debt financing, especially sufficient, timely, and reasonably priced financing from outside sources. It is intended that this three-part debt financing access will boost SMEs' productivity and mandate significant contributions to economic growth (Lin & Xu., 2024).

Although the primary factor influencing SMEs' performance is thought to be their access to loan financing, research looking at the impact of SMEs receiving funding from outside sources has produced varying conclusions. While Myers and Majluf; (in Mori & Ng'urah, 2020) emphasized that debt financing is the right choice when internal sources are exhausted, Modigliani and Miller (1959) came to different results. Numerous investigations have been carried out in response to

capital structure ideas to corroborate these conflicting findings.

Other research, such as Basit and Hassan, (2020); &Sibanda et al.,(2018), looked at how debt financing affected business performance and discovered that it had a detrimental impact on profitability. Other research, however, discovered a positive association between debt financing and the company's performance (Harelimana, 2017). Unexpectedly, research like that done by Badi and Ishengoma (2021); & Mori and Ng'urah, (2020) found that businesses that use over fifty percent of both long term financing and debt financing have negative correlations and decrease in firm value. However, those who use less than experience an increase in the firm value. These investigations were carried out in several nations with various economic environments. In addition, compared to the SMEs considered in this study, most of the surveyed enterprises were accessible to formal bank funding since they were listed on a stock exchange. Furthermore, the data collection approach may vary from the current study. Given that the essence of this inquiry is conceptual. Similarly, the studies that were carried out on impact of accessibility to debt financing on small and medium enterprises in Nigeria using loans financing affordability and adequacy as measures or proxies, are rare and very few. Based on the study intend to examine the effect of loan affordability on the performance of SMEs in Nigeria, and to examine the effect of loan adequacy on performance of SMEs in Nigeria.

II. LITERATURE REVIEW

Performance of the SMEs

The concept performance refers to how well something works toward actualizing its intended goal. Performance needs to be centered on identifying and communicating the factors that propel success, supporting organizational learning, and serving as a foundation for evaluation and incentives, according to Brown (1996). However, according to Mansfield and Mitchell (1996),an organization's performance is determined by its capacity to use its resources effectively and efficiently in order to achieve its goals and objectives. Profit is historically recognized as general indicator of financial performance of SMEs. Azzuwut et al., (2023) identifies the three primary profitability ratios, namely; gross profit margin (GPM), return on equity (ROE), and return on assets (ROA). However, the variations in each were considered as indicators of risk, are also used to assess performance (Lin & Xu., 2024). Therefore, financial performance indicator that allowed company's assets to create revenue is called profitability. Moreover, the financial performance of

SMEs can be measured in a variety of ways, such as growth, cash flow, and profitability metrics (Singh & Kumar, 2017). Since the present operating environment will have an impact on future performance, these are utilized to gauge SME performance.

Accessibility to Debt Financing

Banks ready to provide financial services to those in need, at manageable prices, in a timely manner, and in sufficient quantities, is known as accessibility to debt financing. The ability of banks to supply financial services at affordable prices within a time frame is defined as accessibility to debt financing. On the other hand, accessibility to debt financing refers to a company's ability to obtain debt financing from lending institutions at affordable rates and disburse within a short period, which are repaid at predetermined interest rates and within predetermined timeframes.

Azzuwut *et al.* (2023) opined that all businesses, including SMEs, most frequently use this type of financing to raise capital for investments and to launch new ventures. In this case, agreements between lenders and borrowers on set interest rates, loan kinds and sizes, and payback periods or terms are necessary to obtain debt financing. Debt or loan can be short or long, short-term loans are loans with short time maturity date that is less than a year, whereas long-term loans have a maturity date of more than a year. There are two ways to obtain debt financing: secured and unsecured. Collateral backs secured debt, allowing the principal amount to be recouped in the event of default. When a borrower applies for an unsecured loan, the lender considers their good relationship with the borrower and their reputation when granting the loan. Because long-term loans always have high interest rates, short-term loans are typically preferable in these situations (Lin & Xu., 2024).

Adequacy refers to the state of being sufficient for a specific purpose, implying sufficiency rather than abundance or excellence. The term originates from the Latin word "adaequāre," meaning "to make something equal to something else" (Asikhia et al., 2020). In English, the word emerged in the early 1800s as a derivative of the adjective "adequate." Adequacy essentially means meeting the requirements of a situation without exceeding them, as exemplified by Walter Kerr's critique of an actor: "He has delusions of adequacy" (Kerr, n.d.).

