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DEBT AND DEBT MANAGEMENT EFFECT ON MICRO, SMALL AND MEDIUM SCALE ENTERPRISES IN PLATEAU STATE, NIGERIA

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ABSTRACT

The growth and development of Micro, Small and Medium Scale Enterprises (MSMEs) are vital for global, regional and national economic growth and development because they provide employment opportunities, develop and diffuse new technologies. The governments of Nigeria and Plateau State had made the development of MSMEs a major economic policy objective and had put in place various programs to facilitate their performance. A total of 671 MSMEs spread across the three senatorial zones of Plateau State were administered questionnaires using random sampling and 349 were found to be valid for the study. Ordered Logistic Regression Model was used and the parameters were estimated using maximum likelihood method. Debts by the government, cooperative societies and commercial banks were found to improve the MSMEs in Plateau Sate. Debt management through payment as scheduled, paying debts off and payment of high interest debts before low interest debts were found to reduce the probability of remaining a micro enterprise and, increase the probability of remaining a small and medium scale enterprise in the state. Cooperative societies should be supported by the state with grants to provide soft loans to MSMEs for their growth and development.

Keywords: Micro, Small and Medium Scale Enterprises, Debt, Debt Management, Development, Plateau
JEL Classification: G32, M10

1.0 Introduction

Businesses worldwide are managed by various forms of funding to achieve their objectives. These funding processes can be non–debt related or through debts and the effective management of same. The debts can be from various sources which are government based or private sector based. They can be institutional which consists of funding from financial and other institutions or non-institutional which includes funding from friends, family, relations and local money lenders (Mund, 2020). It is quite difficult to run a firm or business devoid of one form of debt funding or the other. The availability of debts enables firms to utilize resources better and make stable future plans. With borrowing, the firm can enlarge its capacity, ensure smooth production and increase their market share and contribute positively to economic growth in a country.

Micro Small and Medium Scale Enterprises (MSMEs) are crucial for global and national development. MSMEs provide employment, alleviate poverty and improve living standards in countries and are string drivers of innovation and economic development (Endris & Kassegn, 2022; Mund, 2020). According to World Bank Group (2024) they account for about

90 percent of businesses worldwide and about 70 and 50 percent of employment and global gross domestic product respectively. They contribute about 40 percent of national income in emerging countries. World Bank Group further stated that MSMEs matter in achieving economic growth and decent work because the World will need about 600 million jobs by 2030 and 7 out of 10 formal jobs in emerging markets are by MSMEs.

In Nigeria, MSMEs contribution to national income and exports in 2021 was 46.31 and 6.21 percent which was a decline from the 2013 figures of 48.47 and 7.27 percent respectively. Micro enterprises accounted for 96.9 percent of business and 87.9 percent of employment (Small and Medium Scale Enterprises Development Agency of Nigeria [SMEDAN], 2021). Therefore, the growth and development of MSMEs is crucial for reducing global, regional and national poverty, hunger and the attainment of the sustainable development goals (SDGs).

Inadequate finance and poor debt management can adversely affect the attainment of these objectives. According to World Bank Group (2024) the International Finance Corporation (IFC) estimates that 65 million firms, or 40% of formal Micro, Small and Medium Enterprises (MSMEs) in developing countries, have an unmet financing need of $5.2 trillion every year, which is equivalent to 1.4 times the current level of the global MSME lending. MSMEs in Nigeria are also faced with funding problems. According to Federal Ministry of Budget and National Planning [FMBNP, 2020] and McKinsey Global Institute (2024) MSMEs in Nigeria had a funding gap of 32.1 percent in 2020 which will be reduced to 23.7 percent in 2030, 14 and 5 percent in 2040 and 2050 respectively. This gap was because 59 percent of MSME operators rely on personal savings as source of capital and, 34 percent were denied funding by banks in the country. In Plateau State only about 46 percent of MSMEs had access to bank finance (SMEDAN, 2021; GeoPoll, 2023). The survival rate of SMEs is considerably falling as a result of funding issues. According to Dakung and Okwoli (2021) SMEs face a number of financial challenges, and the resources that are available had large impact on their capacity to survive.