However, loan capital adequacy refers to the proportion of a company's loan capital to its total capital. Loan capital includes funds borrowed from external sources such as bank loans, bonds, or

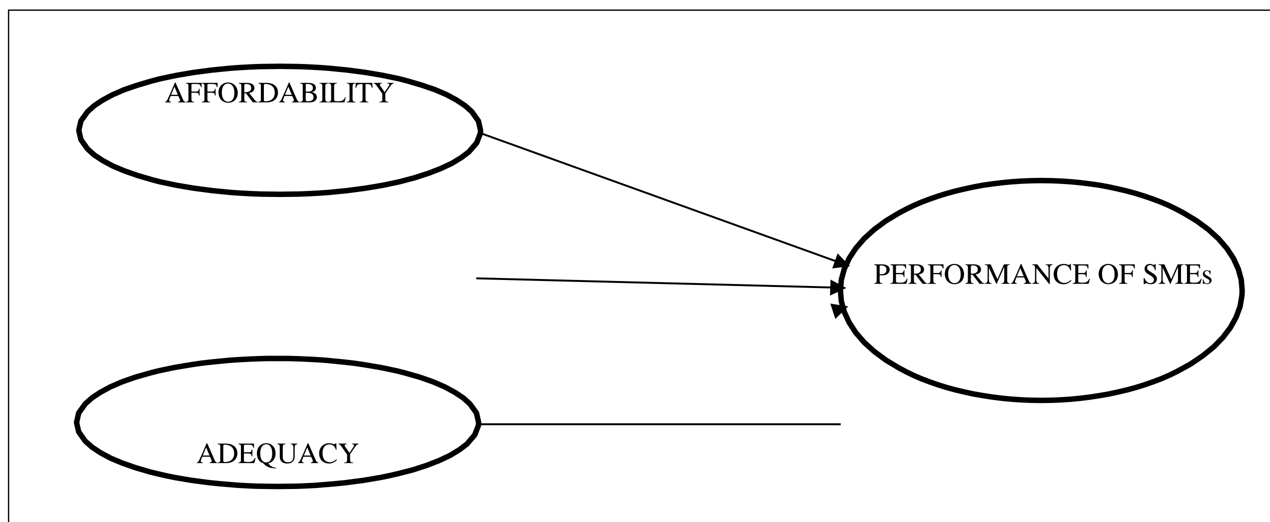
debentures, while total capital is the sum of loan capital and equity capital, which is the investment made by the company or its shareholders. The loan capital adequacy ratio, also known as the debt-to-equity ratio or leverage ratio, measures the extent to which a business is financed by debt versus equity (Beer, 2024).

Affordability to a Loan

The concept of affordability in loans refers to a borrower's ability to repay the loan without compromising their financial stability. Conversely, over-indebtedness occurs when a borrower is unable to fulfill all financial commitments outlined in credit agreements. This determination is made by assessing whether the borrower will face challenges in meeting both present and future debt obligations promptly (CBE, 2023). Affordability is a critical assessment used by lenders to determine whether an individual can comfortably repay the borrowed amount, considering their existing financial obligations. This evaluation is essential for lenders to ensure that borrowers can manage their debt without compromising their financial stability (Buster, 2024).

Loan affordability is a crucial metric that assesses a potential borrower's capacity to repay a loan in full and on time. Each lender employs a unique formula to determine this metric. At its core, loan affordability is grounded in a lender's interpretation of a borrower's income and expenses or obligations (Bijak *et al.,* 2014). Lenders assess a borrower's affordability to determine if they can comfortably make the required loan repayments based on their current financial situation. Affordability is a key factor in the loan application process as it indicates the likelihood of the borrower meeting the repayment schedule on time (Foster Capital, 2024).

Loan affordability is primarily determined by a borrower's income, existing debts, and other financial obligations. The key factors lenders consider when assessing loan affordability include: Gross annual income - This is the total amount of money a borrower earns before taxes and other deductions. Monthly debt payments - This includes recurring monthly expenses like car loans, credit card payments, student loans, etc. Down payment - A larger down payment, typically 20% or more, can increase affordability by lowering the loan amount and monthly payments. Debt-to-income (DTI) ratio - Lenders generally want to see a DTI ratio of 40% or less, which compares a borrower's total monthly debt payments to their gross monthly income (French, 2024). Based on the review the below conceptual frame was extracted.