MSMEs in Nigeria access non-personal funding or debts through the government, nongovernmental organizations, commercial banks, family and friends and other sources. Despite these funding opportunities, MSMEs still struggle to survive, grow and develop from micro to small, small to medium and eventually, to large scale producers. Debts are incurred by producers' with the expectation that their operations and growth will be enhanced and for MSMEs, they are to grow from micro to large scale. They are expected to pay back these debts. Just like countries, debt repayment has an effect on the performance of firms. This study seeks to find out how debt and debt management or repayment by micro, small and medium scale enterprises in Plateau State affects these firms. These categories of producers are expected through growth performance to mature from micro to small and eventually medium scale enterprises. This performance and growth process is usually affected by debt payment strategies of firms.

The study findings showed that debt from the government, commercial banks and cooperative societies reduce the probability of remaining a micro scale business and increases the probability of remaining a small and medium scale enterprises. This effect was also found to the case for debt management. Non-governmental organizations debts also contributed to reducing the probability of remaining a micro business and increase the probability of remaining a small-scale business with a non-statistically significant effect in the case of medium scale enterprises. Debt management of MSMEs through renegotiation and borrowing from less expensive sources were beneficial to micro and small-scale enterprises. The payment of debts as scheduled, paying off the debt(s) and payment of high interest debts first benefits

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micro enterprises by reducing the probability of remaining a micro business and increases the probability of remaining a small and medium scale business.

Literature had focused predominantly on debt and debt structure effect on various performance measures of MSMEs such as productivity, financing and investment at the aggregate level without disaggregating their effects. Also, little studies had empirically explored the effects of debt management strategies on MSMEs development in the state. This study fills this gap by investigating the effect of debt and debt management strategies on MSME development in Plateau State. To the best of the authors' knowledge, this had not been dealt with in existing literature.

To achieve the objective of this study, the paper is structured as follows. Following the introduction as section one is theoretical and empirical literature review as section two. Section three is the methodology while result presentation and discussion make up section four. Sections five and six are summary/ conclusion and recommendations respectively.

2.0 Literature Review 2.1 Theoretical Literature

The pecking order theory is used as the anchor for this study. This theory was advanced by Myers and Majluf (1983) and Myers (1984). The theory provides that firm managers will graduate their levels of debts from less risky and demanding loans to the ones with high risk. There is preference for internal funding of company activities before consideration for external loans and equities in that order (Yıldırım & Çelik, 2021; Frank et al., 2020). The consideration of internal before external sources of funding according to Yıldırım and Çelik is the first stage of the theory. Managers express preference for internal rather than external financing and prefer debt to equity, if external financing becomes necessary (Guizani, 2020; Jansen et al., 2023). Moreover, the funding decision will be based on asymmetric information released by each debt category that will be analysed by firm managers and owners. The order of borrowing is therefore influenced by incomplete information available to investors which makes borrowing costs increase.

The theory is relevant to this study because MSMEs usually utilise less complicated debt systems and structures such as own finance before considering loans from friends and families, government and non-governmental sources to more complicated commercial banks based loans. Also, the process of getting listed on the capital market makes equity financing for MSMEs in Nigeria one of the least considered means of debt financing. The desire for control and not loses ownership of the business also makes external funding especially equity financing unattractive to MSMEs. This according to Guizani (2020) is to avoid negative adverse selection effect(s) and transfer of ownership to outsiders. Moreover, the survival rate of MSMEs makes them less attractive to investors.

2.2 Empirical Literature

Various studies were done to determine the effect of debt on MSMEs and how the structure of such debts affects the activities of this category of business organization(s).

In a study by Ophelia et al., (2021) in Ghana for the period 2015 to 2019 based on data from the Ghana stock exchange for 42 companies, it was found that SMEs financing through short and long terms had detrimental effect on the financial performance of companies. The study employed multiple regression model for its analysis.

In Egypt, Wahba (2013) did a study on debt maturity structure and firm performance using panel data. The study found that it wasn't the level of leverage but debt maturity structure that determines financial performance. Short- and long-term debts had asymmetric effects on financial performance and tend to cancel out.

Abeywardhana and Magoro (2017) studied listed companies in South Africa and Siri-Lanka for the period 2011 t0 2015. The research examined the impact of debt on financial performance of listed firms in both countries using panel data and was estimated based on fixed effects (within) regression model. It was found that short- and long-term debts had negative effects on financial performance of firms in the wholesale and retail sub-sectors of the companies in South Africa. In Siri- Lanka, short term and long-term debts respectively had negative and positive effects on their financial performance.

Githaiga and Kabiru (2015) examined the effect of debt structure on financial performance of MSMEs in Eldoret town in Kenya for the period 2011 to 2013. A total of 4122 SMEs were sampled and multiples regression analysis was used for the model and data analysis. It was found that both short and long terms debts had negative effect on the financial performance of firms.

Cole and Sokolyk (2017) researched on firms and debt type using Kauffman Firm Surveys. This annual survey follows 4928 privately held firms that were established in 2004. The survey results are available for the baseline start-up year (2004) and eight follow-up years (2005–2012). The study found that start-up firms with better performance prospects are more likely to use debts. Three years after firms startup, those who used debt compared to all equity firms, achieved higher levels of revenue and debts obtained in the name of a business was associated with longer survival time, with lower revenue association and, no effect found on survival time by debt obtained in the business owner's name. Thus business debt rather than personal debts in start-ups are associated with more successful outcomes.

In the Philippines, Ibarra (2012) found among 130 selected small and Medium Scale Enterprises that debts, especially bad debt management practices did not differ by location and business type. Bad debts expense estimates and debts written off were almost the same. The study employed a descriptive approach to data analysis.

Dube (2013) in a study of 80 SMEs in Masvingo Urban of Zimbabwe, it was found that debt financing had a positive effect on SMEs productivity. The study used qualitative and quantitative research design.

Otubor, Dariye, Idris, and Vincent (2021) explored the effects of bank loans on small business profitability in Plateau state from survey data involving 435 small businesses. Using linear regression, bank credit and profitability of firms were shown to be significant and positively related. The research concluded that SMEs viability and performance can be positively impacted by bank loans; therefore, firms should take advantage of it to enhance their operations.

3.0 Methodology

3.1.1 Data type and source(s)

Primary data was collected for the study through the use of structured questionnaires that was administered to the units of study, within the study area.

3.1.2 Study Area

Plateau state is chosen as the study area. The state is the twelfth largest in Nigeria, created in 1976 with 17 local governments that are classified into three senatorial zones-the northern,

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southern and central zones. It is located in the central part of the country. It has an estimated population of about 4.7 million persons. It covers a land mass of 30,913 km2 (11,936 sq mi). The State had a total of 32,028 MSMEs and 14,558 registered with the corporate affairs commission as at 2020 (Small and Medium Scale Enterprises Development Agency of Nigeria [SMEDAN], 2021).

3.1.3 Data Collection Strategy

Questionnaires were administered on firms using random sampling technique. MSMEs were sampled from six local governments from the three senatorial zones of the state. A total of 670 questionnaires were retrieved from MSMEs owners and employees and after data cleaning, the study used a total of 349 responses were found to be valid for the study.

3.1.4 Descriptive Statistics

MSMEs were classified based on the number of employees in the firm. Those with less than 10 were classified as micro enterprises while those with between 10 and 49 employees were classified as small enterprises. Those with employees between 50 and 199 were classified as medium scale enterprises. The data set consist of 369 sample sizes after cleaning the data from a total of 670 responses received. From the data set, 263 or 71.27 percent as micro, 101 or 27.37percent as small and 5 or 1.36 percent as medium scale enterprises. This suggests a large presence of micro enterprises in the study sample.

In terms of gender, males were 207 or 59.31 percent while female respondents were 142 or 40.69 percent. Twenty or 5.42 percent preferred not to indicate. This suggests the presence of more male respondents than female. A total of 205 or 55.54 percent of MSMEs were located in urban centres, coded as 1, while 164 or 44.46 percent were located in rural areas of Plateau state.