Conceptual Framework

Figure 1: Conceptual Model

Capital Affordability and Performance of SMEs

In the work of Magoma *et al.* (2021) examine the role of affordability of IBM Cognos business intelligence (BI) tool features suitable for small and medium sized enterprises' decision making in South Africa. For SMEs' decision-making needs, a deductive approach and a quantitative study design proved to be the most appropriate for evaluating IBM Cognos' core features. The variables for the study were all measured and analyzed using statistical analytic tools. A non-probability convenience sampling method was employed, involving a sample size of 200 participants. This included 80 business intelligence (BI) consultants, 60 SME BI developers, and 60 SME managers. The study found that all the IBM cognos business intelligence features, namely; consistency and comfort, an intuitive interface, avoiding impulsivity, cost-effectiveness, information availability, the best-programmed visualizations, and quick and easy reporting, have a significant effect on the financial decision-making on small and medium-sized enterprise (SME).

Similarly, Asikhia *et al.,* (2020) assessed the role of credit affordability on the revenue growth of small and medium-scale enterprises in Southwest, Nigeria. (interest rates, collateral requirement, and loan administration) Research design used in the study was a cross-sectional survey. The data were gathered from primary sources utilizing a self-created, validated, and structured questionnaire. The population of the study comprises the twenty-six thousand seven hundred and

forty-four (26,744) registered small and medium-scale enterprises in Southwest, Nigeria. Eight hundred and forty-three (843) SME owners and managers were the sample size and calculated using Cochran's sample size formula. Partial least square via Smart PLS 3.2.8's is employed to analysed and test the hypothesis. The study found that loan administration and collateral requirement have a significant impact on the revenue growth of SMEs in Southwest, Nigeria. However, the interest rate has no significant impact on the revenue growth of SMEs in Southwest, Nigeria.

Selamat *et al*. (2023) also looks at the perceived relationship between behavioral control, intention and affordable loss behavior among SMEs in Jakarta, Indonesia. The study utilizes a sample size of two hundred (200) respondents who owned and managed SMEs. The study found that perceived behavior control variables can be used to predict behavior linked to affordable loss both directly and indirectly. Therefore, small and medium-scale enterprise owners should adopt an optimistic outlook and consider inexpensive loss behavior as a viable option in the face of an uncertain circumstances.

Adequate Funding and Performance of SMEs

Consequently, Qutieshat *et al.,* (2024) investigate the fund adequacy of the Jordanian legislation in supporting the operation of small and medium scale enterprises in Jordan. The research examined the global trend in regulations of small and medium-scale enterprises and the direction of the United Nation Commission on International Trade Law. The Jordan legal frameworks were also studied, with a focus on trade and companies. This makes the study cover and examines two portions. However, the primary concern was the sufficiency of legislation governing SMEs. Descriptive and analytical comparative legal approach was used to analysed the data. The study concludes that, adequate funding by existing laws promotes SMEs. Therefore, there need for the development of special regulations that offer additional incentives and uphold their sustainability.

Furthermore, Zongo (2024) seeks to use research technique to provide specific recommendations for quickening a growth of SMEs in Africa. It emphasizes how important management is on SMEs' strength to survive, especially in today's interconnected and international society. The study considers selection of a management style, namely; authoritative, democratic, or transformative, for example—and the procedures for making strategic decisions in SMEs. Business owners must always consider the distinctive management styles and philosophies of Africa in order to maintain

productivity and sustainability.

Similarly, Lin and Xu (2024) use a sizable manufacturing sample to examine the effect of digital inclusive finance (DIF) on the corporate environmental performance of Chinese MSMEs. The study found that digital inclusive finance (DIF) plays a very significant role in mitigating the wastewater discharge intensity of MSMEs. Moreover, digital inclusive finance (DIF) has a significant environmental effect on non-state-owned firms, SMEs, firms in locations under greater pressure to reduce emissions, and businesses in the eastern region. Additional examination of the mechanism shows that digital inclusive finance (DIF) can lessen the financial restrictions of MSMEs. Furthermore, there exist noteworthy channels through which digital inclusive finance (DIF) influences corporate environmental performance. This can be achieved through terminal treatment, refining the energy consumption structure, and augmenting research and development expenditure.