Firm indebtedness showed that majority of MSMEs were indebted to friends and family members at 125 firms which was 33.88 percent. This was followed by debts to cooperative societies at 79 MSMEs or 21.41 percent. Sixty-six MSMEs or 17.41 percent were indebted to commercial banks. A total of 35 or 9.49 and 23 or 6.23 percent were indebted to the government and money lenders. Debts to non-governmental organizations and other sources was by 11 and 15 MSMEs which was 2.98 and 4.07 percent, respectively. This seems to be in line with the pecking debt theory where firms go for less risky debts before moving to debts with higher risk.

About 6.23 percent or 23 MSMEs did not indicate if they were paying or managing debts. Those who manage debt through renegotiation of such debts when they fall due were 42 or

11.38 percent. Those who pay off debts at once were 75 or 20.33 percent. One hundred and fifty-one or 40.92 percent manage debt by paying back as scheduled to their lenders. Fifty eight or 15.72 manage debt by paying high interest debts first before paying low interest debt while 20 or 5.42 percent manage debt by borrowing from sources that are cheaper to offset debts that are more expensive.

Age classification showed that 2.58 percent were less than 18 years old and 28.94 and 32.38 percent were between 18 to 30 years and 31 to 40 years respectively. Firms between 41 and 50 years were 22.35 percent and 11.75, 1.72 and 0.29 percent were between 51 and 60, 61 and 70 and above 70 respectively.

3.2 Model Specification.

The nature of the data set had some order and classification where firms with the least number of employees (<10) were classified as Micro, while those with between 10 and 49 employees were classified as Small. Firms with 50 to 199 employees were classified as medium. Due to this, an ordinal regression model was used that takes into consideration the classification hierarchy.

$$Y^{*}=X_i \beta_i+U_i \quad (1)$$

Where Y^* is an indicator variable (1= Micro, 2= Small,3=Medium), X_i is a vector of explanatory variables that consist of the variables of interest and control variables, β_i are parameter estimates and U_i is the stochastic term. Equation 1 is further specified as an ordered logistic regression model thus;

$$Y^{*}= \beta_1 X_1+\beta_2 X_2+\beta_3 X_3+\beta_4 X_4+\beta_5 X_5+U_i \quad (2)$$

Where, X_1 is gender. Male was coded as 1 while female was coded as 2. X_2 is location of business. Those in urban areas were coded as 1 and 2 was used for those in rural areas. X_3 is debt classified by sources with 1 as debt from the government, 2 from family and friends, 3 from commercial banks, 4 from cooperative societies, 5 from money lenders, 6 from nongovernmental organizations and 7 from other sources. X_4 is debt management strategies coded as 1 for renegotiate, 2 for pay off, 3 was used for pay as scheduled, while pay high interest debts first was coded as 4. Borrowing from less expensive sources to offset debt was coded as 5. X_5 is age was measured in years and classified into different age range. Those between 18 - 30 years were coded as 1, 31 - 40 years as 2, 41 - 50 years as 3, 51 - 60 years as 4, 61 - 70 years as 5 while 71 and above were coded as 6.

4.0 Result Presentation and Discussion.

The result of the Ordinal logistic regression model based on average marginal effect is presented in table 1.

Table 1: Average Marginal Effect of debt and debt management strategies on MSMEs.

MSMEs	Marginal effect	Standard error	P-Value
Gender			
Micro	0.086	0.037	0.022**
Small	-0.079	0.034	0.022**
medium	-0.006	0.004	0.109
Location			
Micro	-0.283	0.041	0.000***
Small	0.262	0.039	0.000***
medium	0.021	0.009	0.033**
Debt			

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Government			
Micro	-0.428	0.113	0.000***
Small	0.394	0.104	0.000***
medium	0.034	0.018	0.065*
Family and friends			
Micro	-0.120	0.089	0.176
Small	0.115	0.086	0.179
medium	0.005	0.004	0.205
Commercial banks			
Micro	-0.288	0.100	0.004***
Small	0.272	0.096	0.005***
medium	0.016	0.009	0.067*
Cooperative societies			
Micro	-0.207	0.094	0.028**
Small	0.197	.0905775	0.030**
medium	0.009	.0058841	0.094*
Money lenders			
Micro	-0.167	0.112	0.135
Small	0.159	0.107	0.135
medium	0.007	0.006	0.224
Non-governmental organizations			
Micro	-0.259	0.152	0.089*
Small	0.246	0.142	0.084*
medium	0.014	0.012	0.267
Others			
Micro	-0.008	0.118	0.946
Small	0.008	0.114	0.946
medium	0.0003	0.004	0.946
Debt management/payment strategy			

Renegotiate			
Micro	-0.1278	0.067	0.058*
Small	0.123	0.065	0.057*
medium	0.005	0.004	0.176
Pay off			
Micro	-0.273	0.059	0.000***
Small	0.259	0.056	0.000***
medium	0.013	0.007	0.048 **
Pay as scheduled			
Micro	-0.283	0.049	0.000***
Small	0.269	0.048	0.000***
medium	0.014	0.007	0.036**
Pay high interest debts first			
Micro	-0.328	0.069	0.000***
Small	0.311	0.065	0.000***
medium	0.018	0.009	0.056*
Borrowing form less expensive sources to offset debts			
Micro	-0.253	0.0998236	0.011**
Small	0.241	0.0936147	0.010***
medium	0.012	0.0083065	0.155
Age			
Micro	-0.009	0.019	0.625
Small	0.009	0.018	0.625
medium	0.001	0.002	0.632

Note:*, **, *** implies statistical significance at 10, 5 and 1 percent respectively.

Source: Authors compilation based of field data.

From Table 1, the reference category are firms without debt. The marginal effect of debts showed that, compared to those that were not indebted, debts from the government reduced the probability of remaining a micro business entity by 42.8 percent, while the probability of remaining a small business enterprise due to government loans was 39.4 percent. The probability of remaining a medium scale enterprise was increased by 3.4. This implies that when MSMEs borrow from government through programs like the MSME intervention fund,

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it facilitates the development of such firms. This finding is not unconnected with trainings that require the development of business plans, debt repayment plans and monitoring of debt usage by government officials.

Borrowing from friends and family by MSMEs was found to be statistically insignificant for all categories of MSMEs in Plateau State. The soft nature of such funding sources where friends and family can easily write off debts makes it liable to abuse. Family members do not usually engage in evaluation of the growth plan of such businesses and the application of the loans for the intended purpose.

Commercial bank loans to MSMEs reduce the probability of remaining a micro business enterprise by 28.8 percent compared to those that are without debts. Those in the small scale category increase their probability of remaining small scale by 27.2 percent while those in the medium scale category increase theirs by 1.6 percent compared to firms in the same category without debts from commercial banks. This implies that MSMEs are better off when they borrow from commercial banks. The risk of losing one's asset contribute to proactive utilization of debts from commercial banks. This finding concurs with that of Cole and Sokolyk (2017) where business bank credit influences the survival, development and revenue growth of young entrepreneurial firms rather than trade and personal debts.

Loans from cooperative societies reduced the probability of remaining a micro scale business by 20.7 percent compared to those without debts. In the small and medium scale categories, the probability of remaining in these businesses increased by 19.7 and 0.9 percent compared to those in the same categories without loans. This implied that cooperative societies' loans in Plateau State contributed to the development of MSMEs.

Non-governmental organizations loans also reduced the probability of remaining a micro scale business by 25.9 percent while the probability of remaining a small-scale business increased by 24.6 percent compared to those in the same categories that are without loans. The probability of remaining a medium scale business was 1.4 percent but was statistically insignificant. This implied that loans granted to MSMEs by NGOs are beneficial to the development of such businesses in Plateau State.

Loans from money lenders and other sources of borrowing by MSMEs were found to be statistically insignificant. Both sources had the potential of reducing the probability of remaining micro business enterprises and increase the probability of remaining small and medium scale businesses.

From the study, debts from friends and family, money lenders and other sources were found to be statistically insignificant with regards to MSMEs in Plateau Sate while debts from NGOs was statistically significant (at 10 percent) for micro and small-scale businesses. The most statistically influential sources of debts for MSMEs in Plateau State were loans from the government, commercial banks and cooperative societies. This finding is similar to Dube (2013) in Masvingo Urban of Zimbabwe where debt financing had positive effect on SME productivity and also that of Orji, Nwadialor, and Agubata (2021) that found positive debt effect on firm performance in Nigeria.