Resource -Based Theory

An organizational strategy called resource-based theory emphasizes internal resources as a way to gain a competitive edge. Resource-based philosophy revolves around the concept of managerial framework that gives firm edge over its competitor. The theory suggests that a firm or business utilizes resources that are more of value, rare and difficult to imitate, as well as the one that cannot be easily substituted to engage in processing and manufacturing so as to best position itself for long term success. These strategies allowed the firm to develop capacity that can lead it superior performance over time. There exist multiple strategies for a company to establish a competitive edge. Using its special resources and abilities to create a cost or differentiation advantage is the most popular strategy. For instance, a company may be able to create a unique product that sells for more money or have access to cheaper materials. It is important to remember that not every gain in resources will translate into a competitive advantage. An advantage needs to be hard or impossible for rivals to copy in order to be sustained. The Resource Based theory put forth by Penrose in her 1959 essay "The theory of the Growth of the Firm" served as the basis for this work. Resource diversity and resource immobility are the two fundamental tenets of a corporation's resource-based approach. However, resource based theory, is unique only if it can provide firm with competency and resources that is not possessed by other firms.

Resource immobility: This term refers to a resource that is difficult for competitors to use because

it is costly to develop, acquire, or use. It assumed that firm can afford to use resources and competency that cannot be imitated by competitors. It has a clear advantage over the competitors thanks to technology. The resource-based theory holds that small firms can only exist when an entrepreneur possesses the knowledge and assets required to establish and grow them. Penrose (1959) asserted that a long-term, sustainable competitive edge and success can only be attained by entrepreneurs who possess the necessary resources and competencies. The idea holds that an entrepreneur achieves remarkable success when they make informed judgments based on their vision, intuition, and creativity and when they have a complete understanding of the resource potentials. In a certain company, the entrepreneur will not only be able to prosper but also benefit from a long-term competitive edge and financial success due to resources that are valuable, rare, hard to replicate, and non-replaceable. Due to competitors' ability to quickly erase the results of an entrepreneur's initial labor, their triumphs are transient and lack a sustainable edge (Udu *et al*., 2018).

This theory gave special emphasis to the need that an entrepreneur to have the necessary tools and skills to sustained and have an edge over another firm. Given the dynamic business environment, the aforementioned emphasizes the need for small businesses to continue being proactive. Therefore, a small business that aims to maintain a competitive advantage in a fast- paced business environment needs exceptional knowledge that enables them to have a deep understanding of the financial landscape.

III. METHODOLOGY

To review the literature and draw conclusions, the study used a content analysis technique. This technique allows the study to observe and analyzes the previous study on the topic. Therefore, the previous studies and case studies found in text books and current reputable journal articles that are related to access to debt finance and the performance SMEs in Nigeria were reviewed and analysed. This was done, to identify the role of access to debt finance on the performance SMEs in Nigeria.

IV. RESULT AND DISCUSSIONS

The study found that access to debt finance by small and medium scale enterprises (SMEs) in Nigeria can improve their performance. That is if the businesses can access the finance, they will

perform well. Additionally, the literature review also showed that the lack of adequate funding on of small and medium-scale enterprises is another problem that hinders the performance of SMEs. The study also discovers that access to adequate capital can boost the performance of SMEs in Nigeria. That is, if adequate funding was put in place, it will improve the performance of SMEs. The funding normally come based on long term period. These findings of the study go in line with that of Magoma *et al.,* (2021); Rosli *et al.,* (2021); & Zongo (2024).

V. CONCLUSION AND RECOMMENDATIONS

It is based on the findings of this study; it concludes that accessibility to finance play a very significant role in improving the performance of SMEs in Nigeria. Specifically, both access to debt financing and access to adequate funding enhance the performance of SMEs in Nigeria. Therefore, the study recommends that;

i. Government and financial institutions should provide and make loan facilities accessible and available to individuals who owned and manage SMEs in Nigeria as accessibility to loan facilities proved to be very significant in improving the performance of SMEs in Nigeria.

ii. Government and financial institutions should provide and give adequate loan facilities individuals who owned and manage SMEs in Nigeria as adequate funding of SMEs played a very significant role in improving the performance of SMEs in Nigeria.

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