Form Table 1, the management of debts by MSMEs through renegotiation was found to reduce the probability of remaining a micro business and increase the probability of remaining a small-scale business respectively. For micro businesses, the probability reduced by 12.8 percent compared to those without debts while the probability of remaining a small business firm was increased by 12.3 percent. For the medium scale businesses, the probability of remaining in this category compared to those without debt was 5 percent but statistically insignificant. This implies that renegotiation as a debt management strategy was more beneficial to micro and small-scale businesses.

Paying off debts by micro firms increased the probability of leaving the micro business category by 27.3 percent compared to those without debts and need not employ any debt repayment strategy. In the small and medium scale categories, the probability of remaining in their respective businesses increased by 25.9 and 1.3 percent due to paying off their debts. This debt management strategy increases the goodwill of a business and boost the probability of its growth and development.

The payment of debt as scheduled by firms was found to reduce the probability of remaining in the micro firm category by 28.3 percent compared to firms in the same business category without debt. In the small and medium scale category, it was found that there was 26.9 and 1.4 percent probability of remaining in the small and medium scale firm category respectively.

The management of debt by paying high interest yielding debts first before those with low interest was found to reduce the probability of remaining in the micro firm category by 32.8 percent compared to firms in the same category that are without any form of debts. For the small-scale category, the probability of remaining in this category increased by 32.8 percent when compared to debt free firms i.e. firms managed by owner's capital, ploughed back profit and other non-debt sources of funding. The probability of remaining in the medium scale category due to the payment of high interest debts first was 1.8 percent compared to firms in the same category without debts.

Borrowing from cheaper sources to offset high interest yielding debts was found to reduce the probability of remaining in the micro scale business category by 25.3 percent when compared to those without debt. Small scale businesses increased their probability of remaining in this category by 24.1 percent while those in the medium scale category show positive effect that was not statistically significant compared to firms in the same category without debts.

Renegotiation and borrowing from less expensive sources to offset more expensive debts were statistically insignificant with regards to medium scale enterprises but had positive signs while other forms of debt management and repayment strategies had positive and statistically significant effect. Micro and Small-scale enterprises had beneficial effects through all forms of debt management or payment strategies. This implied that when firms renegotiate, pay off debts at once or pay off debts as agreed with lenders, it affects their businesses positively due to the credibility, trust and good will that such commitments generate from their lenders. Such actions imply that the firms are serious about their businesses and are committed to growth and development. According to Cole and Sokolyk (2017) business start-ups that engage in firm based rather than personal borrowing grow faster because they are subjected to critical reviews before their loans are granted. Moreover, financial institutions monitor their development which contributes in making them succeed compared to those with personal loans.

5.0 Summary and Conclusion

Borrowing by MSMEs in Plateau Sate was found to reduce the probability of leaving the micro scale business category while they increase the probability of remaining in the small and medium scale enterprise category. This implied that borrowing contributes to the growth and development of MSMEs in the state. Similar findings were made with regards to debt management strategies, where the probability of renaming in the micro business category

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reduced while that of remaining in the small and medium scale category increased when compared to those businesses in the same categories that relied on internal or owner funds and are therefore had no need for debt repayment strategy.

Borrowing (debt) and its repayment are therefore beneficial to the development of MSMEs in Plateau State especially to those in the micro and small scale categories.

6.0 Recommendations

The Federal and Plateau State governments should expand their loan schemes to MSMEs by making more funds available through Small and Medium Scale Enterprises Development Agency and Plateau State Micro Enterprises Development Agency. This can be done by setting aside one percent of company import tax or import duties from tradeable goods.

Cooperative societies should also be supported by the state to boost their revenue base for the development of their MSMEs. This will also enable them grant loans to other MSMEs. This can be done by setting aside one percent of internally generated revenue by the state government.

Commercial banks should be incentivized by the government to further strengthen their MSME desk by engaging in risk sharing associated with MSMEs loans in the state. This risk can be shared, based on loan recovery in the ratio of 30 to the government and 70 to the banks.

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